

GENERAL AGREEMENT ON TARIFFS AND TRADE

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REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS
ON THE CONSULTATION WITH BRAZIL

1. In accordance with its terms of reference the Committee conducted the consultation with Brazil under paragraph 4(b) of Article XII (unrevised). The Committee had before it: (a) the "basic document" prepared by the secretariat and (b) documents provided by the International Monetary Fund. In conducting the consultation the Committee followed the "plan" recommended by the CONTRACTING PARTIES. The discussion with the Committee was completed on 10 May 1960. The present report summarized the main points discussed during the consultation.

Consultation with the International Monetary Fund

2. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with Brazil. As a part of the consultation between the CONTRACTING PARTIES and the Fund, the latter transmitted two papers containing background material. In accordance with the agreed procedure the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of Brazil. The statement made was as follows:

"The International Monetary Fund has transmitted to the CONTRACTING PARTIES two background papers on Brazil. These papers are dated April 17, 1959 and May 4, 1960.

"With respect to Parts I to III of the Plan for Consultations, Brazil continues to require measures to stop a serious decline in its monetary reserves. The reserve position remains precarious despite the depreciation of exchange rates within a complex exchange system. The Fund hopes that Brazil will examine measures to deal with this situation, including its fiscal and monetary policies."

Balance-of-Payments Position and Prospects

3. In his opening statement the representative of Brazil recalled that at the time of the last consultation with his country under Article XII:4(b) in 1957, his delegation had stressed the fundamental factors underlying the disequilibrium in Brazil's balance of payments. Reference had been made to the finding of the joint group constituted by the Bank for Development of Brazil and by the Economic Commission for Latin America that a substantial improvement of the balance of payments could hardly be expected prior to 1962.¹ For the period under review, this forecast had unfortunately been confirmed. No significant progress in increasing export earnings had been achieved because Brazil was still mainly dependent on the export of primary products and prices for these products in world markets had experienced a substantial decline. The measures undertaken by the Government to diversify and expand exports through the adoption of a more flexible system of exchange could only be expected to show results over a long period and the improvement in Brazil's export capacity, as a result of these measures taken so far, had necessarily been limited.

4. In the light of Brazil's present economic structure particular emphasis must be placed on the importance of increases in coffee exports. Unfortunately, any measure aimed at increasing coffee exports could involve an appreciable change in the price structure for coffee and might result in upsetting the international market in this commodity. As a result of an Agreement entered into by the main coffee producers it had however been possible to adjust export prices for coffee to a realistic level in relation to demand and supply conditions in the international market for coffee. Under the Agreement, Brazil had been able in 1959 to export 17.7 million bags of coffee to a value of about \$733 million. This represented an increase of 40 per cent in the volume of this export over the previous year, but only of about 8 per cent in terms of value. Other important measures taken in 1959 for the promotion of exports included an increase in export bonuses and the transfer of a larger number of export commodities to the category for which export proceeds were negotiable in the fluctuating free market. In order to relieve the pressure on the balance of payments and to make possible the relaxation of restrictions, the Government of Brazil had sought to attract foreign capital. It was estimated that the net influx of foreign investment capital in 1959 had amounted to approximately \$150 million. Within the limits of the legal provisions concerning foreign capital, wide latitude was afforded to the transfer, through the free market, of profits or dividends from direct investments and interest and repayment of loans by private investors. In view of the vulnerability of Brazil's balance of payments to changes in the level of economic activity abroad and the present economic structure of the country, it had not yet been possible to eliminate exchange restrictions. Brazil had gradually changed over from an administrative exchange control to a system operating on a substantially automatic basis. The complete elimination of

¹ See L/746/Add.2

such restrictions could only be achieved at a very cautious pace for this would require, among other things, high levels of economic activity abroad.

