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Committee on Balance-of-Payments Restrictions

REPORT ON THE 1981 CONSULTATION WITH BRAZIL

1. The Committee consulted with Brazil in accordance with its terms of reference and the Declaration of the CONTRACTING PARTIES on Trade Measures Taken for Balance-of-Payments Purposes (BISD 26S/205). The consultation was held on 1 December 1981 under the Chairmanship of Mr. J.N. Feij (Netherlands). 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:

Basic Document	(BOP/223 and Add.1)
Secretariat Background Paper	(BOP/W/56)
IMF Recent Economic Developments, dated 30 October 1981	

Opening Statement by the representative of Brazil

3. In his introductory statement, the full text of which is attached as Annex I, the representative of Brazil described his country's current balance-of-payments situation and the measures adopted to cope with it. He also discussed the relationship between these measures and Brazil's rights and obligations under the General Agreement, and analyzed the measures in the broader context of the adjustment of the Brazilian economy to balance-of-payments difficulties generated by external constraints.

Statement by the representative of the International Monetary Fund

4. At the invitation of the Committee, the representative of the International Monetary Fund made a statement, the full text of which is reproduced in Annex II.

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

5. Several members noted that, according to both the statement by the Fund representative and to the Basic Document submitted by Brazil, the overall balance-of-payments was expected to be in approximate equilibrium in 1981. They doubted whether in these circumstances the trade restrictive practices followed by Brazil could be justified under the General Agreement. The view was also expressed that the increase in oil import payments should not be used as a justification for import controls since most contracting parties' external financial position was adversely affected by the rise in energy prices. The members of the Committee shared the hope of the IMF that a further strengthening of Brazil's external financial position would enable it

to reduce substantially its reliance on restrictive practices. One member said that, if Brazil were to accelerate the pace of its gradual devaluations, it could consider a reduction of the tax on the purchase of foreign exchange from the current 25 per cent rate to a rate of say ten to fifteen per cent in early 1982 in the light of Brazil's improved balance-of-payments position.

6. There were expressions of concern in the Committee about the severity and complexity of impediments to imports, in particular about the concurrent application of import licensing suspensions, import surcharges and the financial transaction tax on import payments. It was said that the multiplicity of restrictive practices made it impossible for the Brazilian authorities to evaluate the effects of each individual measure. One member said that it would be in Brazil's own interest as a new competitive supplier of manufactured goods if it were to rely on general policy measures, rather than restrictive trade practices, to resolve its payments difficulties since it would thereby make a positive contribution to maintaining a strong line against protectionist pressures.

7. In response to these various comments the representative of Brazil said that, although the deterioration of the overall balance-of-payments situation had slowed down and the trade account was now in surplus, the deficit on current account was likely to remain in 1981 at about the same level as last year because of the deterioration in the services account resulting largely from the rise in the level of interest rates in international markets. Therefore it was not possible to consider a relaxation or elimination of the measures adopted to cope with the balance-of-payments problems. Brazil's international reserves had dropped from US$ 11.9 billion at the beginning of 1979 to less than US$ 7 billion at the beginning of 1981. At present reserves stood at close to US$ 7 billion which was clearly insufficient. A decline in reserves in 1981 was only avoided because of total capital inflows of US$ 17.7 billion (including net investments), which corresponded to approximately 6 per cent of GDP.

8. One member asked how the Brazilian authorities intended to resolve the problem of rising external indebtedness. The representative of Brazil replied that the annual, nominal increase in external debt had been 35.8 per cent in 1978 and had declined to 14.7 per cent in 1979 and 7.9 per cent in 1980. The gross external debt at the end of this year was expected to reach US$ 61 billion which would represent a nominal increase of 13.3 per cent from the level at the end of last year. There had thus been a decline in the rate of expansion of the external debt. In response to a question on exchange rate policies, the representative of Brazil confirmed that the exchange rate was now pegged to the rate of domestic inflation, without any correction for external inflation; this policy resulted in a real depreciation of the cruzeiro.

