1. In accordance with its terms of reference the Committee has conducted the 1977 consultation with Portugal, and has examined Portugal's temporary import surcharge introduced on 31 May 1975 and an additional surcharge introduced on 6 June 1977. The last consultation with Portugal had taken place in November 1976 (see BOP/R/93).

2. The Committee had before it a basic document supplied by the Portuguese authorities (BOP/182), an additional document describing the Portuguese economic situation in 1977 (BOP/182/Add.1) and notifications of changes in the surcharges and the introduction of an import deposit scheme (L/4433 and Adds. 1 to 4). The International Monetary Fund supplied a supplementary background paper dated 3 October 1977. The Committee generally followed the plan for such consultation recommended by the CONTRACTING PARTIES (see BISD, 18th Supplement, pages 52-53). The consultation was held on 26 January 1978. 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 Portugal. Upon the invitation of the Committee, the representative of the Fund made a statement as follows:
Portugal's economy continues to be severely afflicted by the aftermath of the disturbances caused by the events in 1974 and 1975. In addition to the problems associated with the economy's modest level of development and the world recession, serious structural difficulties were caused by the loss of important protected export markets, the entry into the labor force of large numbers of expatriates from the ex-colonies and the attempt to rapidly redistribute income and improve the social welfare system. These developments led to high unemployment, labor disruptions, stagnating output, a sharp increase in inflationary pressures, and a major deterioration in the balance of payments. Consequently, the authorities were faced with the dual and closely interrelated tasks of restoring internal and external economic stability and of mounting a major economic reconstruction and development effort.

After a decline in real gross domestic product of nearly 4 per cent in 1975, the Portuguese economy recovered sharply in 1976, with a real growth rate estimated at close to 6 per cent. This recovery was assisted by an expansionary fiscal policy and a substantial acceleration in the rate of domestic credit expansion. The public sector deficit rose from 5.6 per cent of gross domestic product in 1975 to 11.5 per cent in 1976, and the rate of domestic credit expansion (as a percentage of money stock at the beginning of the period) increased from 17 per cent in 1975 to 24 per cent in 1976.

Following sizable wage awards in the early postrevolutionary period, wage increases had moderated substantially by 1976. This, together with more stable import prices (in foreign currency terms) and continued price controls, contributed to a lowering of the domestic rate of inflation to an annual rate of less than 15 per cent by mid-year. However, the acceleration of domestic demand, the emergence of distribution problems, as well as a faster effective depreciation of the currency during the second half of the year, raised the annual rate of inflation once more to over 30 per cent at year-end.

The export volume increased somewhat in 1976, after two years of substantial declines, but this growth was more than offset by a continued decline in export prices (in foreign exchange terms). At the same time, the higher rate of growth of domestic demand and output generated a sharp increase in imports, leading to a deterioration in the current account deficit, from the equivalent of 6 per cent of gross domestic product in 1975 to about 8 per cent in 1975. Despite some improvement in the capital account, the overall balance of payments deficit widened slightly. As a result, the level of foreign exchange reserves fell to a low level, and the Bank of Portugal undertook substantial compensatory borrowings, partly secured by gold holdings. In addition, Portugal purchased SDR 115 million under the IMF oil facility in early 1976, and a further SDR 58 million under the compensatory financing facility in July 1976.
"In response to the economic deterioration, the authorities, in early 1977, embarked upon a wide ranging stabilization programme, involving a 15 per cent depreciation of the escudo, legislation limiting wage increases to 15 per cent in 1977, substantial price increases for essential commodities subject to price control, a liberalization of price controls on other commodities, a 20 per cent increase in sales taxes, increases in rediscount rates and other interest rates, reopening of the stock exchange, and the announcement of plans to compensate foreign owners for property nationalized or expropriated. In addition, the authorities embarked upon fiscal and monetary policies designed to reduce substantially the deficit of the balance of payments.

"The rate of real growth in domestic demand and output remained high in the first half of 1977. Despite a disappointing performance in the agricultural sector and an expected slowing down in manufacturing in the second half of the year, it is presently expected that gross domestic product will still have grown by about 6 per cent in 1977 leading to some reduction in the high rate of unemployment.

