GENERAL AGREEMENT ON
TARIFFS AND TRADE

RESTRICTED
Spec(80)13
14 May 1980

Committee on Balance-of-Payments Restrictions

DRAFT REPORT ON THE 1980 CONSULTATION WITH ISRAEL

1. The Committee has consulted with Israel in accordance with its terms of reference and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (L/4904). The consultation was held on 9 May 1980 under the Chairmanship of Mr. C.S.F. Jagmetti (Switzerland). The International Monetary Fund was invited to participate in the consultation pursuant to Article XV of the General Agreement.

2. The Committee had the following documents before it:

- Report on the last consultation with Israel held on 29 May 1978 (BOP/R/101)
- Basic document supplied by the Israeli authorities (BOP/203)
- Background paper by the secretariat (BOP/W/37)
- IMF, Recent Economic Developments, dated 21 May 1979
- IMF, Supplementary Background Material, dated 27 March 1980

Opening statement by the representative of Israel

3. In his opening statement, the Israeli representative said that despite Israel's difficult balance-of-payments situation his authorities were pursuing a liberal trade policy. The Government aimed at resolving the payments problem by promoting export oriented industries and improving their competitiveness rather than by restricting imports. He noted that the export performance was a most

positive aspect of the Israeli economy. The level of the remaining import restrictions was very low for a developing country with payments problems of the magnitude Israel was facing. The Israeli representative added that in line with its liberal trade policy his Government had

- reduced in June 1979 the duties on 270 import items with a total coverage of 220 million dollars by 20 per cent;
- eliminated duties on about 60 per cent of all imports from the EEC in accordance with the free-trade area agreement with the EEC;
- terminated the bilateral payments agreement with Portugal and Brazil;
- signed on 8 May 1980 a trade agreement with Egypt; and had
- committed itself in the MTN to the binding of tariffs on about 85 items as of January 1987 but intended to gradually implement these bindings before this date.

4. The representative of Israel emphasized that the import deposit scheme introduced in November 1979 complied in all respects with the Declaration on Trade Measures Taken for Balance-of-Payments Purposes, in particular the additional conditions established in paragraph 1: it was the restrictive import measure with the least disruptive effects available, no other import measures were imposed for payments purposes.

5. The representative of Israel said that the Israeli Central Bureau of Statistics had revised its balance-of-payments statistics. The revised figures appear in the Annex to this document; this Annex replaces Annex V of the Basic Document provided by the Israeli authorities (BOP/203).

6. The representative of Israel further stated that the deposit scheme was only one of the elements of a comprehensive policy package aimed at solving the balance-of-payments problem. It had an effect on the price of imports and a monetary effect. In the secretariat Background Paper the increase in the import price of covered goods had been estimated to be 7 per cent; using more recent import statistics than those that were available for the secretariat, his authorities had arrived at an estimate of 6 per cent. For the consumer the price increase was only 2 per cent, because in the total cost of imports for the consumer also the customs duty, the purchase tax, the profits of the importer, wholesaler and retailer, as well as the value added tax were included. The deposit requirement had increased for this reason the consumer price index only insignificantly, namely by 0.1 per cent up to May 1980; therefore it had not caused any meaningful distortion to trade.

7. The monetary impact of the deposit scheme had been a major consideration for the introduction of the scheme. It was to complement the very restrictive monetary policies that the Bank of Israel had introduced to reduce domestic demand. The total reduction in liquidity resulting from the deposit was estimated to be 3.5 billion Israeli pounds or 9 per cent of the narrow money supply. The figure for estimated money supply reduction differed slightly from that of the secretariat (11 per cent) mainly because of the use of more recent statistics that were not available to the secretariat and different assumptions regarding the depreciation rate.

8. The various policy measures introduced to fight inflation were now beginning to show their effect. The pace of economic activity had slowed down since the last quarter of 1979, private consumption and investment had declined considerably, inflation was lower and exports had increased

at an unprecedented rate. If there were hesitations about the immediate removal of the deposit scheme, they originated from doubts as to whether an injection of liquidity of 3.5 billion Israeli pounds that would result from a termination of the scheme might not be premature in the present economic conditions.

Statement by the representative of the International Monetary Fund

9. The representative of the Fund summarized recent developments in the economy of Israel and noted that expansionary fiscal and monetary policies during 1978 and 1979 had contributed to a recovery of overall economic activity. During the same period, the current account of the balance of payments deteriorated sharply as a result of rising imports, but the deficits were more than covered by official transfers and net capital inflows. The Fund representative reviewed the overall balance-of-payments situation and, in that context, suggested that the relatively high level of Israel's gross reserves at the end of 1979, nearly SDR 2.4 billion, should be seen against the background of some special factors of uncertainty, considerable dependence on short-term capital inflows, and a relatively high level of external debt.

