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Working Party on Structural Adjustment  
and Trade Policy

RECORD OF DISCUSSION ON COUNTRY CONTRIBUTIONS  
RELATING TO EXPERIENCE WITH STRUCTURAL ADJUSTMENT

Brazil  
(Spec(82)6/Add.11 and Suppl.1)

1. The representative of Brazil introduced his delegation's submission which he said would not necessarily be limited to the mandate of the Working Party and would be without prejudice to Brazil's position in various Committees, such as the Committee on Balance-of-Payments Restrictions, the Committee on Subsidies and Countervailing Measures, the Committee on Tariff Concessions, and the GATT generally.
2. The process of economic adjustment in Brazil had been heavily influenced by the two oil price "shocks". Data contained in Spec(82)6/Add.11/Suppl.1 showed the deficit which had accumulated in the trade balance as a result of the first price rise, the debt increase which had been needed to finance it and the long period which it had taken to redress the situation (table I). The deficit, which had moved from 1.6 to 7.1 billion dollars between 1973 and 1974 (table II), had been absorbed through increases in production and exports, when in late 1979 and early 1980 the second "shock" occurred. The options were then much more limited: a new trade deficit was not possible as the debt service on foreign loans was already very heavy, with the value of imports increasing dramatically. However, at a price per barrel of oil at 30-34 dollars, domestic oil and gas, shale oil, coal, biomass involving ethanol/methanol, charcoal, wood and vegetable oil, as well as hydroelectric energy, became feasible alternatives to imported oil. Other comparative advantages - in agriculture and in some manufacturing sectors - provided scope for increasing exports; in fact exports presently represented only eight per cent of a total GDP of about 250 billion dollars, and Brazil's share of world trade was smaller than it had been in the 1950s and 60s.
3. The second oil price increase made it obvious that structural changes had to be effected at the level of trade to free the country from its dependency on imported oil, to foster production of alternative energy sources and to provide conditions for continued importation of goods indispensable for the development process through export expansion.
4. In view of a debt in 1980 running at about 50 billion dollars and a debt service consuming 70-80 per cent of exports, the question remained how to mobilize the economy in the short run to achieve favourable long-term perspectives. For the country to maintain its financial

credibility, more than 17 billion dollars (10 million dollars in interest payments on loans and 7.5 billion dollars in amortization) had to find a profitable turnover each year by being absorbed into projects that would contribute importantly to overcoming the financial constraints. All efforts were now directed towards handling adequately the foreign debt. Here trade had a very important rôle to play.

5. Thanks to oil substitution and growth of exports, the 1981 trade results had been quite spectacular and had transformed a trade deficit into a surplus without reducing basic imports. However, as table III in Spec(82)6/Add.11, Suppl.1 showed, prices had started to drop already by 1981 and the increased value of exports was basically due to quantity expansion. In 1982 commodity prices were at their lowest level ever and created problems both at the commercial and financial level. As indicated in table IV the total export value in 1982 was falling at a rate of 8.5 per cent. While quantities were maintained or increased in markets like the United States, the EC and Japan, Brazilian export expansion came to a halt and even decreased due to high interest rates. Table V showed the extent to which Brazil had been hurt by the present market performance of the main commodities: the terms of trade (1979-1982) moved from 100 to 61. This meant that if 1979 prices had prevailed in 1982, an additional revenue of 17 billion dollars would have been earned, a figure which corresponded to foreign loans required. Referring to Table VI, the Brazilian representative noted that oil represented 50 per cent of total imports, although demand had been kept under control and was expected to decline in 1982.

6. The Brazilian representative went on to explain the policy of "mini-devaluations" whereby the cruzeiro was devalued weekly to make up for the Brazilian inflation so as to maintain the relative parity of the cruzeiro to the US dollar. This policy was very reliable; exporters could expect their purchasing power to be constant and payments on foreign loans would not change. As a transitory measure, a 10 per cent tax on imports allowed a control to be kept on the balance of payments. The tariff policy was directly linked to the foreign debt management requirements. Brazil would have preferred to import much more but the trade objectives had to be set so as not to damage the country's financial credibility. In fact, the government believed that more dynamic imports and more foreign competition would benefit economic development in general and also have a very positive impact on the pace of inflation. Brazil therefore looked forward to a debt situation which permitted this additional policy tool to be used.

7. Referring to table VII, the Brazilian representative noted that the policy of import promotion had been pursued during the period in which Brazil had had a trade surplus. In fact, this surplus had been generated by oil substitution and conservation measures. With import elasticity and energy elasticity in relation to the GDP both at around one, other imports must be growing when oil imports decreased, just as domestic production of energy was necessary in order to make more imports possible.