"The domestic price situation deteriorated sharply, in large part as a result of the corrective measures in February. The rate of inflation rose to an annual rate of about 10 per cent by mid-1977. Without further shocks, the rate of price increases began to moderate around the middle of the year, however, and the average rate of inflation was expected to be somewhat less, or about 28 per cent for 1977 as a whole. The wage ceiling has been maintained at 15 per cent and a substantial fall in real wages was expected for 1977.

"The rate of domestic credit expansion continued to accelerate in the first half of 1977, to a large extent as a result of larger than expected public sector recourse to the banking system. This, in turn, reflected both the emergence of a substantial deficit on the social security accounts of the Government and the inability of the Government to raise funds from the non-banking public to the extent originally envisaged.

"One factor contributing to a continued high growth of domestic output in 1977 has been the growth in exports of goods and services. Most of this growth is, however, expected to come in the form of non-factor services and particularly as receipts from tourism. The volume of exports of goods is presently expected to increase only moderately faster than in 1976. The high rate of growth in domestic demand and
in manufacturing output has, together with crop failures and some
speculative imports, led to a continued growth in imports, leading to
a significant increase in the trade deficit in the first half of 1977.
Although the rate of import growth is expected to moderate in the
second half of the year, the trade deficit is forecast to exceed that
of 1976 and reach about 16 per cent of gross domestic product. So
far, the deterioration in the trade balance has been nearly offset by
a substantial increase in the inflow of emigrants' remittances and
tourist receipts. Continued improvement in these areas lead the
authorities to project that the current account deficit in 1977 can be
limited to only slightly above the 1976 level. Substantial further
recourse to compensatory borrowing by the Bank of Portugal, partly
against gold collateral, has been necessary so far in 1977 as the
level of readily available foreign exchange reserves has reached a low
level. As commercial banks also have increased their foreign indebted-
ness, net foreign assets of the banking system turned negative early
in 1977. Portugal has also purchased SDR 42.4 million from the Fund
under a first credit tranche standby arrangement, granted in April 1977
and a further SDR 29.3 million under the compensatory financing
facility in July 1977.

"In October 1976, the import surcharges were increased from 20 and
30 per cent to 30 and 60 per cent respectively. At present, the former
rate is estimated to apply to about 28 per cent and the latter to about
2 per cent of 1976 imports. At the same time, an import deposit
requirement of 50 per cent of the c.i.f. value was imposed on about
7.5 per cent of total imports, all within the category of imports
already subject to the surcharge. In February 1977, quantitative
restrictions in the form of value quotas related to the average value
of imports for 1975 and 1976 were introduced for such items as auto-
mobile parts, domestic appliances, coffee and bananas, affecting
approximately 6 per cent of 1976 imports. In connexion with the Fund's
standby arrangement, the Portuguese authorities have expressed their
intention to eliminate the import deposit requirement and to review the
quantitative restrictions with the Fund before the end of 1977. They
have also stated that the import surcharge will be phased out gradually
as soon as the balance of payments position permits.

"In order to seek an improvement in the external accounts, the
authorities announced, in August 1977, the introduction of a crawling
peg system for the escudo, designed to compensate for differential
price developments in Portugal and its major trading partners. Up to
September 15, the effective exchange rate depreciated by 4 per cent.
At that time, the authorities began announcing forward exchange rates
for the currencies of major trading partners for one, three and six
months, to reflect a prospective depreciation of 1 per cent a month.
Also in August, domestic interest rates were raised by an average of
4.5 per cent.
The authorities regard the import surcharge and the other trade restrictions as temporary measures to help contain the current account deficit, while alternative policies are being formulated and implemented. The Fund believes it important that the import surcharge and other trade restrictions should be used on a temporary basis and that a schedule for their gradual removal and early abolition be established and announced at an early opportunity. A continued and prolonged maintenance of these measures can only lead to a further aggravation of the existing serious problems of domestic resource allocation.