9. Several members expressed serious concern about Brazil's domestic subsidies, in particular those granted in the form of government supported credits. One member said that the subsidies introduced

distortions in the Brazilian economy and in the pattern of trade. Another added that the subsidy policy had been partly responsible for the high rates of inflation since 1979 since it had aggravated Brazil's fiscal deficit which had in turn had an adverse impact on the balance-of-payments situation. The representative of Brazil remarked that at present, 70 per cent of all credit operations were subsidized; but access to subsidized credit, in particular in the field of agriculture, was now being restricted and further limitations were planned.

10. There were also expressions of concern in the Committee about the potentially disruptive effects of subsidized Brazilian exports, in particular in areas in which Brazil was already internationally competitive. One member said that Brazil had agreed, when acceding to the Subsidy Code, to reduce its direct export subsidies of 15 per cent to 9 per cent on 1 January 1982, to 3 per cent on 1 January 1983 and to eliminate it completely on 30 June 1983. Now Brazil proposed to slow down the phasing-out of the subsidy (cf. document SCM/13). This, the member said, was a departure from Brazil's commitment under the Subsidies Code, which could not be justified by Brazil's balance-of-payments situation. Another member expressed his serious concern about the introduction by Brazil of discriminatory export taxes on a series of products and about their distorting effects on trade. On the latter point the representative of Brazil stated that this matter did not fall within the competence of the Committee.

11. The Chairman pointed out that it was not the task of this Committee to pass a judgement on the legality of the subsidy practices, but these could be discussed in the Committee in view of their relation to Brazil's payments situation. The representative of Brazil indicated that, although he was willing to provide information on the subject, he concurred with the Chairman's opinion that the matter did not fall under the purview of the Committee. He then said that, when accepting the Subsidy Code, Brazil had committed itself to an elimination of its main subsidy scheme by mid-1983 and that the adjustment of the phasing-out schedule was fully consistent with the commitment undertaken unilaterally by the Brazilian government, as the agreed termination date was being maintained. He also referred to the understanding surrounding these commitments when undertaken by developing countries and to the fact that, in this context, flexibility as to the contents of the commitments was an important element. One member pointed out that there was a difference between flexibility in arriving at a commitment and flexibility after a commitment had been arrived at. This member also regretted that this action was taken at a time when the balance-of-payments situation in his view did not require measures of this type.

12. One member sought clarification on the administration of Central Bank Resolution 638. The representative of Brazil informed the Committee that the administration of the Resolution was fully consistent with the provisions of the Resolution which clearly stated that annual cumulative import transaction in excess of US $ 100,000 were subject to minimum external financing requirements.

System, method and effect of the restrictive import measures

13. The Committee members noted that Brazil maintained three measures restricting trade for balance-of-payments purposes, namely a temporary scheme of licensing suspension, temporary surcharges, and a financial transaction tax on purchases of foreign exchange for imports. The view was expressed that these measures were not in conformity with Brazil's obligations under Article XVIII:10 of the General Agreement and paragraph 1 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes.

14. It was also noted that Brazil had not established a time-schedule for the termination of the application of the financial transaction tax to imports and the view was expressed that this ran counter to paragraph 1(c) of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes. It was further said that, although termination dates had been announced for the licensing suspension scheme introduced in 1976 and the surcharges applied since 1974, they had been routinely extended from year to year and had therefore in practice not met the purpose of paragraph 1(c) of the Declaration.

15. The representative of Brazil replied that the suspension of issuance of import licenses was fully in conformity with Brazil's obligations under paragraph 1(a) of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes. To this paragraph a footnote was attached which recognized that developing countries had to take into account their individual development, financial and trade situation when selecting the particular measure to be applied. The licensing suspension could not be said to have a disruptive effect on trade since the licensing suspensions had a maximum theoretical coverage of only 2.6 per cent of total imports in 1981. This theoretical limit was not in fact reached in view of the effective use that had been made of the exceptions provided for in the legislation. As to the surcharges, the representative of Brazil pointed out that the share of imports subject to this measure had continually declined and had in 1980 represented only 8.5 per cent of total imports. He further said that paragraph 3 of Decree-Law No. 1775 of 12 March 1980 stated that the surcharges were not applicable to items bound in GATT. As to the trade shares affected by the licensing suspensions and the surcharges, one Committee member remarked that the more restrictive a measure was, the less trade coverage it was likely to have.