5. Although at present trade with eighteen countries was still conducted under bilateral or multi-partner trade and payments arrangements, some progress had been made towards multilateralism. The limited convertibility regimen for imports from the member countries of the "Hague Club" had been suspended in favour of a freely convertible system. In another move, the bilateral payments arrangements with Japan and Sweden had recently been withdrawn and negotiations were at present in progress in Rio de Janeiro with several European countries with the purpose of multilateralization of payments. Also, it was expected that as a result of the creation of the Latin American Free Trade Area, trade with a number of South American countries would soon be placed on a multilateral basis.

6. In concluding his opening remarks, the representative of Brazil pointed out that it had been his Government's intention to further relax restrictions pursuant to the Customs Tariff Law of August 1957, but that Brazil's heavy external obligations, which took up about 20 to 30 per cent of foreign exchange earnings, were an important factor in the continued application of restrictions. The restrictions which it had been necessary to retain were, however, based on a system of automatic exchange control and were applied without any discriminatory intent. Despite the comprehensive efforts of his Government to strengthen his country's foreign reserve position, there appeared to be little hope of a significant improvement within the near future. The Brazilian Government welcomed the opportunity provided by this consultation and would not fail to give its fullest consideration to whatever views might be presented, especially views that were helpful to Brazil's efforts at improving its foreign exchange position and at removing restrictions.

7. Members of the Committee thanked the Brazilian delegation for the clear and concise statement. It was noted that Brazil's gold and foreign exchange reserves net of outstanding liabilities had been \$27.4 million at the end of 1959 and that total imports amounted to \$1,228 million during the year. It also appeared that Brazil's external payments situation had further deteriorated during the first quarter of 1960. Members of the Committee enquired about the expected development of Brazil's balance of payments during the current year and about signs on which Brazil was basing its expectation of an easing of the pressure on the balance of payments after 1962. The representative of Brazil explained that the country's balance-of-payments position depended mainly on the export prospects for coffee. On the assumption that in 1960 Brazil could again, as it did in 1959, export at stable prices its full quota under the Washington Coffee Agreement, there should be a fair prospect for Brazil's being able to meet both its debt repayment obligations and the estimated import requirements. Maximum export earnings for 1960 had been estimated at some \$1,400 million. Of this amount, \$475 million had been

earmarked for interest and amortization payments during the year and for certain import commitments. He explained that the large element of committed payments in Brazil's balance of payments was one of the main reasons for the precarious reserve position.

8. In discussion of the influence of Brazil's external indebtedness on the country's present import possibilities, members noted with satisfaction that it had been possible for Brazil during 1959 to reduce its outstanding medium-term balance-of-payments loans while increasing its long-term obligations to the United States Export-Import Bank and the International Bank. The decrease in these medium-term loans had been \$95 million as compared with an increase in the long-term obligations of \$44 million. On the other hand, there appeared to have been a substantial increase in 1959 in Brazil's overall external debt which could be roughly estimated at \$359 million. It was particularly noted that registered suppliers' credits had risen by about \$183 million, from \$425 million at the end of 1958 to \$608 million at the end of 1959, also credit obligations from so-called swap operations¹ had increased by \$115 million. In response to several questions about the reasons for these credit increases and the treatment accorded these loans, the representative of Brazil explained that the substantial increase in Brazil's foreign indebtedness during 1959 was largely a reflection of the confidence which creditors had in the prospect for the economic development of Brazil. Although these loans were, as a rule, not accorded special treatment, the general policy to give priority in the foreign exchange allocations to interest and amortization payments might have been a factor favourable to the availability of foreign credits. The Government had not placed a ceiling on such short and medium-term capital imports but loans with a maturity period of five or more years were preferred because these would not contribute to the pressure on foreign reserves during the next few difficult years. Although the allocations for debt servicing and amortization were given priority over increased allocations for imports, the Government had always tried to put up for auction the maximum amount of foreign exchange. This was limited only by the requirements of debt servicing and repayment and by the amounts set aside for payments for certain imports, needed for economic development or otherwise deemed highly essential, which were not subject to the allocation of foreign exchange under the auction system. Some members of the Committee pointed out, however, that the sector of imports not subject to foreign exchange auction included such important import items as wheat, petroleum and petroleum products as well as certain industrial and agricultural equipment, spare parts and a number of other goods. For example, in the budget for 1960, provision had been made for the allocation of \$180 million for imports of petroleum and petroleum products, \$130 million for the importation of wheat. When allowance was made for debt servicing, amortization and other payments commitments, the amount of foreign exchange available for imports subject to exchange allocations in the exchange market was rather limited, amounting to about \$450 million.

