GENERAL AGREEMENT ON
TARIFFS AND TRADE

DRAFT REPORT OF THE WORKING PARTY ON THE
DANISH TEMPORARY IMPORT SURCHARGE

I. Introduction

1. In accordance with its terms of reference the Working Party has examined the
Danish temporary import surcharge notified in document L/3602 and discussed in the
Council of Representatives on 9 November 1971 (C/M/74). For this purpose the Working
Party met from 14 to 17 December under the Chairmanship of Mr. P. Eastham (Canada).

2. The terms of reference of the Working Party were as follows:

Without prejudice to the legal issues involved

(a) to examine, in the light of the provisions of the General Agreement and of
the discussion in the Council, the Danish temporary import surcharge introduced
on 21 October 1971 as notified in L/3602 and Add.1. In executing this task the
Working Party will take into account, inter alia, the nature of the balance-of-
payments difficulties, the rationale for the surcharge and the modalities of its
implementation; the anticipated effects on trade; the possible effect on the
economies of other contracting parties; and, in particular, the effect on the
economies of the developing countries;

(b) to consult with the International Monetary Fund in pursuant of Article XV;

(c) to submit a report for consideration by the Council at a meeting as soon as
possible after the necessary determination by the International Monetary Fund is
available; and

(d) to continue to be available for consultations as necessary.

3. The Working Party had before it the following documents: L/3602 and Addendum 1
submitted by Denmark, as well as background papers supplied by the International
Monetary Fund dated 12 February and 24 November 1971.
II. Consultation with the International Monetary Fund

4. Pursuant to the provisions of Article XV of the General Agreement, the International Monetary Fund had been invited to consult with the Working Party on the balance of payments and monetary reserve aspects of the matters under consideration. The representative of the Fund made the following statement:

"The Fund shared the concern of the Danish authorities about the considerable deterioration of Denmark's external payments position in 1969-70, and in the regular consultations with Denmark note has been taken of the successive measures taken by the Government to restrain internal demand and thereby to check this deterioration. The various measures taken by the Government are described in the paper entitled 'Recent Economic Developments' which was prepared in connection with the 1970 consultation report on Denmark and has been made available to the CONTRACTING PARTIES. The Fund has also transmitted to the CONTRACTING PARTIES a supplementary paper on recent developments. In this paper attention is called to the fact that in the course of 1971 the balance of payments has responded to the policies of constraint; it has also benefited from a moderation of import demand induced by a cyclical downward adjustment in inventory investment. The deficit on current account, some $540 million in calendar year 1970, is tentatively calculated to have narrowed to a seasonally adjusted annual rate of less than $350 million in the period covering the second and third quarters of 1971. In spite of this reduction, the current account deficit, together with expenditures of about $80 million a year for installments due on public foreign loans and for lending to developing countries, remains well above the amount that the Danish authorities expect to be able to finance from long-term capital inflow."
"Thus, as the new Danish Government took office in early October 1971, the authorities felt that it was necessary to bring about a further reduction in the current account deficit. The Government has stated its firm intention to maintain the parity of the krone and has decided to implement a series of measures to correct the balance of payments. These include, inter alia, the maintenance of the restrictive monetary and fiscal policies which have already been in force for some time, including continued restraint on the growth of public expenditure. The trend of internal demand is not, in the view of the Government, such as to require a further tightening of monetary and fiscal policy, which would tend to exacerbate the problems of rising unemployment and stagnating investment.

"The circumstances outlined above indicated the need for additional measures to reduce the current account deficit with minimum delay. The temporary import surcharge introduced on October 21, 1971, which covers about 55 per cent of Danish imports, is intended for this purpose. At the present time this import surcharge does not go beyond the extent necessary to bring about the desired improvement in the balance of payments. The Fund welcomes the announced provisions for a phasing out of the import surcharge with reductions in the rate on July 1, 1972 and on January 1, 1973 and its removal on April 1, 1973. The Fund will conduct its next Article VIII consultation with the Danish authorities before the end of 1972 and will then review all aspects of Denmark's balance-of-payments position taking into account the developing international situation."