Opening statement by the representative of Portugal

The representative of Portugal made an opening statement, the full text of which is annexed, in which he outlined the present difficulties of the Portuguese economy and the prospects for 1978. In 1977, the GNP of Portugal had grown by 6 per cent against 5 per cent in 1976. This was essentially due to a rapid growth of industrial production (8 per cent) and in the building industry (14 per cent); the agricultural production had declined by 5 per cent after having stagnated in 1976. The inflation rate had risen in 1977 to 30 per cent, however since March there had been some improvement. Receipts from tourism had increased substantially, but the trade balance had deteriorated. The 1977 trade deficit might have exceeded by 50 per cent that of 1976. In the face of these developments Portugal had to take a series of policy measures designed to redress the external financial position of Portugal and in order to gradually reduce the restrictiveness of its import system and it had decided to abolish the import deposit system as of 31 December 1977. A new government was now being formed and the political agreement that had been signed in this connexion stipulated that the future government policy was to rest on two basic instruments, namely the "1978 Economic Stabilization Programme" and the "Medium-Term Development Plan for 1979-1984". The purpose of these instruments was, inter alia, to reduce the deficit on the current account, curb inflation and unemployment, restrain monetary expansion, improve fiscal policies (e.g. balancing the current budget,) establish a ceiling on wage increases and encourage private investment. The representative of Portugal concluded by appealing to the economically stronger countries to stimulate their economies and to liberalize their imports.
I. **Balance-of-payments position and prospects - alternative measures to restore equilibrium**

5. The members of the Committee commended the representative of Portugal for the comprehensive and detailed documentation the Portuguese Government had submitted to GATT and for the frank and revealing opening statement. They expressed their sympathy for the continued economic difficulties Portugal was facing. The documents submitted by the Portuguese authorities and the supporting analyses made available by the International Monetary Fund showed clearly that Portugal had severe balance-of-payments difficulties and that temporary trade measures were necessary to cope with them. They further expressed their support for the efforts of the Portuguese Government to adopt fundamental measures to improve the balance of payments, such as the 1977 devaluation of the Escudo. They welcomed the statement of the Portuguese representative that Portugal remained committed to liberalize its trade and commended the Portuguese Government for having terminated the import deposit scheme.

6. One member of the Committee wondered whether the decline in the inflation rate during recent months was expected to continue. In this context he asked whether the Portuguese authorities had taken measures to contain the increase in liquidity that was going to follow the abolition of the import deposit scheme. The Portuguese representative replied that a reduction in the rate of inflation was one of the main goals of his country's economic policies. The political agreement on the basis of which the new government was now being formed aimed at the reduction of the inflation rate to 20 per cent during 1978. Regarding this target, the agreement expressed
the hope that the anti-inflation policy could be reinforced by an agreement with the trade unions to curb wage increases. It was not possible to eliminate inflation within a short period of time; only a relatively modest goal therefore had to be set. It was true that the abolition of the import deposit scheme would increase liquidity as past deposits were repaid and no new deposits were required. However, the overall impact of this on liquidity was minimal. The deposits to be repaid amounted to only Esc 1.3 thousand million while the overall money supply (M1) had been Esc 276,000 thousand million in 1977.

7. In response to a query on the exchange rate policies of Portugal the Portuguese representative stated that his country had adopted in August 1977 a crawling peg system. The current policy was to announce exchange rate modifications six months in advance; at present the Escudo was being devalued at the rate of one per cent per month in terms of a basket of ten currencies.

8. One member noted that there had been a substantial outflow of capital and he wondered whether Portugal had any specific policies for reversing this flow. In response the Portuguese representative listed four sets of measures the Portuguese authorities had taken to counter capital flight. First, interest rates had been increased so as to attract capital into Portugal and to contain the outflow of capital. Second, the Bank of Portugal was now only accepting Escudos presented by foreign commercial banks if these had not exchanged more than Esc 1,000 per person, the amount residents travelling abroad were allowed to take out of the country in Portuguese currency. Third, measures against leads and lags were taken. Thus, it was no longer permitted to pay bills for imports before maturity. Fourth, the Portuguese authorities
had taken measures against the over-valuation of imports as a means of illegal capital export. There were now thorough analyses of invoices. The surcharges and the former deposits scheme had also created incentives to avoid over-valuation. The difference between world market prices and import prices that could be observed in 1974/75 had now disappeared completely, which showed that over-valuation was no longer widely practised.

9. One member of the Committee wished to be informed of the measures Portugal was taking to diversify its export markets and, in particular, to increase exports to the oil-producing countries. In reply the representative of Portugal stated that at present 80 per cent of Portugal's total exports were going to OECD countries but efforts were made to increase the share of exports to oil producing countries. Bilateral trade agreements had been negotiated inter alia with Iraq, Iran, Morocco, Tunisia and Algeria and it was hoped that these would improve the present negative trade balances with these countries. He also mentioned in this context that the trade balance with Portugal's former territories in Africa had considerably improved in 1977, showing a surplus as a result of increased exports, and that exports to COMECON countries had increased from near zero to five per cent of total exports since 1973.