16. The representative of Brazil further explained that the exchange rate policy found its limitations in the need to avoid penalizing private enterprises which had tapped the external financial markets, as well as to encourage such enterprises to continue to seek financial resources abroad. As to the application of the financial transactions tax to the purchase of foreign exchange for import purposes, he recalled that the measure had been approved by the IMF. The representative of Brazil added that the trade measures adopted were in accordance with the note to Article XVIII:11 of the General Agreement. In the present, still uncertain, balance-of-payments situation Brazil was therefore not required to remove the restrictive import measures. He added that his authorities had liberalized the import regime

whenever the balance-of-payments situation had improved and would continue to do so in the future. He emphasized that the balance-of-payments measures in force were of a temporary nature. However, given the impossibility to predict Brazil's future payments situation - in particular in view of the uncertainty surrounding oil prices and interest rate levels - Brazil could not commit itself to announcing a phasing-out programme for the measures taken for balance-of-payments purposes. This statement gave rise to expressions of disappointment by Committee members.

17. Members of the Committee expressed their dissatisfaction with the lack of prior detailed information on Brazil's restrictive import measures. They regretted in particular that the Basic Document submitted by Brazil for the consultation contained no detailed information on the import regime and asked Brazil to submit this information without delay. The Brazilian representative supplied details at this meeting and said he was ready to provide the secretariat with copies of the relevant laws and regulations.

18. Several questions were asked about the prospects for a relaxation of Brazil's restrictive practices in 1982, in particular as to the prospects of removing items from the list of goods subject to licensing suspension. The Brazilian representative said that the uncertainties of the balance-of-payments situation did not permit the undertaking of commitments at this stage. In response to other questions, the representative of Brazil said that the investment performance requirements, the public sector import ceilings and the foreign financing requirement for certain imports were not imposed for balance-of-payments reasons but reflected developmental, budgetary and financial considerations.

19. In reply to a series of questions on the administration of the import licensing system, the representative of Brazil said that importers had been required, since the end of 1980, to submit annual import programmes before they could obtain import licenses because there had been a sharp increase in speculative imports. As the rate of inflation rose beyond the level of monetary correction which had been prefixed, and in the expectation of a significant devaluation of the cruzeiro, which turned out to be necessary indeed, importers had built up speculative stocks of industrial inputs, equipment and components, which had contributed decisively to the deficit of US$ 2.8 billion in the trade account in 1980. The representative further informed the Committee that the import programmes were not negotiated but were prepared by the importers themselves in accordance with CACEX Communication 81/21 of 14 September 1981, as authorized by CONCEX Resolution 125 of 5 August 1980. In 1981 the import programmes were in principle not to exceed 1980 levels which, as he had already indicated, had been grossly inflated due to speculative movements; for 1982, the base year for determining the size of the import programme would be 1981. In reply to questions the representative further said, that the problem of an inflationary erosion of the authorized import values was non-existent, since the base year changed annually. The grant of import licenses was normally not contingent on commitments by importers to export, or to purchase specified amounts of goods

domestically. If, however, an importer wished to import more than estimated in the original programme, the importer's export performance, among other factors, could be taken into consideration in the decision on whether or not to allow the additional imports. Bilateral trade balances with other countries were not a consideration in the decisions to grant import licenses.

20. One member said that there was a disturbing lack of transparency in the administration of the licensing system. There had been reports in 1980 that CACEX was under instructions to engage in administrative slowdowns in order to reduce the rate of imports, and that it followed confidential guidelines specifying particular products which should either be prohibited from importation or subject to quantitative limitations. He had noted the statement by the representative of the IMF that the submission of annual import programmes by importers had "facilitated the issuance of licenses and avoided the recurrence of administrative delays so far in 1981", but he had been advised that importers in Brazil continued to complain about slowness and stifling bureaucracy in obtaining import licences. The representative of Brazil stated that the reports and advice received by that Committee member were inaccurate and without any foundation. He said further that the import programme introduced at the end of 1980 had reduced red tape by giving a global authorization for the licensing of all imports estimated in the annual import programme. In addition, the programme eliminated uncertainty and was fully transparent.

21. In response to a remark on import restrictions on data processing equipment the representative of Brazil confirmed that such imports did require prior approval of the Special Secretariat for the Informatics, as now regulated by CACEX Communication No.8123 of 18 September 1981. This requirement had been introduced to rationalize the use of data processing equipment in the country, which was underutilized. From 1969 to 1977 imports of such equipment had risen by 651 per cent and if projected into 1978 would have risen by 877 per cent. If imports of these items had not been checked they would have reached US$ 1 billion in 1980.

