

GENERAL AGREEMENT ON TARIFFS AND TRADE

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

B R A Z I L

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 (BOP/3), supplemented by material supplied by the Brazilian authorities, to be issued as document BOP/7; and (b) documents provided by the International Monetary Fund as noted in paragraph 2 below. In conducting the consultation the Committee followed the "Plan" recommended by the CONTRACTING PARTIES. The discussion was completed on 7 May 1962. The present report summarizes the main points of discussion 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. 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 the Executive Board decision relating to the last consultation with Brazil under Article XIV of the Fund Agreement and the background material prepared in connection with that consultation.

"With respect to Part I of the Plan for Consultations, relating to balance-of-payments position and prospects, and with respect to Part III, relating to system and methods of the restrictions, the Fund calls the attention of the CONTRACTING PARTIES to the Executive Board decision of March 14th, 1962, taken at the conclusion of its recent consultation with Brazil, and particularly to paragraph 4 which reads as follows:

'The Fund notes that Brazil's exchange system was further simplified since the measures of March 1961, particularly through the elimination of the preferential exchange rate. Moreover, dependence on bilateral payments arrangements has been reduced. The Fund notes that Brazil's balance of payments in 1961 benefited substantially from these and earlier improvements. However, certain imports remain severely restricted and informal payments restrictions have arisen

recently from limitations on the freedom of the exchange market. The Fund considers it essential that freedom in the exchange market be restored promptly and that the exchange rate therein be permitted to respond to market forces. The Fund urges Brazil to implement its plan to terminate bilateral payments arrangements with other Fund members and to reduce the restrictiveness of import practices as soon as possible. The Fund will keep under close review Brazil's exchange rate policies and, in the meantime, does not object to the maintenance of Brazil's exchange practices on a temporary basis, but urges Brazil to eliminate the discriminatory aspects as soon as possible.'

"With respect to Part II of the Plan for Consultations, relating to alternative measures to restore equilibrium, the Fund draws attention to the decision taken at the conclusion of its last consultation with Brazil. The Fund has no additional alternative measures to suggest at this time."

Opening statement by the representative of Brazil

3. In opening the discussion, the representative of Brazil outlined the changes in Brazil's import and exchange control policy since the last consultation with the Committee in 1960. He stated that he was happy to report that the exchange reform measures initiated with Regulation 204 of 13 March 1961 of the Superintendency of Money and Credit (SUMOC) had had the result of considerably relaxing restrictions and had contributed to a remarkable improvement in the balance-of-payments position. According to statistics available, the balance of payments for 1961 had shown a surplus of US\$50 million. This compared with balance-of-payments deficits averaging US\$250 million per year during the period 1957-60. The favourable development was even more remarkable since there had been a slight increase in import outlays in 1961 over those of the preceding year.

4. While part of this favourable development could be traced to economic causes, such as the considerable increase in exports, encouraged by the establishment of a more realistic exchange rate, increased confidence in the soundness of the measures adopted by the new Brazilian Government for ensuring further rapid economic development had also played an important rôle in bringing about the increase in private capital imports, and capital repatriation during most of 1961. Another important element in the improvement of the balance of payments had been the successful negotiation in 1961 of arrangements for rescheduling payments on Brazil's external debt and, last but not least, increased import facilities under foreign aid programmes.

5. As regards developments in domestic monetary and fiscal policy, the Government of Brazil was stepping up its efforts to counteract the still strong inflationary forces in the economy. In implementation of its anti-inflationary policy, and in order to provide a mechanism for reducing the sudden impact of the exchange reform on the level of liquidity, the Government had found it necessary in March 1961 to introduce a prior deposit requirement for about one third of all imports, equivalent to 100 per cent of the exchange contract. This deposit requirement which had subsequently been raised to 150 per cent was a temporary measure and was being reduced at the rate of 10 percentage points per month in accordance with Regulation 221 of SUMOC of December 1961. It was now 100 per cent and therefore the deposit requirement would be eliminated by March 1963 unless, for monetary reasons and in the absence of other appropriate measures to reduce excess liquidity, its further maintenance was found necessary. In this connexion the representative of Brazil explained that his Government intended to introduce a comprehensive anti-inflationary programme, providing inter alia new monetary and fiscal authority for various anti-inflationary measures. Significant aspects regarding this programme, as outlined by the representative of Brazil in his opening statement, are summarized in paragraph 14 of this report. In view of the anti-inflationary measures already adopted by the Government of Brazil or planned to be introduced in the near future after their approval by Congress, it could reasonably be expected that excessive demand and pressure on imports arising therefrom would be reduced and eventually eliminated.