¹ i.e. Selling of foreign exchange arising from capital importation to the Central Bank against the undertaking by the latter that foreign exchange for interest and amortization payments would be supplied after an agreed period, normally at the rate prevailing at the time of the purchase.

9. Several members of the Committee expressed their concern over the relatively large share of Brazil's trade which was still subject to bilateral trade and payments arrangements. They noted in particular the fact that even with certain countries whose currencies had become externally convertible, Brazil still conducted its trade on a non-convertible basis. In this connexion, it was pointed out that although there could be no doubt about the desirability of conducting trade and payments on a multilateral basis, Brazil was faced with special difficulties as a result of a high level of foreign indebtedness and its reliance on a few export commodities. Some members of the Committee considered that bilateral arrangements with countries which would only trade on a non-convertible basis (e.g. some countries in Eastern Europe) enabled Brazil to have a higher level of exports than would otherwise be possible and thus assisted in the country's balance of payments, while some other members considered that some other bilateral agreements would also have such effects. Some members pointed out, however, that although it was understandable that Brazil in its present precarious balance-of-payments position would try to avail itself of all possible trading opportunities, the reliance on bilateral agreements was not without serious disadvantages to Brazil. The effect on Brazil's capacity to export, once these restrictions which had made the present arrangements possible had disappeared, would be the more severe the longer an adjustment to free competitive conditions in export markets had been delayed. Moreover, imports from bilateral sources could be substantially dearer in terms of foreign exchange than similar imports from countries whose currencies were convertible for Brazil. In view of the move to external convertibility by many countries, discriminatory restrictions on currency grounds were no longer justified.

10. In response to further questions the representative of Brazil explained that about 25 per cent of Brazil's total trade was conducted under bilateral payments arrangements. This figure included trade with Eastern European countries. He stated that his Government was fully aware of the desirability of conducting all trade and payments on a multilateral basis. The relatively large share of Brazilian trade which was still subject to bilateral arrangements had not only been dictated by payments considerations but had also been caused by the otherwise difficult access to certain markets, especially in Europe. Brazil had every intention to move further away from bilateral agreements if it could be assured the same import facilities which were enjoyed at present for some of its major export products in a number of bilateral account countries. There was reason to fear, however, that such import facilities might not be available. The Brazilian representative reassured the Committee that his Government was nevertheless constantly striving to reduce reliance on bilateral trade and payments arrangements. He pointed out again that the

Limited convertibility regime for imports from the United Kingdom, Federal Republic of Germany, Benelux, France, Italy, Austria, had been discontinued in favour of a freely convertible system, that more recently the bilateral arrangements with Japan and Sweden had been terminated, and that a similar move was at present being negotiated with other Scandinavian countries.

Alternative Measures to Restore Equilibrium

11. Members of the Committee recalled that in 1957, at the time of the last consultation, the delegate from Brazil had referred to internal inflation as his country's most pressing problem. Members of the Committee noted the large budget deficit in 1958 and 1959 and the continuation of inflationary pressures as a result of deficit spending and credit expansion. It was pointed out that exchange reserves would remain under pressure as long as internal inflation continued to be a major problem. The representative of Brazil agreed that the achievement of a fairly stable level of internal prices was indeed one of the prerequisites for the restoration of external equilibrium. The Government had therefore taken all possible measures to halt inflation and a certain success in these policies seemed to be already apparent. Referring to the concern expressed at the time of the last consultation that unless greater stability was achieved, foreign resources to finance sound development projects would not be forthcoming, the representative of Brazil pointed out that these fears had fortunately not materialized. In fact, there had been a net inflow of foreign investment capital of about \$150 million in 1959, which might justifiably be considered a sign of confidence by foreign investors in his Government's intention to keep inflationary pressures within reasonable limits. Although serious efforts were being made to combat inflation, he considered that a certain degree of inflation was almost inevitable in view of the comprehensive programme for rapid economic development which was actively being pursued by his Government.