III. Consideration of particular aspects and problems

The Balance-of-Payments Difficulties of Denmark

5. The representative of Denmark first outlined the details of the 10 per cent surcharge. He emphasized its temporary nature in that a clear time-table had been set for its phasing out, with the rate to be reduced to 7 per cent on
1 July 1972, to 4 per cent on 1 January 1973 and to be completely eliminated on 1 April 1973. Originally the surcharge had covered about 53 per cent of Denmark's imports but a bill regarding additional exemptions which would reduce the percentage to 50 per cent, had just been approved by the Danish parliament. The surcharge had, so far, applied to imports from all contracting parties but after 1 January 1972, when Denmark implemented the Generalized System of Preferences, all goods covered by the system, when originating from the ninety-one countries members of the Group of 77 on 1 July 1971, would be exempted. The combined effect of this exemption and the general exemption already in force for raw materials and foodstuffs would be that developing countries, for all practical purposes, would not be hit by the surcharge. The Danish representative stressed that this was a step not taken lightly by Denmark, a country for which foreign trade accounted for 25 per cent of its GNP. Denmark fully recognized that the General Agreement did not contain any provisions concerning import surcharges for countries in balance-of-payments difficulties but the Danish representative believed that the action had been taken in accordance with the spirit of Article XII, and that it was in the best interests of all Denmark's trading partners that quantitative restrictions had not been applied. He realized the difficulty that the temporary surcharge created for Denmark's trading partners.

6. The representative of Denmark pointed out that only once in the last ten years (1963) had Denmark had a balance-of-payments surplus on current account. This persistent deficit in the trade balance was only partially offset by earnings on invisibles. In the first half of the 1960's the trade deficit had been equivalent to 1.6 per cent of GNP, in the second half 2.3 per cent and in 1970, 6.8 per cent. A major reason for these continuous large deficits was structural, relating to the problems faced by Denmark's agricultural exports in its principal export markets and the consequent need to switch rapidly to industrial production. It was foreseen that many of these structural difficulties would disappear when Denmark became a member of the EEC. The surcharge was only one part of a programme
of economic measures designed to correct these problems; Danish fiscal policy was the strictest in Europe and North America and the credit policy was exceptionally tight. These other policies had begun to show their effects on the balance of payments, but too slowly. Another factor had been the sensitivity of the Danish economy to the current unrest in the international currency markets which, combined with the large balance-of-payments difficulty and very small exchange reserves, had forced the Danish Government to take action. Provisional estimates suggested that the action taken would reduce the deficit by 50 per cent which would then be roughly equal to the recent levels of long-term capital imports. The IMF report had stated that the measures did not go beyond the extent necessary to bring about the desired improvement in the balance of payments. The full text of the Danish statement is annexed.

7. All members of the Working Party, recognized that Denmark had been running a large and continuous deficit on current account and that trade was a major contributing factor to this deficit. They also noted, however, that recently the situation had been improving.

8. Some members, asked whether an exchange rate adjustment would not have been a more appropriate step, since the balance-of-payments deficit seemed to be chronic, and indeed, perhaps a result of a deliberate policy to encourage capital inflow. It appeared that Denmark had taken a short-term step to reverse a basic balance-of-payments disequilibrium. They asked what had been the situation of the Danish krone since the beginning of international monetary crisis. In reply to these questions the representative of Denmark said that the devaluation of the krone would not have been an appropriate measure in the Danish situation. The devaluation of 1969 had had unsatisfactory results. Since Denmark's export industries largely depended on imported raw materials devaluation merely created less favourable terms of trade. In any case, a devaluation by Denmark would have not been a practical possibility in the current monetary crisis where all major currencies were floating. The Danish krone was now valued about 3 to 4 per cent above its official parity with the dollar but had seen an effective devaluation vis-à-vis the currencies of some of Denmark's major trading partners.
9. Referring to the remark by the Danish representative that the increase in short-term external debt had been a factor in the decision to implement the surcharge, some members questioned the seriousness of this debt from a balance-of-payments point of view, as other European countries had short-term obligations of comparable magnitude. In this context it was suggested that re-consolidation of the short-term debt might be an appropriate alternative measure. In reply the Danish representative said that repeated current account deficits had led to an expansion in short-term debt and that an objective of the surcharge was to reduce the current account deficit to the extent that it would be covered by long-term obligations. The composition as well as the size of the short-term debt was important in that a large part consisted of Eurodollar debts to foreign banks which, as past experience had shown, were very susceptible to exchange market crises. The Danish Government had recently acted to consolidate the short-term debt by heavy borrowing on the international market to supplement foreign exchange reserves.

