WORKING PARTY ON ITALIAN MEASURES

Draft Report

1. The Working Party on Italian Measures, established by the Council of Representatives at their meeting of 17 September 1976 (C/M/116) was asked:

"To examine, in the light of the relevant provisions of the General Agreement and of the statements made in the Council on this subject, the monetary measures introduced by Italy in May 1976 (L/4353), in particular the deposit requirement for payments abroad, and their implications; to report to the Council and to continue to be available as necessary."

2. The Working Party noted that Deposit Requirements for Payments Abroad had been introduced, among other monetary measures, in Italy with effect from 6 May 1976, it subjected payments abroad (and imports inter alia) to a non-interest bearing deposit requirement of 50 per cent. This measure was later extended and modified (see L/4353 and Adds. 1, 2 and 3, and L/4354 and Adds. 1, 2 and 3). The deposit requirement is scheduled to be reduced and phased out by 15 April 1977. The Working Party also noted that on 23 October 1976 Italy had introduced a 7 per cent special tax on the purchase of foreign exchange; that this measure had not been notified to the GATT, but that the legal texts were submitted to the Working Party (see Annex I).
3. The Working Party met on 8 November 1976 and in accordance with the provisions of Article XV of the General Agreement carried out a consultation with the International Monetary Fund, which supplied two background papers dated 22 September and 13 October 1976.

4. The Working Party heard a statement by the representative of the European Communities who stressed the monetary and exchange character of the Italian measures; which were applied, as a rule, to all purchases of foreign exchange, whether for imports, services or other purposes. He added that, from the GATT point of view, these measures were dealt with by the provisions of Article XV and could not be compared to traditional restrictions such as import deposits or surcharges which affect imports only. He recalled that the deposit requirement on the purchase of foreign exchange had been examined in different fora, including in the IMF and that the Communities were prepared to discuss them in this Working Party according to the terms of reference. The Communities were also prepared to explain the 7 per cent special tax on the purchase of foreign exchange recently introduced by Italy — and for this purpose the text of the decree was submitted for annexing to the report — although they could not say very much at this stage about its effects or prospects. The representative of Italy made a statement, the full text of which is reproduced in Annex II, in which he recalled the difficulties encountered by the Italian lira on exchange markets that had led his authorities to adopt a number of monetary measures, among which the deposit on the purchase of foreign exchange. He stressed the monetary and exchange
character of the measure; described its positive effects on the exchange rate, and stated that it had no restrictive impact on the trend of imports which, on the contrary, had increased substantially since the introduction of the deposit. A further deterioration of the exchange rate had led to the introduction on 1 October 1976 of a special temporary tax of 10 per cent on the purchase of foreign exchange; this had been in force for two weeks and due to the renewed deterioration of the lira was replaced on 23 October 1976 by a 7 per cent special tax on the purchase of foreign exchange, due to expire in four months. He explained further that these measures had been taken in conjunction with a number of fiscal and monetary measures. He also described the balance-of-payments situation and the reasons for the severe deficit on current account, as well as the high rate of inflation, budgetary and public institutions indebtedness and the measures taken or envisaged to correct the accumulation of these problems. With regard to the recently introduced 7 per cent special tax on the purchase of foreign exchange he explained that his authorities were examining the possible effects of this measure and would endeavour to terminate it before the date of expiry established. He added that an even more rapid depreciation would have had, in the short run, certain advantages for Italian exporters, but these would have been considered intolerable by other trade partners. He concluded by saying that the measures introduced on 6 May 1976 as well as the special tax of 7 per cent were measures whose objectives were in conformity with the General Agreement as their aim was to facilitate a regular and harmonious development of Italy's trade with all other countries.
5. The Working Party heard a statement by the representative of the International Monetary Fund, the full text of which is reproduced in Annex III, which concluded as follows:

"In the light of the critical balance of payments situation of Italy the imposition of the deposit requirement on purchases of foreign exchange was warranted on a temporary basis, and its later extensions have been necessitated by the delay in introducing comprehensive alternative measures that would help restore equilibrium in the balance of payments on a sound and lasting basis."

With regard to the 7 per cent tax on the purchase of foreign exchange introduced on 23 October 1976 for a period of four months he added that the Fund had been informed and had had discussions on this matter, although no formal action had yet taken place. The tax should be considered as an emergency measure rather than a solution and it was too early to project the possible effects it could have. It would, of course, have some restrictive effect on trade. He concurred with the statement by the representative of Italy that efforts should be made to eliminate the measure as soon as possible and recalled the Fund's view that there was urgent need for progress on a comprehensive programme to cope with the problems of the Italian economy.

6. Members of the Working Party thanked the representative of Italy and of the International Monetary Fund for their comprehensive and detailed statements on Italy's balance-of-payments situation and restrictive measures. They noted that
Italy was not invoking Article XII. They stressed the importance attached to the
careful examination in the appropriate GATT body, of all restrictive measures
having a direct or indirect effect on trade, be these measures monetary in form
or not. There was some divergence of views as to what constituted an
appropriate GATT body, the Balance-of-Payments Committee or an ad hoc Working
Party. Some members stressed the need for uniformity in the examination of
balance-of-payments measures in the GATT and regretted the fact that a number of
different procedures and practices had been followed in this respect. The
representative of the European Communities recalled that the terms of reference
of the Balance-of-Payments Committee provided for the examination of measures
adopted under the provisions of Articles XII and XVIII:B. The GATT was
characterized by its pragmatism and the flexibility of its examination procedures,
which allowed for the diversity of situations which could arise.