System and Methods of the Restrictions

12. Several members of the Committee commented on the prevalence of different sets of exchange rates for convertible and non-convertible currencies and the discrimination resulting therefrom. For example, imports payable in non-convertible currencies benefited from auction rates which were considerably lower than those applying to convertible currencies. Furthermore, bilateral account currency was normally traded for spot delivery while convertible currency was traded for delivery after 150 days. Exporters in countries which conducted their trade with Brazil on the basis of convertible currencies were thus at a considerable disadvantage as compared to exporters in bilateral account countries. The use of differential exchange rates could have in practice the effect of up to 20 per cent price advantage in cruzeiros for goods imported from bilateral account countries and every effort should therefore be made to eliminate the discriminatory element in the system through which imports were regulated.

13. The representative of Brazil discussed with the Committee the difference in the auction rates for convertible and non-convertible currencies which at present had the effect of creating certain discrimination in treatment of imports from different sources. The Government was making every effort to eliminate whatever discrimination existed. Not only had the use of trade agreement currencies been substantially reduced in the moves referred to above, but the Government had taken further action to reduce and eventually eliminate discrimination resulting from differential exchange rates. In November 1959 the Government had fixed the minimum bid level for bilateral agreement currencies at 85 per cent of the previous week's average exchange rate for convertible currencies. Subject to this minimum, auction rates were determined by market forces. The exchange rate for non-convertible and convertible currencies quoted in Rio de Janeiro during the first week of May (calculated in terms of US dollars) had, for example, been 185 and 211 cruzeiros to the dollar for bilateral account and convertible currencies respectively. He pointed out, however, that these differentials reflected the operation of market forces and that subject to the conditions which made it necessary for the Government to conduct part of its trade under bilateral agreements there was no intention by the Government to favour imports from any particular source. He also explained that spot delivery of bilateral account currencies at auctions had been possible because the position of bilateral accounts at any given time was a known factor while on the other hand the availability of convertible currencies, depending as it did, on foreign exchange receipts, was often unpredictable.

14. Several members of the Committee commented on the practice of holding ad hoc exchange auctions for specified imports from certain bilateral account countries. They noted that the effective rates of exchange for such transactions were considerably more favourable still than those prevailing for bilateral currencies in regular exchange auctions. In many instances the price advantage to exporters benefiting from these special currency allocations was more than 50 per cent of the f.o.b. price of an equally-priced product subject to exchange allocations at regular auctions. Furthermore, the relative availability of foreign exchange for goods benefiting from these allocations was considerably larger due to the practice of making these special allocations in respect of specified imports from specified sources. One member of the Committee referred in this connexion to the payments arrangements for the import of fruit from Argentina and the auctions for the importation of so-called "Christmas items", etc., from a number of bilateral account countries. As a result of the preferential rates applying to certain types of imports the share of one supplying country for apples, for example, had been reduced from 162,000 bushels before the war to 1,000 bushels in 1958. The share for the same country of the Brazilian market for dried prunes had been reduced from 906,000 lbs. in 1953 to nil in 1958. Another country which once had supplied about 95 per cent of imports of cod fish into Brazil had now practically lost that market as a result of differential

exchange rate arising from the special auction for bilateral account currencies. Traditional suppliers of pears, fresh grapes and, to a certain extent, suppliers of newsprint had, as a result of the preferential treatment given to imports from bilateral account countries, also suffered large declines in their share of the Brazilian market. Similarly, the disproportionately large share of imports into Brazil of agricultural tractors and machinery from bilateral account countries during the last few years had significantly reduced the market share of some traditional suppliers of these imports. Members of the Committee pointed out that whereas the losses suffered by the traditional suppliers as a result of the diversion of trade were substantial, the disruption of market might have caused injury to trade far exceeding these measurable losses.