10. Some members commented on certain internal factors in the Danish economy that might be contributing to the balance-of-payments deficit. For example, the rate of increase in prices, and wages in Denmark had for some time been among the highest in Europe. Public expenditure had been growing at a much higher rate than private consumption. They pointed out that if the surcharge were not accompanied by internal measures of adequate severity, its effect would be inflationary, thus worsening, rather than improving the present situation. The Danish representative said that the introduction of an incomes policy had not been seriously considered as most current wage agreements extended into 1973. He pointed out that due to the very large increase in income taxation there would be no significant increase in real disposable income. The increase in public expenditure would be covered by the budget surplus and there was no question of deficit financing. The 10 per cent surcharge was not needed to obtain a budgetary surplus. Foreign borrowing had had little effect on central government expenditure which was financed from
domestic revenue, while strong efforts were made to control the borrowing by local authorities. It was not expected that the surcharge would aggravate existing price problems but, on the contrary, that it would have a net deflationary impact. In Denmark there was a linkage between wages and prices which in the present situation meant that the earliest increase in wages based on cost of living allowances, could not take place until autumn 1972. In the interim period the full deflationary effect of the price rises would be in effect.

11. Another member, whose country was an important trading partner of Denmark, pointed out that the import surcharge in the way it had been designed, contained elements of a protective nature since most exceptions were in the field of raw and semi-processed materials while the main part of finished products were subject to the 10 per cent surcharge. Danish import competing manufactures thus seemed to be given a strong advantage. The representative of Denmark, basing his comments on the experience of the 1969 devaluation of the krone and the fact that strict time-table for removal of the surcharge existed, did not agree that the surcharge would result in significant import substitution but rather in import postponement.

**Modalities of the Implementation of the Surcharge**

12. Many delegations, while commenting favourably on the fact that a definite time-table had been set for the removal of the surcharge, at the same time, considered that the existence of such a time-table should not inhibit the Danish authorities from removing the surcharge at an earlier date if improved conditions should so warrant.

13. One member expressed concern over the existence of a fixed time-table in that, in his view, it introduced an unnecessary element of rigidity. He asked whether the Danish Government had the flexibility to remove the surcharge earlier than provided for or whether it would be necessary to seek new authority from
Parliament. He also sought information on the criteria used in determining the timing and size of the stages in the time-table. The representative of Denmark replied that it would indeed be necessary to obtain new authority to accelerate the time-table, and that the main criterion in the timing was that the first half of the year was traditionally the most unfavourable period for the Danish balance of payments.

14. In reply to a question concerning the date on which new products would be included among the exceptions to the surcharge, the representative of Denmark said that the respective bill had just been approved by Parliament and would enter into effect immediately.

15. Turning to the question of the goods to be subjected to the surcharge, members of the Working Party noted that most of the exempted goods were raw materials and some semi-manufactured products; they asked on what criteria the list had been drawn up. Products not exempted which caused special concerns included some vegetables, fruit, canned foodstuffs and wine. The representative of Denmark said that in general, raw materials and some semi-manufactured products had been exempted because since Denmark was a country without raw materials, and as had already been explained, the imposition of a surcharge would be counter-productive for their exports. Omissions occurring in the first list of exemptions had made it necessary to pass a new bill expanding the list of exemptions. He could not indicate what the specific criteria had been. The new list of exemptions would be made available to contracting parties without delay. It was noted that the surcharge imposed by Denmark could not be considered to be general as a number of goods were exempted and more would get that benefit when the GSP entered into effect. The point was made that this was at the same time a measure concerning domestic economic policy and balance-of-payments difficulties. The latter was the only adequate justification for this kind of measure.
16. In reply to another question the representative of Denmark said that the surcharge was imposed on the customs value of the commodity, that is, on the c.i.f. price without the normal tariff.