6. The Brazilian Government considered internal equilibrium an important factor for a sound balance of payments. However, if internal equilibrium could not be achieved, a change in the exchange rate could be considered as a necessary measure to preserve the identity between the internal and external value of the monetary unit. Any sound expansion of Brazil's foreign trade and further economic development depended to a certain extent on increased exports. Encouragement to exports was consequently a major plank of economic policy and some welcome increase in exports had been achieved since the last consultation. Total export earnings in 1961 had been approximately 10 per cent higher than in 1960. Except for coffee and cocoa, Brazil's two major export commodities, an increase in exports was registered for most items, with increases in the miscellaneous category which included the new lines of production reaching an average of 25 per cent. In order to assist in facilitating an expansion of exports requiring medium or long-term financing the Superintendency of Money and Credit, in September 1961 had issued Regulation 215 which provided the basic structure for such export credits. The representative of Brazil further explained that export promotion was important not only for assisting the expansion of export earnings required for financing additional imports but also because an expansion of outlets created possibilities for improving the competitiveness of industries by permitting more efficient large-scale production techniques to be adopted.

7. In concluding, the representative of Brazil pointed out that even though the improvement in export performance was in many respects heartening, it had to be remembered that Brazil continued to be faced, particularly during the next four years, with very heavy repayment obligations on its external debt. Consequently an improvement in the trade balance was not necessarily reflected in an increase of available foreign exchange reserves. Although developing countries, for social and economic reasons, could ill afford to accumulate large foreign exchange reserves and consequently to forego much needed development imports, a low level of freely disposable funds abroad rendered it more difficult to remove import controls entirely. The liberalization measures introduced under the exchange reform programme were ample proof, however, that within the limits of sound financial practice and due account being given to Brazil's international obligations, every effort would be made by Brazil to move towards the elimination of control measures.

Balance-of-payments position and prospects

8. The Committee thanked the representative of Brazil for his clear and comprehensive statement, and congratulated the authorities of Brazil on the progress made since the last consultation in simplifying the system of import and exchange controls and on the improvement in the country's balance-of-payments position. The Committee welcomed the considerable progress made by Brazil in expanding and diversifying its exports during 1961. Members of the Committee enquired about the prospects of this favourable development continuing. The representative of Brazil stated that in view of the measures taken by the Government of Brazil to encourage exports, and in view of the growing export-mindedness of the Brazilian business community it was hoped that this development would indeed continue. On the other hand, it might be difficult to improve upon, or even to maintain, the rate of increase in exports achieved in 1961. While progress in expanding exports of the infant industries had been particularly gratifying, it had to be recognized that exports of manufactured items still accounted for only a small proportion of total exports and that consequently their contribution towards an improvement of the trade balance, though growing, was still relatively small. Exports of certain primary and agricultural products which had registered some welcome increases in 1961, particularly exports of cotton, had in many cases still not regained their pre-war level. Prospects for increasing exports of these items were in many instances adversely affected by measures of agricultural support and protectionism in certain of Brazil's traditional markets.

9. Export proceeds from coffee, the most important export commodity, accounting for about one half of total exports, had further declined in 1961, as compared with 1960, despite a slight increase in the volume of exports in 1961. He said that the deterioration of the world coffee market in recent years was obviously an important factor in Brazil's balance-of-payments difficulties. Prospects for a rapid and significant improvement of the international market for coffee were not reassuring. In discussion of the influence of recent changes in the terms of trade on Brazil's trade balance the representative of Brazil explained that, according to estimates made by the Brazilian authorities, export earnings from coffee in 1961 could have been higher by \$300 million if 1953-54 average export prices for coffee had prevailed in 1961. In view of the impact of fluctuations

in commodity prices on the export earning capacity of developing countries primarily or largely dependent for the bulk of their exchange earnings on a few primary products, Brazil supported the efforts being made in the context of commodity agreements or arrangements for reducing excessive price fluctuations and for achieving a better balance between supply and demand.