15. The representative of Brazil expressed his understanding of the difficulties which had resulted for particular exporters or industries from a loss of markets due to such special arrangements. He pointed out, however, that imports in the "special" auction category were only a small proportion (in 1959 about 1 per cent) of total imports. A member of the Committee noted that since about 25 per cent of Brazil's total trade was conducted under bilateral payments arrangements, the extent of discrimination was considerably greater than that which was indicated by the proportion of trade subject to the "special" auction category, even though not all bilateral arrangements were necessarily discriminatory. In fact, the amount of Brazil's trade affected by discriminatory arrangements seemed to be substantial. The Brazilian representative noted that the types of products imported through the specific exchange allocations were usually non-essentials, such as "Christmas items", etc., which could not otherwise have been imported with convertible currencies in view of the preference which had to be given to the importation of essential items. These imports had been permitted because of the availability of inconvertible currencies in a number of bilateral accounts. In other instances such special exchange auctions were held to permit exchanges which would not otherwise be possible; for example, the import of apples from Argentina was a prerequisite for finding an export market in that country for Brazil's banana production. There was no intent by his Government to favour certain supplying countries at the expense of other trade partners. The decline in the importation of newsprint, as a proportion of total imports of this product with respect to one of Brazil's traditional suppliers, was also due to the necessity for his Government to utilize bilateral currency reserves as long as convertible currencies continued to be in very short supply. There had, however, also been an increase in domestic production of newsprint from 40,000 tons in 1955 to 75,000 tons in 1959.

16. In response to several other questions concerning the experience which Brazil had had with bilateral trade flows, the representative of Brazil explained that it had not always been possible to reach the target of exchanges foreseen

in these bilateral agreements partly because of the difficulty of finding sufficient markets in Brazil. He explained that in the case of automobiles, for example, some import targets had during the past year been under-utilized while others had practically not been used at all. In further discussion of this point he explained that it was difficult to forecast what the market for imported automobiles in Brazil would be in coming years. Brazil had a few years ago established a domestic automobile industry which was increasingly meeting the demand for certain types of vehicles and there had even been some modest exports. He pointed out, however, that, subject to the allocation of foreign exchange through the exchange market, there were no further restrictions on the importation of automobiles except for passenger vehicles with an f.o.b. value in excess of \$3,500. In response to another question concerning the trade agreement which had recently been concluded between Brazil and the USSR, the representative of Brazil stated that no details about the schedule of contemplated exchanges were yet known but that the target of two-way trade between the two countries of \$25 million was so small in relation to Brazil's total trade that it was not expected that the agreement would have significant repercussions on the trade of other countries.

17. One member of the Committee enquired about the criteria used by Brazil in selecting products for inclusion in the restrictive "special" category. He also asked about the criteria and procedure whereby goods in the "special" category might be transferred into the "general" category, and about the prospects for such transfers being made in the near future. Another member noted that the "special" category expressly included goods already manufactured in sufficient quantities in the country. The representative of Brazil explained that the "general" category included raw materials, capital goods and essential consumer goods in short supply in the domestic market while all other commodities were in the "special" category. In terms of actual imports, goods in the "general" category accounted for 96 per cent and those in the "special" category for only 4 per cent of total imports covered by the "general" and "special" auctions. The distribution between the two categories had been relatively stable since 1957 when these two categories had been introduced at the time of the enactment of the new Tariff Law. The Customs Policy Council was responsible for determining whether a product fell into the "special" or "general" category. On the other hand, the allocation of foreign exchange to each category was determined by the Council of SUMOC. So far, the Government had moved few commodities, for purely administrative reasons, from the "general" to the "special" category. In general, the policy had been to enlarge the number of goods in the "general" category, i.e. those benefiting from more liberal foreign exchange allocations, and ninety-five products had been transferred from the "special" category to the "general" category since 1957. In response to a specific question the representative of Brazil confirmed that imports of rubber were effected by private firms which were free to choose the source of supply. Discrimination was not intended and the "general" auction rate taken as a guide. He also explained that the limitation placed on imports in the "special" category was not aimed at the protection of domestic industries but was principally for the protection of the balance of payments. In response to another question concerning the criteria used by the Council of SUMOC in determining the allocation of various foreign currencies to each import category, the representative of Brazil explained that, although account was taken of such considerations as the traditional pattern of imports or commitments under trade agreements, the main emphasis was placed on the requirements of the Brazilian economy.