10. In reviewing overall economic and financial policies of the Israeli authorities, the Fund representative referred to the aggravation of inflationary pressures during 1978 and 1979, and noted the endeavours of the monetary authorities to counteract monetary expansion resulting from the budget deficit. There was evidence that, at the beginning of 1980, some moderation had occurred in economic activity, the growth of imports, and the rate of inflation. The IMF representative referred to the substantial depreciation of the Israeli currency during the past year, and welcomed the maintenance of a liberal exchange system in respect of current payments and transfers since the comprehensive reform undertaken

in October 1977. He noted, in addition, that the advance import deposit requirement on taxable imports, introduced in November 1979, had been intended to remain in effect for six months.

Balance-of-payments situation and prospects - alternative measures to restore equilibrium

11. Members of the Committee expressed appreciation for the thorough presentation by the Israeli delegation of Israel's current economic situation and balance-of-payments problems and for its detailed explanation of the comprehensive set of government policies being followed to restore equilibrium and to reduce domestic inflationary pressures. In particular, they welcomed Israel's firm commitment to maintain open trading policies, and its intention to pursue efforts to base redress of current economic difficulties on the shift of domestic resources towards the export sector and to avoid the use of restrictive import measures to the fullest extent possible. Members of the Committee also expressed the view that continued progress on this front was desirable as a payments imbalance of the present magnitude was clearly not sustainable in the long run.

12. In this connexion, and with particular reference to the trade gap, several members of the Committee asked what were the long-run prospects for growth in exports and what measures were being taken by the Israeli Government to encourage sustained expansion in this area. The representative of Israel explained that a rapid expansion of exports had been experienced in recent years, despite setbacks in diamond trade, and that this was expected to continue. He indicated that during the first four months of 1980 exports had increased by 42 per cent in nominal terms, as a result of the impact of the domestic restrictive policies which led to a decline in local demand and greater availability of labour. In the long run continued growth in exports could be expected due to the gradual shift in the structure of Israel's

production resulting, on the one hand, in an increased share of exports in total production and, on the other, in an increase in the proportion of exports of technology-intensive products based on local R and D in total exports. Generally speaking, the economic policies of Israel aimed at shifting resources to the export sector and at developing competitive export industries without recourse to direct export subsidies; the latter had in fact been abolished already in November 1977. However, the representative of Israel stressed the difficulties inherent in reaching such long-term objectives in an economy burdened with severe rigidities on the import side of the trade account due to the high import content of defense expenditures and the very fast increase in import prices, especially prices of oil and raw materials, not to speak of the heavy burden of foreign debt service on the balance of payments.

13. Several members asked what was the relative importance of oil in the total import bill of Israel, and what measures the Israeli Government had taken or envisaged to take to alleviate the resulting burden on the balance of payments. The representative of Israel explained that his authorities had adopted extensive and co-ordinated measures to conserve energy and develop alternative energy resources. This included legislation to enforce the use of energy-saving devices and the active development of projects in the fields of solar energy and coal-fired power plants. In the short-run, the sharp increases in the prices of energy products had permitted to maintain Israel's energy consumption per capita at a stable level during the last three to four years.

14. Members of the Committee expressed concern at the level and structure of Israel's foreign indebtedness and they asked what measures the Israeli authorities envisaged to take in order to reduce pressures in this area. The representative of Israel stated that three basic approaches were being contemplated by his authorities to deal with this problem. First, they intended to pursue their efforts to improve the trade account through the continuation of present restrictive domestic policies. Second, they would endeavour to maintain the international credit standing of the country so as to be able to mobilize foreign capital as required. Third, they would continue to rely on the financial assistance of the Jewish communities throughout the world and of friendly foreign governments. The representative of Israel remarked, however, that the present debt structure of Israel was relatively favourable despite a recent increase in short-term borrowing from abroad; about 88 per cent of the total outstanding public debt was of a long and medium-term character and part of it had been placed on advantageous terms.