10. Several members of the Committee indicated a keen interest in Portugal's new code for foreign investments. The representative of Portugal explained that the main purpose of this new code was to clarify the previously existing law and to bring it in conformity with international practices, in particular with the OECD Code of Liberalization of Capital Movements, and to establish thereby long-lasting relationships with foreign companies. The code
substituted the concept of non-resident investor for that of non-national investor (in line with OECD and EEC practices). It established an exchange guarantee for investors repatriating profits and thereby accepted the view expressed in World Bank reports that foreign investors must be protected against an erosion of their earnings by some form of exchange guarantee. There were for the time being no limitations on the annual transfer of profits and dividends and of the compensation paid for a nationalization; however, when Portugal's balance of payments was in serious imbalance a delay in the transfers of up to five years could be imposed. The new code further provided that foreign firms may raise credit locally and foreigners may work in key positions. The regulations regarding the transfer of the savings and the personal effects of key personnel had been eased. Decisions on foreign investments were now centralized in the Foreign Investment Institute. The political agreement on the basis of which the next government was to be formed declared that foreign investments have an important rôle to play in the Portuguese economy as a means of obtaining finance, technology and access to new markets.

11. One member of the Committee said that during the last consultation the Committee had been informed of a medium-term economic plan for 1977-1980, the core of which was an inventory of public investment projects. He wondered whether this plan had actually been introduced. The representative of Portugal replied that the plan had been formulated and submitted to parliament but had not yet been debated or put into effect.
12. One member of the Committee noted that a large part of the Portuguese Government's revenue was based on indirect taxation and he wondered whether there were plans to increase the share of direct taxes. The reply was that efforts in this direction were being made, but that it had to be recognized that the raising of indirect taxes was, in the short run, a better way to increase substantially tax receipts. A commission was presently studying the possibility of creating a unique direct tax that would raise the share of direct taxes in total fiscal revenues and improve the flexibility of the fiscal system.

13. One member of the Committee wished to know why the rate of increase in import prices in 1977 had been higher than the rate of the devaluation of the Escudo. The Portuguese representative answered that this difference was due to world inflation. Another member asked whether Portugal's exchange rate policies ensured that the competitiveness of Portuguese industry in foreign markets was maintained. In reply the Portuguese representative said that it was very difficult to establish precisely the changes in competitiveness of the Portuguese industry. Nevertheless, studies made in the Bank of Portugal indicated that, in 1976, the decline in competitiveness that had been observed had stopped. As a result of the February 1977 devaluation and the subsequent introduction of the crawling peg system, the competitiveness of the Portuguese industry may have been brought back to the level of 1973. The present flexible exchange rate policies made it possible to adjust the exchange rates continuously with regard to competitiveness requirements.

14. Another question concerned Portugal's debt service requirements and the amortization structure of its debts. The Portuguese representative replied that no definitive figures on Portugal's current debts were as yet
available. Portugal was receiving technical assistance from the World Bank to clarify its debt situation. Debts had increased from 1976 to 1977 and interest payments amounted in 1978 probably to about 4-5 per cent of the value of imports. The same lack of information together with the possible renewal of part of the debt did not allow precise estimates of the amortization payments for 1978.

15. In reaction to expressions of regrets regarding the continuous use of surcharges as balance-of-payments measures, the representative of Portugal declared that studies were being undertaken to evaluate the possibility of gradually reducing the 30 per cent surcharge with a view to phasing it out and of substituting the 60 per cent surcharge by internal fiscal measures.

16. In reply to a question regarding the extent of public sector borrowing, the representative of Portugal explained that figures on the total amount of public sector borrowing for 1978 were not yet available. However, an indication for the amount of public sector borrowing in the past was the fact that 12.6 per cent of the total current expenditures provided for in the 1978 budget was allocated to the servicing of public debts.