10. Members of the Committee enquired about Brazil's prospects in the short-term for increasing foreign exchange earnings through an expansion of exports to member countries of the Latin American Free Trade Association (LAFTA). The representative of Brazil explained that there were real possibilities for Brazil to expand its exports to LAFTA countries. It had to be borne in mind however that at present, on account of certain similarities in the structure of exports of the countries in the region and on account of the early stage of industrial development at which these countries found themselves, intra-area trade accounted for only a small proportion of their export trade. Thus, trade between LAFTA countries, even if it developed at a brisk pace, should not be expected to provide immediate and significant relief for the balance of payments or to present an alternative to increased exports to Brazil's traditional markets. The representative of Brazil agreed, however, that intra-regional trade expansion was of considerable importance and that regional co-operation arrangements presented a challenge to domestic industries to rationalize production. In fact, possibilities for establishing and expanding industries with a view to producing for a market transcending national boundaries had from the outset stirred the imagination of the people of Latin America and had been one of the main reasons for the establishment of the Latin American Free Trade Association. While no detailed overall plan for industrial co-operation in the framework of LAFTA had so far been established there had been contacts between industries of different member countries with a view towards increasing co-operation. Once the needs and the combined resources of the countries constituting the Latin American Free Trade Association became better known, increased industrial co-operation across national frontiers could be expected which in turn would open up additional trading opportunities.

11. In discussing other factors influencing the development of the balance of payments the representative of Brazil stated that, as a result of restored political stability in the country and because of the financial stabilization measures adopted or about to be introduced by the Government, capital repatriation was accelerating and private capital inflows were again increasing, following a decline in the second half of 1961 from the high rate registered after the adoption of the exchange reform measures in the spring of 1961.

12. In reply to a question on expected developments in the structure and composition of Brazil's import trade, the representative of Brazil explained that, in view of the country's rapid industrial development and the necessity to economize foreign exchange resources, the trend towards an increasing share in overall imports of capital equipment and industrial material, particularly noticeable since 1954-55, was likely to continue.

13. Members of the Committee noted that, as an exception to the free play of market forces, the exchange rate for the US dollar was being held at a specified level (Cr\$310 buying and Cr\$318 selling per US\$1), with exchange rates for other convertible currencies based on these rates and on the dollar quotations for such currencies in international markets. They called attention to the decision of the International Monetary Fund wherein it was stated that "the Fund considers it essential that freedom in the exchange market be restored promptly and that the exchange rate therein be permitted to respond to market forces". They expressed the hope that this limitation on the freedom of the exchange market would be removed in the near future. The representative of Brazil explained that this limitation was only temporary and that Brazil's policy remained to maintain, in the long run, the balance between the external and internal value of the Brazilian currency.

Alternative measures to restore equilibrium

14. In his opening statement the representative of Brazil explained the importance which the Government attached to counteracting the considerable inflationary pressures in the economy. The Government was aware of the desirability and of the need to reduce and eventually eliminate the gap between public revenue and expenditure. In order to avoid inflationary deficit financing the Government had proposed to Congress a compulsory loan to be derived from payments on income taxes due in 1962 and the issue of bonds guaranteed against devaluation. At the same time the Government proposed to reduce and defer expenditure. Only a small part of the federal cash deficit was proposed to be covered by paper issue, with currency circulation in 1962 to increase by not more than 10 per cent, a much smaller increase than in 1961. On the monetary side the Government proposed to enlarge the authority for the Superintendency of Money and Credit to prescribe and enforce minimum reserve requirements. The anti-inflationary measures adopted earlier by the Brazilian authorities and the implementation of measures of restraint on expenditure had already resulted in a smaller cash deficit for the first four months of 1962, as compared with the like period for 1961, despite an increase in prices since that time by approximately 40 per cent.