17. Asked if the products sold to Danish purchasers by means of contracts entered into prior to 21 October 1971, were affected by the surcharge, the representative of Denmark said that those goods included under Chapter 84 and positions 85.01 and 85.11 of their tariff could be exempted of the temporary import surcharges if the customs value of each product exceeded Dkr 5,000 and if the respective binding instruments concerning the purchase or rent of the products had been concluded before 21 October 1971.

18. Many members stressed that there was no provision in the GATT for recourse to import surcharges for balance-of-payments difficulties. Concern was expressed that such measures should not be made to appear acceptable. The Danish representative said that his country's action had been taken in the spirit of Article XII as the Danish situation met the criteria of both Article XII:2(a)(i) and 2(a)(ii) in that Denmark had very low monetary reserves, never amounting to more than forty-five days normal imports, and at the same time seemed threatened with a serious decline in these reserves.

19. One member was not convinced that the criteria of Article XII:2(a) had been satisfied. He asked why, since Denmark had held comparably low reserves over most of the past ten years, had no action been taken until October 1971. The representative of Denmark referred to previous comments he had made regarding the composition of these reserves and added that what might have been considered to have been adequate reserves in the past could not be regarded as such in the present international monetary situation.
20. The Working Party noted that, as from the introduction of the Danish general preference scheme on 1 January 1972, products included in that scheme would be exempted from the surcharge when imported from members of the Group of 77. Several members of the Working Party welcomed this decision of the Danish Government, noting that this had been one of the recommendations of the Group of Three. Some of these members hoped that, if particular exports of developing countries not excluded from the surcharge were harmed, Denmark would give sympathetic consideration to any specific requests made by developing countries. Other members of the Working Party expressed concern that the exemption did not extend to all developing countries, nor to dependent territories of developed countries.

21. Some other members of the Working Party stated that the discriminatory application of the surcharge was inconsistent with the most-favoured-nation principle. Members of the Working Party representing developing countries said that, since there were no provisions in the GATT covering surcharges imposed for balance-of-payments reasons, their non-application to developing countries could not be contrary to the GATT. These members also said that the Danish action was covered by paragraph 1(a) of Article XXXVII. Since the developing countries were not responsible for the present difficult monetary situation it would be wrong to make them bear the burden of readjustment. Other members pointed out that the provisions of Article XXXVII did not modify the provisions of Article I. The representative of one developing country requested these other members not to insist on the inclusion of this point in the present report.
22. The representative of Denmark explained that his Government had aligned its
general scheme of preferences on that of the European Communities. The Danish
Government had wanted to live up to the moral obligation which it had undertaken
as part of the Generalized System of Preferences and had felt obliged to exempt
the products covered by the scheme - this went against the balance-of-payments
philosophy of the scheme but the amount of trade involved was relatively small.

Anticipated Effects of the Surchage on Trade and on the Economies of Other
Contracting Parties - in Particular on Developing Countries

23. In discussing the effects of the surcharge, the representative of Denmark
supplied the following data, based on the existing legislation and without
considering the effect of the legislation that had just been approved by the
Danish Parliament. The countries most hurt by the surcharge were the other
EFTA countries and the member countries of the EEC. About 60 per cent of
Denmark's imports from those countries were affected by the surcharge. These
percentages would decrease as a consequence of the new legislation recently
enacted. In the case of the United States, 47 per cent of Danish imports from
that country were affected. About 25 per cent of the total exports from EFTA
countries were subject to the surcharge; this figure was less than 1 per cent
of the total exports of the EEC countries and 0.3 per cent of the total United
States exports.

24. The representative of Spain indicated that on the basis of 1969 figures,
50.8 per cent of Spanish exports to Denmark would be affected. According to
1970 figures 53.4 per cent of those exports were affected and, if the first nine
months of 1971 were taken into consideration 70.21 per cent of the Spanish exports
were affected.
25. The representative of the EEC said that about 60 per cent of their exports to Denmark were affected by the surcharge and that they represented about 2 per cent of the Community's total exports. Moreover, the effect of the surcharge was aggravated by the fact that certain EEC currencies had been revalued vis-à-vis the Danish krone.

26. The representative of the United Kingdom said that in 1970 his country had exported £220 million worth of goods to Denmark. This accounted for nearly 14 per cent of Denmark's total imports and 2.7 per cent of his country's total exports. Sixty-two per cent of its exports to Denmark, representing about £137 million worth of trade, were liable to the surcharge.