II. System, methods and effect of the restrictions

17. Several members of the Committee said that their governments had received complaints from exporters concerning time delays in the issuing of import licences by the Portuguese authorities in practically all import sectors. They asked whether the representative of Portugal could explain his authorities' policies on the issuing of import licences and whether there were plans to modify the licensing requirements. The representative
of Portugal said that a prior registration in the form of an import "bulletin" was required for all imports with an invoice value over Esc 5,000. Last year a new data processing system had been introduced in the Central Bank and in this connexion new forms serving at the same time customs, foreign exchange and statistical purposes were introduced. As a result there were, for a short period of time, delays in the issuing of import "bulletins". This had been misinterpreted by importers as a decision of the Government to increase the restrictiveness of the import régime and many of them doubled or even tripled their import applications. Now, however, it looked as if the situation had stabilized and the initial problems of the new system had been overcome.

18. One delegate noted that, according to the basic document submitted by Portugal, the surcharges applied without any discrimination. He wondered whether this meant that the charges applied to products of EEC or EFTA origin were the same as those applied to imports from other countries. The representative of Portugal confirmed that the surcharges were the same for products from all exporting countries whether EEC or EFTA members or not.

19. Some members of the Committee noted that there were, according to the basic document submitted by Portugal, bilateral quotas for specified agricultural products from certain EFTA countries and that imports of industrial products, except certain steel products and assembled automobiles, were free from import restrictions when originating in EFTA or EEC countries. They wondered how this action was consistent with the non-discriminatory clause in Article XIII of the GATT. The representative of Portugal replied that the treatment in respect of EFTA and EEC countries was justified under
Article XXIV of GATT which read, in part, "the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area". One member of the Committee speaking on behalf of several members supported the view of the Portuguese representative. Another however felt that quantitative restrictions imposed for balance-of-payments reasons were not regulated by Article XXIV of the GATT but by the balance-of-payments provisions of the General Agreement. The invocation of Article XXIV did therefore not mean that the balance-of-payments provision of GATT, in particular the obligation not to discriminate contained in Article XIII, no longer had to be observed. It was agreed that the Balance-of-Payments Committee was not the proper forum for pursuing this debate. As far as the import quota system introduced in 1977 was concerned the Portuguese representative said that it was non-discriminatory. One member of the Committee enquired in this connexion whether the importer, once he had obtained an import licence, could use it for imports from all countries. The answer was positive.

20. One member of the Committee noted that an Exchange Guarantee Fund had been created in 1977. He wished to be informed how this Fund operated, what its likely affect on exports was, and what the costs of the Fund to the Portuguese Government were. The representative of Portugal explained that the main purpose of this Fund was not to finance exports but to give importers an incentive to obtain foreign financing of imports by establishing exchange rate guarantees for them. Its cost to the Government were nil since its capital was subscribed by commercial banks and its expenditures were financed through mainly charges to customers and surcharges applied by commercial banks on consumer credits. The importance of the Fund was not as great as had originally been anticipated, because it had declined with the
introduction of forward rates when the crawling peg system had been implemented. The Fund could give guarantees up to one year, the crawling peg system guaranteed exchange rates for up to six months. As a consequence the Fund's functions were now for all practical purposes limited to guaranteeing the exchange rates for credits with a maturity of six to twelve months.

21. A further question related to a system of special export credit interest rates, the spread between export and domestic rates, and the system's cost to the Government. The reply was that the spread was about 5 per cent and that it was financed not by the Government but by the Central Bank.

22. One member of the Committee said that, judging by the documents presented by the Portuguese authorities, it appeared that the surcharge introduced in 1975 had been extended by various decrees at various intervals and that the last decree extended the surcharge until 31 December 1977. He wondered what the present legal basis of the surcharge was and until when the surcharge had now been extended. The representative of Portugal said that the decree extending the validity of the surcharge system until the end of last year was still being applied because the budget for 1978 had not yet been discussed pending the formation of a new government after the governmental crises in December.

Conclusions

The Committee recognized that Portugal had serious balance-of-payments difficulties which justified the resort to surcharges and import restrictions
as temporary measures to contain the current account deficit while more fundamental policies were being implemented. It welcomed the abolition of the import deposit scheme as of the end of last year and asked Portugal to pursue its plans to replace the import surcharges by internal fiscal measures or to phase them out as soon as the balance-of-payments situation permits. It shared the view of the International Monetary Fund that the establishment and the public announcement of a schedule for the gradual removal of the restrictive measures and their early abolition would help avoid a further aggravation of the existing resource allocation problems in Portugal and would facilitate the return to a liberal trade régime.