15. The Committee expressed satisfaction about the importance attached by the Government of Brazil to measures conducive to financial stability and about its intention to use additional measures and safeguards to check further monetary expansion and inflation. The Committee expressed the hope that the measures adopted or envisaged to be introduced under the new anti-inflationary programme would soon prove effective in arresting inflation.

System and methods of the restrictions

16. In the discussion of the different measures used by Brazil for controlling imports, the representative of Brazil explained that the prior deposit requirement of an amount equivalent, at present, to 100 per cent of the value of the exchange contract was primarily a measure for reducing excess liquidity. The prior deposit requirement introduced in March 1961 in connexion with the exchange reform measures put into effect at that time had never been considered as a commercial policy measure or as any more than a temporary device. Consequently, the rates of prior deposit were being reduced each month by ten percentage points in accordance with Regulation 221 of SUMOC with a view to the elimination of the prior deposit requirement by March 1963. Referring to his opening statement, members of the Committee invited the representative of Brazil to comment on the possibility of prior deposit rates not being reduced as envisaged in SUMOC Regulation 221. The representative of Brazil explained that it was expected that the tempo in reducing the deposit requirement would be maintained. On the other hand a situation might arise where a continuation of the deposit requirement would be dictated by the need to assure monetary stability. The broad programme of action devised by the Government to arrest inflation made it unlikely, however, that the Government would have to rely on prior import deposits as one of the major tools of monetary policy. The representative of Brazil pointed out in this connexion that a Bill had been approved by the Cabinet and had been passed by Congress during the previous week which would give the Superintendency of Money and Credit the long sought authority to prescribe, and ability to enforce, higher minimum bank reserve requirements. Once this Bill had been signed by the President, the monetary authorities would have at their disposal an effective instrument for influencing credit expansion which would render unnecessary prior import deposits as a means for reducing excess liquidity.

17. In further discussion of the use by the Brazilian authorities of prior deposits, the representative of Brazil explained that the exception of imports by official agencies from the deposit requirement was an indication that this measure was used as a monetary device. The extension of the prior deposit requirement to imports by official agencies would not have served the purpose of reducing excess liquidity in the hands of the public. He further explained that although the deposit requirement was not intended to regulate the flow and composition of imports, certain essential development and maintenance imports and imports from member countries of LAFTA had been exempted from this requirement by SUMOC Regulation 208 of 27 June 1961.

18. Members of the Committee pointed out that although they sympathized with the efforts made by the Brazilian authorities to arrest inflation, there could be little doubt that the prior deposit requirement had a pronounced inhibiting effect on imports from those countries not exempt from the requirement. Some members of the Committee said that exporters in their countries had felt the diversionary effects of the prior deposit requirement. Members of the Committee noted that the prevailing market discount on Bank of Brazil notes, acquired by importers as a result of the deposit requirement, was evidence of the significant extra cost factor involved. This had already caused a number of their

exporters difficulties in maintaining their share of the market, a share which had been established by supplying a quality product at competitive prices. Members of the Committee emphasized that, without wishing to enter into a discussion in the Committee of the legal aspects, there were economic arguments for avoiding discrimination such as that arising from the exemption of imports from LAFTA countries from the prior deposit requirement. They pointed out that measures applied in a discriminatory manner might not contribute to the strengthening of the balance of payments. To the extent that importers were able to shift their purchases from the restricted sources to members of the Free Trade Area benefiting from the exemption, the discriminatory measures would not have served the purpose of reducing foreign exchange expenditure on imports. Furthermore, this diversion of trade might lead importers to purchase from sources of supply that would, in the absence of discrimination, be less attractive and thus might actually lead to an increase in foreign exchange expenditure on imports. Members of the Committee, therefore, urged Brazil to consider eliminating the discriminatory aspects of the advance deposit requirement. In this connexion they called attention to paragraph 4 of the IMF decision wherein the Fund urged Brazil to eliminate, as soon as possible, the discriminatory aspects of its exchange practices. The representative of Brazil explained that prior to the coming into operation of the Free Trade Area, trade with most LAFTA countries had been conducted under bilateral agreements. Also, it had to be remembered that the deposit requirement was only a temporary measure and was constantly decreasing in importance in line with the decrease in deposit rates.