15. Some members of the Committee asked for clarification on the actual level of Israel's reserves and on the rationale for maintaining what appeared to be a high level of reserves in the face of severe balance-of-payments difficulties, notably in the light of the relevant provisions of the General Agreement concerning the justification of trade restraints for balance-of-payments purposes. The representative of Israel stated that at the end of 1979 official reserves represented about three months of imports. Regarding the general aspects of the question, he drew attention to the special situation of Israel, which was highly dependant on foreign supplies (imports represented about 40 per cent of the country's total resources) and needed to

maintain a good credit standing on international capital markets in view of its heavy foreign borrowing requirements. A sound reserve level was essential from these two standpoints. Further, he stressed that the liberalization of exchange controls to which his authorities had proceeded in the context of the recent opening up of the Israeli economy carried great risks in view of the numerous instability factors at work in the Middle East region. The Israeli Government feared that a decline in official reserves might be taken as a sign of the possible reinstatement of exchange restrictions by the Israeli public, leading to a loss of confidence which might well result in an effective run down of reserves. Consequently, the Israeli Government, while recognizing the high cost of maintaining sizeable official reserves, considered that this was the price it had to pay for maintaining financial stability and security.

16. One member of the Committee enquired about the effectiveness of the monetary and credit policies being followed by the Israeli Government and asked what additional measures would be envisaged in the event that such policies proved insufficient. In his reply, the representative of Israel pointed out that it was the current monetary policy stance that had been mainly responsible for the more favourable trends in the balance of payments recorded during the last six months, but he stressed that the squeeze had been very severe and that such policies could not be pursued for very long without giving rise to bankruptcies and socially unacceptable levels of unemployment. Domestic credit expansion had been practically stopped, a strictly enforced ban on foreign short-term borrowing had been instituted, development loans and mortgages had been linked to the consumer price index and, in a situation of three-digit inflation, positive interest rates had been introduced in 1979. Finally, the temporary import deposit scheme had been adopted as a supplementary measure, taking into account the fact that monetary restrictions had reached the limits of tolerance.

17. The representative of Israel, answering questions by some members of the Committee concerning current fiscal policies of the government, indicated that domestic subsidies had been abolished except for two items of mass consumption (bread and public transportation) and that even for these items subsidies had already been reduced and would be reduced further. Recognizing that the reduction or abolition of subsidies tended to reinforce inflationary pressures in the short-run, he explained that the Israeli authorities were conscious of this fact but that they had preferred to place emphasis on the immediate impact of this measure as a means of absorbing excess liquidity from the public and of improving budgetary equilibrium. Further, it was hoped that these effects would contribute to reducing the pace of inflation later in the year.

18. Regarding the question of budgetary prospects for 1980 raised by one delegation, he indicated that planned reductions in government expenditure and increased efficiency of tax collection were expected to improve public accounts, though the final out-turn would depend on the actual pace of inflation during the rest of the year.

System, method and effect of the restrictive import measures

19. Members of the Committee enquired about the rationale for the 10 per cent import deposit scheme in the context of the comprehensive demand management policies adopted by the Israeli delegation since the last consultation and requested the Israeli delegation to furnish indications on the possibility of removing or phasing out this scheme in the near future.

20. In responding to these concerns, the representative of Israel reaffirmed his government's firm commitment to a liberal trading system and stated that it was not their intention to maintain the import deposit scheme as a long-run element of trade policy. The scheme was to be viewed in relation to the macro-economic stabilization policies described previously particularly as a complementary measure of monetary restraint since its primary purpose was to reduce domestic liquidity. This it had done to an amount estimated at 3.5 billion Israeli pounds up to the present. In addition, the representative of Israel underlined the fact that the scheme had played a useful rôle in focusing the attention of the Israeli public on the balance-of-payments objectives of these macro-economic policies and that it had contributed to balancing the burden of adjustment as between different sectors of the economy.

21. Following a discussion on the likely impact of the import deposit scheme on domestic liquidity, inflation and demand for imports, and having noted that this impact had been relatively small and would be even smaller if the scheme remained in operation beyond the initial six-month period, members of the Committee expressed the hope that the deposit requirement could be gradually phased out in the near future and that a timetable for its removal could be announced soon by the Israeli authorities. The representative of Israel, noting that the Israeli authorities' own estimates of the impact of the scheme were close to those of the secretariat, recognized that the scheme played a modest rôle compared to other counter-cyclical policies followed by his government. Nonetheless taking into account especially the socio-economic considerations which had motivated its adoption and the monetary consequences of its removal, he was not in a position to

commit his authorities to the abolition of the measure or to the fixing of a definite timetable for its removal. However, he reiterated his government's firm intention to proceed with the implementation of open trading policies and expressed the hope that the Committee would consider the question of the import deposit scheme against this background.