8. This situation had been matched by a capital account policy laying down the strict requirement that foreign loans must have a minimum duration of eight years. The interest rate policy had been not to influence the market conditions but an attempt had been made to make foreign loans more attractive to the private sector than domestic loans. If loans contracted by

the private sector did not meet the total amount required each year from abroad, the public sector would borrow through the public enterprises - thus allowing the government to keep control of the foreign debt. It had never been necessary to pay more than 12-15 per cent of the total debt per year. Table VIII showed how the current account deficit was financed; the relationships of debt to GDP and to exports improved from 1979-1982 but the momentum was lost in 1982 because exports slowed down.

9. The monetary policy of Brazil was tight. The 1981 inflation rate was 95 per cent whereas money supply increased by 60-65 per cent. A similar situation was expected for 1982. In order to avoid an undesirable income distribution and to make long-term contracts possible, generalized indexation was used although the continuation of this system was being debated. In so far as the budgetary policy was concerned, the public deficit had been reduced over the last three years, from eight to five per cent of the GDP and was expected to be in the order of 3-4 per cent in 1983. The past device of issuing money had been replaced by an aggressive policy of selling public bonds. This was a non-inflationary means of keeping up with the deficit and was pursued in accordance with the general interest rate policy. Other measures included increased income tax and - more recently - some alignment between contributions to and benefits from pension schemes.

10. In the field of production and employment, table IX summarized some of the efforts to foster domestic production of energy which had almost doubled over a five-year period. Crude oil production was running at around 270,000 barrels a day; about 7,000 gas stations had started to sell gasohol and presently one third to 50 per cent of Brazilian cars used gasohol. Domestically-produced coal had also become economical. The approach was very selective in so far as direct investments by the government or public enterprises was concerned. The Brazilian representative elaborated on the important public sector project being started in a mineral-rich region where private industry was already producing aluminium and where substantial foreign investment had been made. Total investment was expected to be in the order of 40 billion dollars over a ten-year period and would generate around 15 billion dollars in annual production. With the exception of some public enterprises like the oil company, the electric energy company, the railway company and the agricultural technological development company, the policy of the government was to carry out a privatization of the economy in the firm belief that democracy and private sector opportunities were closely inter-related.

11. Crop failures had been experienced in agriculture up to 1979. The government had then introduced generous credit conditions, and production had increased, as indicated in Table X, in the three first years of the new programme period by 6.5, 9.0 and 8.6 per cent respectively. The 1982 growth rate was estimated to be negative, due solely to the coffee production. Had the latter stagnated instead of declining, the total growth figure for 1982 would have been 5 per cent. Brazilian agricultural production was directed primarily at the home market but the hope was that Brazil might share its wealth with the rest of the world by way of cheap food supplies. During 1981, the policy had moved from subsidizing credits to a price-oriented system, which had had positive results on prices; in fact inflation had recently been a reflection of industrial prices. Industrial production had decreased by 10 per cent in 1981 - the first decrease ever - and was a sign

of the structural adjustment going on: automobile output, for instance, decreased by more than 40 per cent. Credit on favourable conditions was given to firms willing to engage in conservation or production of energy; credit lines existed for firms willing to introduce advanced technology; a Technological Development Council attempted to promote integration between universities, research institutes and the private sector. Apart from this, industrial policy as such did not exist nor was protection given to Brazilian industry. There were no production plans for the various sectors of the economy. The government's rôle consisted in giving signals to the market and in promoting competition.

12. Table XI concerning unemployment in Sao Paulo was intended to give a general picture of industrial production, Sao Paulo being the most industrialized state and the one most hurt in the present economic situation. Some smaller States, on the other hand, which benefitted from comparative advantages in, for instance, sugar cane or alcohol production, were experiencing growing employment levels. When deeply rooted structural changes were taking place, unemployment increased because of a lack of labour force mobility.

13. In a comment, one member of the Working Party noted that Brazil was largely confronted with problems similar to those of developed countries. He was satisfied that the representative of Brazil had not gone into a sector-by-sector analysis which in his view was unnecessary. Government assistance was indeed given to certain sectors or programmes, as the statement had indicated, and this was in his view inevitable. This again showed that the situation did not differ much from that of, for instance, European countries.

14. Referring to table II of Spec.(82)6/Add.11/Suppl.1, another member inquired about the share of foreign investment in export-oriented activities. He further stated that it would have been more appropriate to group all Eastern European countries together in table IV. He also noted that Brazil had traditionally had a substantial surplus in trade with his country. The representative of Brazil replied that the government did not control the amount of foreign direct investment which went into export activities. The countries in table IV had been grouped together according to the development of their trade with Brazil.