10. Members of the Committee welcomed the further reduction of Brazil's reliance on bilateral payments agreements and the reduction in the discount at which agreement currencies were made available to importers. Members of the Committee expressed the hope, however, that the Brazilian authorities would continue their efforts to terminate bilateral payments arrangements wherever possible and to eliminate the spread in exchange costs between convertible and agreement currencies. One member of the Committee pointed out in this context that the practice of providing exchange for imports from partners in bilateral agreements at a discount adversely affected his country's competitive position in the Brazilian market of fisheries products.

20. In response to a question by a member of the Committee concerning possible discrimination in favour of bilateral partners in the application of the prior deposit requirement, the representative of Brazil stated that there was no such discrimination. The only difference in treatment which might favour bilateral partners was the 5 per cent discount on sales of agreement currencies. He pointed out that imports by public entities were exempt from the prior deposit requirement. Any differential treatment to which this might give rise, however, would be based on the classification of the importer rather than the source of the imported goods.

21. The representative of Brazil stated that his Government would continue its policy of eliminating bilateral trade and payments agreements whenever and wherever possible. Considerable progress in this direction had already been made both as regards the reduction in the number of countries with which trade

and payments were on a bilateral basis, and in the rate of discount applying to agreement currencies. The rate of discount which had been as high as 30 per cent four to five years ago and had amounted to 15 per cent in 1960 had been reduced to 5 per cent at present. The proportion of total imports effected under bilateral arrangements had decreased from approximately 25 per cent in 1960 to approximately 16 per cent in 1961. He confirmed that the information on bilateral agreements in force contained in the secretariat document reflected the current situation. In reply to a question on trade relations with State-trading countries, the representative of Brazil explained that it was not currently envisaged to establish a State-trading organization or similar body in Brazil to effect trade with State-trading countries.

22. Members of the Committee noted that General category treatment was afforded for certain commodities included in the Special category if imported from LAFTA countries. They enquired whether imports from LAFTA countries benefiting from this preferential treatment under the Brazilian import régime included agricultural and primary products. The representative of Brazil explained that, in general, the General category included raw materials, items for use in production and goods of which the supply in the internal market was inadequate. A list of products included in the General category, published in Portuguese in Circular No. 23 of the Ministry of Finance of 4 September 1957 (as amended), had been supplied to the secretariat. Any product not appearing on that list or subsequently added to the list was subject to Special category treatment. He further explained that in the wake of the dismantling of trade barriers under the LAFTA Agreement, with the exception of a few items, all imports from LAFTA countries benefited from General category treatment.

23. One member of the Committee noted that certain items on which the tariff was bound were subject to Special category treatment. The need to purchase licences for these products at auction was equivalent to an additional import duty and seemed to be contrary to the provisions of Article II:1(b). He urged, therefore, that all bound items be transferred in the near future from the Special category to the General category.

24. The representative of Brazil explained that it was the intention of the Brazilian authorities to rely less and less on the Special category as a means of regulating imports. In the meantime he would convey to his authorities the comments and views of members of the Committee regarding Special category imports.

25. In discussing other measures affecting imports into Brazil it was noted that imports financed by official Brazilian credit institutes had to be carried in Brazilian ships. One member of the Committee pointed out that such flag discrimination was probably not in the interest of Brazil. He expressed the hope that this requirement would be re-examined by the Brazilian authorities with a view to its early elimination. The representative of Brazil informed the Committee that the problem of flag discrimination was at present under consideration by his Government.

26. In reply to a question concerning the import policy for wheat of the Foreign Trade Department which had the monopoly for wheat imports, the representative of Brazil explained that no attempt was made to maintain prices for wheat at an artificial level. The fact that the Government did not intend to maintain an artificial price level for this commodity was evidenced also by the recent abolition of the preferential exchange rate for wheat imports.