7. Members of the Working Party expressed full understanding for the seriousness
of the balance-of-payments and economic situation prevailing in Italy. It was
also appreciated that corrective measures were called for but it was regretted
that the Italian authorities had had to resort to the imposition of a deposit on
the purchase of foreign exchange which could not fail to have an impact on trade.
With regard to the recently introduced 7 per cent on the purchase of foreign
exchange some members of the Working Party asked that this measure be notified to
the contracting parties. They felt that it was not an appropriate measure, in
terms of its effects on trade, to solve the fundamental problems of disequilibrium.
It was further regretted that the deposit requirement due to expire on
6 November 1976 had been prolonged. The measures were non-discriminatory in their
application. However, members of the Working Party underlined the temporary and emergency nature of the measures and felt that they should be replaced as soon as possible by comprehensive alternative measures that would help restore equilibrium on a more lasting basis. One member of the Working Party, while regretting the balance-of-payments need to impose a prior deposit, and feeling that the special tax was inappropriate in this case, welcomed the fact that Italy had chosen broad, non-discriminatory measures such as a prior deposit instead of more restrictive measures such as quantitative restrictions.

8. Several members of the Working Party asked what the prospects were for developments in the balance-of-payments situation for the end of 1976 and for 1977. The representative of Italy remarked that although official forecasts existed they should always be allowed a margin for error. At present official forecasts pointed to a surplus in 1977 of some Lit 100 to 200 billion on current account. The situation for the capital account would be quite different as in 1977 there was a large part of foreign loans to be repaid. Details were asked on the more comprehensive measures which had been adopted or which were in preparation to restore equilibrium. The representative of Italy explained that a number of emergency measures had been adopted by the Government and had to be enacted by Parliament to remain in force to correct the situation; there were measures to encourage the return of private expatriated capital, which had had no notable effects so far. He added that both the Italian Government authorities and legislative powers were fully aware of the gravity of the economic situation and of the need to adopt austerity measures to redress it. Other measures taken included increases in the Bank of Italy discount rate, increases in administered prices, in the withholding tax on distributed company profits and the compulsory
investment in government bonds of inflation-linked wage increases above a specified level.

9. Members of the Working Party noted that the current rate of inflation in Italy was running at some 20 per cent per annum and asked questions on contributing factors such as budget deficits and wage policy. It was noted that real wages had increased by more than 10 per cent, and had not been matched by a corresponding increase in productivity. It was also asked how the budget deficit would be financed in 1977. Also in this context, it was asked whether the Italian authorities expected the 7 per cent tax on exchange as well as the refunding of the deposits on exchange, to have an inflationary impact by making imports more costly. The representative of Italy recalled that a number of measures had been adopted to mop up excess liquidity in the market such as the increase in the bank rate. Increases of real wages had presented a more difficult problem. He explained that Italy had a system of "scala mobile" (moving-scale) payments which, for social reasons, linked wages automatically with cost-of-living increases. Thus even an attempt to reduce liquidity by increases in taxes and in prices of administered goods had been frustrated to some extent as these were items that were included in the price index to which wages were pegged. Action was being considered by the Government to reduce the rate of wage increases and to bring them under better control. With regard to the budget deficit the representative of Italy recognized the need to reduce the deficit but said that public expenditure was notably rigid and that there was little margin to significantly reduce expenditure. Nevertheless, estimates for 1977 had foreseen a reduction of Lit 1,000 billion in the deficit i.e. from Lit 14,000 billion in 1976 to Lit 13,000 billion in 1977. With regard to the effect of the 7 per cent
special tax the representative of Italy confirmed that it would make imports more costly and that his authorities shared the concerns of the members of the Working Party in the possible inflationary impact of this measure. They hoped to abolish the measure before the date of expiry. For the present, his authorities had had no choice but to impose it in order to contain the level of speculative imports and the corresponding decline of reserves.

10. Several questions were asked with regard to the deposit requirement for foreign exchange: whether the effects of the deposit on trade could be quantified and whether the Italian authorities were satisfied with the effectiveness of the measure in reducing liquidity. It was noted that the measure was applied on a non-discriminatory basis and that it would be phased out gradually by 15 April 1977. Members of the Working Party expressed concern that as the measure would be phased out and refunds effected the result would be to increase the level of liquidity. The representative of Italy replied that the deposit had been an effective measure to mop up excess liquidity; to date it was estimated that some Lit 4,000 billion had been withdrawn from circulation through the deposit requirement. As such the measure was effective to reduce the level of liquidity. The Italian authorities had not felt up to now the effects of the refunds; however it was obvious that as the phasing out of the measure continued and refunds increased, liquidity would also increase. On the other hand other measures would help reduce the level of liquidity such as the 7 per cent special tax and the new ceilings on bank credits. The representative of the European Communities added that the effect on trade of the deposit requirements were not quantifiable, although it was clear that a 50 per cent deposit for ninety days would have some effect. He stressed that the measure was not only applicable to
trade but also to services and payments and was essentially a monetary measure applied in the field of foreign exchange regulations. Some members of the Working Party felt the measure had a direct impact on trade. The representative of the European Communities added that statistics up to the month of July 1976 showed that there had been no reduction in volume or value of imports. The measure had therefore been essentially successful as a tool to mop up excess liquidity. In reply to a question on the possible effects of the reduction and phasing out of the deposits on the State budget the representative of Italy stated that there would be no effect on the budget as the money collected was not and could not be entered as State revenue. On the other hand the 7 per cent special tax did constitute State revenue and therefore would have some effect in reducing the budgetary deficit.