15. Another member raised the question of energy. While the presentation had described the impact on the economy of the oil price "shocks" in a macro-economic sense, further indications might be useful on the way the various programmes had been stimulated by government efforts. In view of the reduction of oil prices he was interested to know what measures had been taken or were contemplated to protect the massive capital investments in alternative energies or to prevent a return to imported oil. Noting that the traditional relationship between energy production and GDP had been reduced to one half/one third in many industrialized countries, he wondered whether Brazil had experienced a similar trend which reflected increased efficiency in the use of energy. Referring to the statement that Brazil had found it necessary to "mobilize" its comparative advantage in some sectors to stimulate exports, he asked whether these export incentives meant concrete stimuli or whether the term had been used in a broad, macro-economic sense. He was struck by the fact that the increase in money supply had been consistently much lower than inflation; in his view, this

could not be expected for any substantial period of time, and he therefore wondered whether the Brazilian authorities expected an end to the apparent increase in the speed of circulation of money, which would imply that inflation be brought down to the level of the increase of the money supply, or below. The fact that in no agricultural sector exports accounted for more than 50 per cent of production testified to the size of the Brazilian market; however, he did not agree with the conclusion that agriculture was therefore oriented towards the domestic market. His country's experience was that the prices and trade in the domestic market were influenced by world prices. He also sought additional information on subsidies and their trends in agriculture. As to the industrial sector, various facts indicated that Brazil's industry did not solely react to market signals but that a fairly high rate of protection existed in certain sectors. Figures on such protection and their trends would also be of interest, as well as some details on the advantageous credit terms granted to Brazilian industry for oil substitution and high technology efforts.

16. The representative of Brazil explained that apart from budgetary support, the activities of PETROBRAS were free from detailed government intervention. The electric energy companies were owned by state governments. Alcohol production facilities belonged entirely to the private sector, the rôle of government being in the nature of providing credit lines. Some energy prices were fixed by the government; others were set freely by the market. There were no subsidies paid, for instance, per barrel of oil produced. Special protection for the energy sector had not been found necessary but uncertainty prevailed as to the development of alternative energy prices and posed very important problems which required objective government analysis.

17. He recalled the policy of devaluations aimed at ensuring a steady growth in the purchasing power of exports. Exportation had also become relatively more profitable than that in sales to the domestic market which had resulted in the development of large idle capacities. Concerning inflation, although velocity of money was a relevant factor, the rate of inflation corresponded roughly to the growth of the credit expansion. The monetary supply was under full control, but credit expanded, as an influx of 17 billion dollars was needed for balance of payments reasons. He agreed with the comments made as to the influence of world prices on domestic agriculture. However, Brazilian agriculture was much less affected by world market fluctuations than that in countries that were more heavily dependent on foreign trade. As to the points made concerning the industrial sector, he emphasized that production targets for the major part of industry had existed in the previous Five-Year Plan but had since been abandoned. Although some tariffs protected infant industries, the existence of high tariffs did not reflect protectionism; the intention was rather to allow the import bill to be consistent with Brazil's foreign debt. Reductions of high tariffs would be considered if, in future GATT negotiations, Brazil's trading partners tabled adequate offers, which had not always been the case in the past. The government's technological development schemes consisted, inter alia, of sharing the risk with the private sector and participating in the innovative process on a case-by-case basis, although not with the intention of creating a permanent partnership. Government funding was used only in respect of technological development at the research level. For oil saving equipment the government provided credit, to be reimbursed with full indexation, i.e. according to inflation, plus a 5 per cent interest.

18. One member sought further details on the kind of temporary restrictions (referred to on page 3 of the submission) Brazil had found necessary due to the adjustment process. The representative of Brazil reiterated that constraints existed in respect of the import capacity; the latter was highly dependent on the amount of exports. Quantitative restrictions maintained by other countries as well as the drop in commodity prices placed restraints on the ability to export. The temporary restrictions had been justified in the Committee on Balance-of-Payments Restrictions. They would be lifted as the situation evolved and more foreign exchange was generated. This depended, however, on all the factors enumerated in the presentation.

19. Another member was gratified to learn of the reliance placed in the market mechanism in Brazil. He was interested to know, however, about the rôle of the government in sectors other than energy and what the considerations were in such instances. The representative of Brazil replied that some historical conditions existed in this regard. Whenever profitable schemes were presented by private firms for entering into public sector activities the government was willing to discuss this. It was not always as easy, though, to move activities from the private sector to the public sector.

20. In reply to other questions the representative of Brazil explained that the movement from credit-oriented to price-oriented support was paramount to reducing the public debt. Support prices with indexation had progressively replaced a system whereby credit had been provided at an interest rate which was below the inflation rate. Structural adjustment was by necessity an easier process in time of economic growth because of the key investment factor. He saw no trade-off between efficiency and political stability but there was in his view a trade-off between efficiency and dollar generation; a country might pay a high price in terms of efficiency, when it had to generate substantial amounts to honour debts; this policy was necessary, however, because the long-term respectability of the country was involved.

21. As to the question what percentage of total Brazilian GNP was accounted for by external trade the Brazilian representative stated that the figures concerning exports were 6.6 per cent for 1979, 8.1 per cent for 1980 and 8.2 per cent for 1982; the figures for imports were 7.8 per cent in 1979, 9.2 per cent in 1980 and 7.8 per cent in 1981.