Effects of the restrictions

27. Members of the Committee noted the progress made by Brazil in simplifying the system of exchange and import controls. This progress was particularly welcome since at the time of the last consultation anxiety had been expressed that the maintenance of a complex system of exchange rates and special import categories might lead to the diversion of factors of production to uneconomic uses and consequently impede sound economic development and Brazil's ability to compete in world markets. They expressed the hope that Brazil, in implementing its import policy, would continue to give special attention to the avoidance of measures having an incidental protective effect, and thus favouring the maintenance or expansion of uneconomic lines of production.

General

28. The Committee thanked the representatives of Brazil for the frank and helpful manner in which they had engaged in the consultation. The Committee welcomed the simplification in Brazil's system of trade and exchange controls and the further reduction of reliance on bilateral arrangements. The Committee noted that despite some improvement in 1961 Brazil continued to experience balance-of-payments difficulties. It welcomed the intention of Brazil to adhere to a new stabilization programme and expressed the hope that the measures adopted, or envisaged would be effective in restoring equilibrium at an early date. The Committee noted that certain imports remained severely restricted and that there continued to be an element of discrimination affecting a large sector of Brazil's import trade. The Committee urged that Brazil eliminate discrimination as soon as possible and move further towards the relaxation and simplification of the control system. Members of the Committee expressed the hope that further progress would be made in the reduction of bilateral arrangements.

29. The representative of Brazil thanked the Committee for the understanding shown throughout the consultation of the problems facing his country. He stated that his delegation would bring the views of the members of the Committee and their recommendations to the attention of the Brazilian authorities.

ANNEX

International Monetary Fund Executive Board Decision Taken
on 14 March 1962 at the Conclusion of the Consultation
between the Fund and Brazil

1. The Government of Brazil has consulted with the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.
2. Inflation accelerated in 1961, when money supply increased much more rapidly than in any recent year due principally to a seriously deteriorating fiscal situation. Deficits in government-owned or subsidized enterprises increased sharply. There was a substantial increase in wage payments to government employees. Bank credit to the private sector continued to increase substantially at rates comparable with the expansion in 1960. The impact of this internal monetary expansion on the foreign sector was limited by a substantial depreciation of exchange rates, especially in the first part of 1961. Increases in exports, PL 480 assistance, and reduced payments for invisibles and amortization permitted the monetary authorities to maintain net foreign assets virtually unchanged in 1961. The budget for 1962 as approved by the legislature foreshadows a further deterioration of the fiscal situation. Also, due to a new attempt to hold the exchange rate, the foreign exchange position of Brazil has deteriorated at the beginning of 1962.
3. The Fund urges the Brazilian authorities to take early and determined action to arrest the inflation. Such action should include measures designed to eliminate the fiscal deficit within a short period. For this purpose firm action to reduce the deficits of the government-owned or subsidized enterprises will be essential, together with strict economy on all non-productive investment. Elimination of the deficit will also require increasing revenues. Measures to limit the increase of bank credit to the private sector to amounts consistent with price stability will also be needed, together with effective wage restraint.
4. The Fund notes that Brazil's exchange system was further simplified since the measures of March 1961, particularly through the elimination of the preferential exchange rate. Moreover, dependence on bilateral payments arrangements has been reduced. The Fund notes that Brazil's balance of payments in 1961 benefited substantially from these and earlier improvements. However, certain imports remain severely restricted and informal payments restrictions have arisen recently from limitations on the freedom of the exchange market. The Fund considers it essential that freedom in the exchange market be restored promptly and that the exchange rate therein be permitted to respond to market forces. The Fund urges Brazil to implement its plan to terminate bilateral payments arrangements with other Fund members and to reduce the restrictiveness of import practices as soon as possible. The Fund will keep under close review

Brazil's exchange-rate policies and, in the meantime, does not object to the maintenance of Brazil's exchange practices on a temporary basis, but urges Brazil to eliminate the discriminatory aspects as soon as possible.

5. In concluding the 1961 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Brazil.