27. The representative of Japan stated that in 1970 Japanese exports to Denmark amounted to US$64 million constituting 0.3 per cent of the total Japanese exports. Seventy-three per cent of its exports to Denmark were subject to the surcharge, or about 0.2 per cent of the total exports of his country.

28. The representative of Sweden said that 9.8 per cent of his country's total exports in 1970 had been to Denmark. From 1969 to 1970 imports to Sweden from Denmark rose by 20 per cent and Swedish exports to Denmark by 17.2 per cent. During the period 1960/1970, Swedish total exports had increased by 165 per cent while exports to Denmark had grown by 295 per cent. Taking into account the list of further exemptions just adopted by the Danish Parliament, it was estimated that approximately 61 per cent of Swedish exports to Denmark will be affected. This corresponded to around 6 per cent of overall Swedish exports. Before the new exemptions, these figures were 66.7 per cent and 6.5 per cent respectively. Sweden thus was the country most affected by the surcharge.

29. The representative of the United Kingdom, speaking on behalf of Hong Kong, indicated that 96 per cent of its 1970 exports to Denmark were affected because they constituted mainly manufactured products and that Hong Kong would be doubly affected since it would not be exempted as would other developing countries.
30. The representative of Australia said that 50-55 per cent of its exports to Denmark were affected by the surcharge, and pointed out that, like Hong Kong, the dependent territories of Papua/New Guinea were not included in the exemption.

31. In reply to a question, the representative of Denmark said that the value of their total imports was US$4-4.5 billion. Ten per cent of their imports came from developing countries - that is $400-500 million worth of goods. Ninety per cent of those imports had been exempted from the surcharge from the outset; thus, $40-45 million had been subject to the surcharge initially. This amount would be reduced with the new legislation recently enacted. Most of the balance would be covered by the GSP, and thus the effect on developing countries would be negligible.

32. In response to questions, the representative of Denmark said that prior to imposing the surcharge, Denmark had an estimated current account deficit for 1972 of Dkr 2.5 to 2.75 billion. With the imposition of the surcharge the deficit for 1972 would be between Dkr 1.25 and 1.5 billion.

IV. Conclusions

33. The Working Party took note of the findings of the International Monetary Fund and recognized that Denmark was in a serious balance-of-payments situation.

34. The Working Party expressed its concern, however, that Denmark had chosen to introduce the 10 per cent import surcharge at this time, given the present delicate international trade and monetary situation.

35. Some members considered that, in view of the situation faced by the Government of Denmark, the action taken was not inappropriate in itself. Some other delegations were, however, of the view that recourse to the surcharge was not appropriate.
36. The Working Party urged the Danish Government to keep the surcharge under constant review and to reduce and eliminate it as rapidly as possible, accelerating its scheduled removal if at all feasible. A re-examination might be particularly appropriate after the settlement of the current monetary crisis.

37. The Working Party agreed that, in pursuance of its terms of reference, it should continue to be available for consultations as necessary.

38. Denmark, taking into account the findings of the IMF, considered that although the implementation of an import surcharge was not explicitly covered by any provision of the GATT, such action had been taken in the spirit of Article XII:2(a). It had resorted to the surcharge mechanism as the quantitative restrictions provided for in Article XII would have had a more serious effect on the interests of its trading partners. It was noted that a number of other contracting parties had taken similar action when confronted with situations of this kind. All members of the Working Party noted that the surcharge, to the extent that it raised the incidence of customs charges beyond the maximum rates bound under Article II, was not compatible with the provisions of the General Agreement.

39. Some members welcomed the provisions in the Danish legislation to exempt products and countries covered by the Danish generalized system of preferences from the surcharge, while other members expressed the hope that this exemption would be extended to all developing countries, whether or not members of the Group of 77. All these delegations were of the view that such an exemption was consistent with the provisions of the General Agreement, especially Article XXXVII. Other members, however, did not share this view, and were of the opinion that the exemption was contrary to the most-favoured-nation provisions of Article I. Denmark emphasized the moral obligation which it had undertaken as part of the generalized system of preferences to allow free entry for the products covered by the scheme.

40. It was understood that this examination in no way prejudiced the rights of contracting parties under the General Agreement.