22. Some delegations asked for clarification on the status of quantitative restrictions referred to in the Basic Document submitted by the Israeli delegation, notably as regards the justification of those restrictions on balance-of-payments grounds. The representative of Israel stated that his authorities considered the licensing requirements in question to be of a residual character. Although in the prevailing balance-of-payments situation it was difficult for the Israeli Government to envisage significant reductions in such requirements, it was their intention to gradually shorten the list of products subject to licensing when this would be made possible by improvements in the balance-of-payments situation.

23. In reply to a question by one member concerning the nature, scope and effect of the TAMA and the need to maintain this measure in operation, the representative of Israel explained that the TAMA was not a tax, but simply a means of calculation of standard trade mark-ups designed to assess the tax base for the limited number of imported products subject to a single-stage purchase tax levied at the wholesale level. He added, in reply to a further question by the same member of the Committee, that he saw no connexion between the TAMA and methods of customs valuation. Consequently, this measure was not seen as needing special attention in the context of Israel's examination of the possibility of joining the GATT code on customs valuation.

Conclusions

24. The Committee noted the sharp deterioration in the balance-of-payments situation of Israel that had taken place since the last consultation and it commended the Israeli Government for the very comprehensive set of measures of an internal character it had adopted in order to restore equilibrium and fight domestic inflation. The Committee also welcomed the renewed commitment of the Israeli Government to a liberal trade policy and to methods of adjustment which aimed to avoid the use of import restrictions to the fullest extent possible.

25. The Committee noted that a temporary import deposit scheme had been introduced in November 1979 at a relatively moderate level as part of an overall package of counter-cyclical policies. Recognizing that the restrictive effect of the scheme was small, the Committee took note of the fact that the Israeli delegation was not in a position to announce a firm timetable for its removal. The Committee, recalling the conclusions of the last consultation concerning products subject to import licensing, noted that the Israeli authorities considered that in present circumstances it would be premature to remove the residual quantitative restrictions that they maintained on a limited number of products.

26. Noting that Israel's balance-of-payments prospects for 1980 remained a cause for concern, the Committee encouraged Israel to pursue its efforts to restore equilibrium through appropriate domestic policies and expressed the hope that the balance-of-payments situation would soon improve sufficiently to enable the Israeli authorities to announce a timetable for the gradual phasing-out of the import deposit scheme.

Israel's Balance of Payments 1978-1980

($ million)

	1978			1979 (corrected)			1980 (Temporary Estimate)		
	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net
Goods and Services (f.o.b. c.i.f.)	6969	10308	-3339	8398	12151	-3753	10595	15415	-4820
Goods (excl. defence imports)	3685	5521	-1836	4277	7175	-2898	5,530	9 000	-3470
Defence Imports	-	1624	-1624	-	1158	-1158	-	1800	-1800
Services	2824	2810	14	3589	3388	201	4485	4065	420
thereof: Transportation	1055	760	295	1129	892	237	1410	1090	320
Travel	592	344	248	787	429	358	1015	455	560
Insurance	306	290	16	354	317	37	450	400	50
Investment Income	494	993	-499	764	1372	-608	865	1700	-835
Government	20	150	-130	19	131	-112	25	160	-135
Other Services	357	273	84	536	247	289	680	300	380
Trade with Administered Territories	460	354	106	532	430	102	620	510	110
Unilateral Transfers (net)	2400	-	2400	2281	-	2281	2900	-	2900
Restitutions from Germany	406	-	406	439	-	439	480	-	480
Personal and institutional Remittances	841	-	841	970	-	970	1100	-	1100
Government Transfers	1153	-	1153	872	-	872	1320	-	1320
Capital Movements, Long and Medium Term	2186	1110	1076	2234	1123	1111	3175	1340	1835
Development Bonds	400	-	400	411	-	411	450	-	450
United States Government Loans	982	-	982	1027	-	1027	1375	-	1375
Other Loans	685	-	685	594	-	594	1130	-	1130
Investments	119	137	-18	202	231	-29	220	190	30
Repayment of Loans	-	973	-973	-	892	-892	-	1150	-1150
Net Short-Term movements, Errors & Omissions	-	135	-135	361	-	361	85	-	85
of which: Change in Central Bank Net Reserves		883			328			-	
GRAND TOTAL	11555	11555	-	13274	13274	-	16755	16755	-
Memo Items: end of period									
Outstanding Foreign Debt			12882			14999			17000
Net Reserves in Central Bank			2242			2570			2570
weeks of import equivalent to net reserves			11			10			8