18. Members of the Committee commented on the complexity of the system of controls and other measures affecting imports in Brazil and enquired whether the Government had considered the use of simpler and more flexible methods in order to lessen the harmful effect on trade and to reduce the element of discrimination. The representative of Brazil explained that the impersonal and semi-automatic control of imports through the operation of the exchange market as it had been in force since 1957, had been introduced to minimize the element of administrative discretion and the possibility of regional differences in import treatment which had been not uncommon in the licensing system employed previously as a result of the difficulty of controlling effectively the application of the Law in a large number of de-centralized and remote licensing offices which it was necessary to maintain in a country as large as Brazil.

Effects of the Restrictions

19. Members of the Committee observed that the complexity of the system of restrictions used by Brazil was likely to leave a permanent mark on the country's economic development which in the long run, might not necessarily be desirable. For example, the maintenance of a number of special categories for the allocation of foreign exchange might divert economic factors of production to less economic uses and consequently impede Brazil's ability to compete in export markets. One member of the Committee enquired in this context what repercussions the present development programme was expected to have on the level of agricultural production in Brazil. The representative of Brazil explained that his Government was aware of the possibility of adverse effects on economic development and efficiency resulting from the need to maintain restrictions and to give special treatment for certain specified commodities or with respect to imports from certain countries. These special measures had however no protective purpose, but were designed to permit the maximum amount of trade consistent with the need to protect the balance of payments. The development programme was not aimed at economic self-sufficiency and the Government remained convinced of the benefits to be derived from international specialization and trade. Within the limits of the availability of foreign exchange Brazil had always tried to follow a fair and liberal trade policy. Also, Brazil was endeavouring to follow a policy consistent with a balanced development of the economy. Despite the comprehensive programme of rapid industrialization sponsored by his Government the need to improve and increase agricultural production had been given full consideration. Special measures had for example been taken on behalf of imports of fertilizers and agricultural equipment and materials. On the other hand, the Government had attempted to restrain the output of coffee as long as that commodity continued to face difficulties in expanding export markets. Brazil would, however, continue to be dependent for some time for a large part of its foreign exchange on the exports of a few agricultural commodities, such as coffee. It was for this reason that Brazil welcomed the significant reduction of internal coffee prices which had recently been announced by Poland and Czechoslovakia following negotiations between Brazil and these countries and in line with the recommendations of Committee III of GATT. He expressed the hope that import facilities for Brazil's main exports would also be widened in other important markets and thus contribute to an improvement in his country's balance-of-payments position.

General Observations

20. Members of the Committee thanked the delegation of Brazil for the frankness and the spirit of co-operation with which they had participated in the consultation. They welcomed the intention of the Government of Brazil to reduce the existing spread between the market rates for convertible and non-convertible currencies and to work for a further reduction and eventual elimination of the share of trade subject to bilateral arrangements. It was widely felt in the Committee that every effort should be made to achieve the elimination of these bilateral arrangements especially with countries having convertible currencies. At present, the Brazilian system of controls, even if it was not intended to be discriminatory, in effect involved substantial discrimination against imports from many sources. The Committee felt that the methods for controlling imports were, to say the least, complex and that consideration should be given to the simplification of controls and procedures.

21. The representative of Brazil stated that his delegation had taken due note of the views expressed by the other members of the Committee and assured them that these would be conveyed to his Government for careful and sympathetic consideration.