22. The representative of Brazil confirmed, in reply to a question, that imports of steel and non-ferrous metals also required prior approval. In October of each year importers of these products had to submit their estimate for imports during the following year and it was on the basis of these estimates that import approvals were granted. This regime was now applied to both private and public enterprises and had no discriminatory features.

23. It was noted that the licensing suspension scheme was not fully applied to imports from members of the Latin American Integration Association (LAIA) and that a lower financial transaction tax (20 rather than 25 per cent) was applied to payments for imports from LAIA countries, and questions were raised on this subject. There was a short discussion during which it was noted that the different views on matters related to balance-of-payments measures and regional groupings had been discussed on a number of occasions and were well known. The representative of Brazil recalled that at a recent consultation this

question had once more been raised, and that the Committee had then decided that the Committee was not the proper forum to pursue this debate. One member asked the representative of the International Monetary Fund what conclusion the Fund had reached on the discriminatory application of the financial transaction tax when it approved this measure in accordance with Article VIII of the Fund's Articles of Agreement. The representative of the Fund replied that this measure, together with other measures requiring approval, as described in the IMF document "Recent Economic Developments" dated 30 October 1981, had been examined by the Fund but that the differential application aspect as such had not been considered.

Conclusions

24. The Committee noted that, according to the IMF, the recent pursuit of restrictive financial policies had helped the Brazilian authorities reverse the deterioration in Brazil's balance-of-payments, that the overall balance was now expected to be in approximate equilibrium in 1981, and that the adoption of a more realistic exchange-rate policy would result in a real depreciation of the cruzeiro. The Committee shared the hopes of the Fund that a further strengthening of Brazil's external position would enable the Brazilian authorities to reduce substantially their reliance on restrictive practices.

25. The Committee noted that Brazil maintained three restrictive measures for balance-of-payments purposes, namely surcharges of 30 or 100 per cent on a total of 4.108 items (affecting 8.5 per cent of total imports in 1980), a suspension of the issuance of import licenses for 372 items considered non-essential (affecting in terms of 1975 trade figures 2.6 per cent of imports in 1981), and a financial transaction tax of 25 per cent (affecting about one-third of all imports). While noting that serious difficulties persisted in Brazil's current account, the Committee regretted that the maintenance of multiple, and in some cases severe, impediments to imports was considered necessary by the Brazilian authorities despite the present relatively favourable overall balance-of-payments situation, including the recent appearance of a surplus on the trade account.

26. The Committee noted the simultaneous application by Brazil of restrictive measures for balance-of-payments purposes and recalled in this regard paragraph 1(b) of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes. It noted that Brazil had not announced a time-table for the phasing-out of the application of the financial transaction tax to imports and it requested Brazil to do so in the light of paragraph 1(c) of this Declaration. The Committee further requested Brazil to relax its import licensing suspension scheme taking into account Article XVIII:10 of the General Agreement and to reduce the surcharges imposed for balance-of-payments purposes.

27. The Committee noted that Brazil had not included in its Basic Document for the consultation the expected detailed description of the restrictive import measures. The Committee therefore asked Brazil to provide, for circulation by the secretariat, additional information in order to cover fully the points listed in Annex II of the consultation procedures (BISD/18S/53) and the points included in the Brazilian presentation. The Committee requested the secretariat to complete, in collaboration with the Brazilian authorities, its Background Paper (BOP/W/56) in the light of the additional information.

ANNEX I

Statement by the representative of Brazil

The Brazilian Government is represented at this consultation by a delegation made up of officials from the various departments concerned with our external economic policy. Our expectation is that, through a constructive debate, this Committee may view the Brazilian BOP situation in its appropriate context. We feel we are in a position to explain the serious constraints, both internal and external, under which our authorities have operated in formulating our foreign economic policy.

We propose to do this by first describing the essential elements of Brazil's current BOP situation, then analysing the strategy followed by our authorities and the measures adopted to cope with that situation, and finally indicating how these measures fit within Brazil's set of rights and obligations under the GATT.

After our last full consultation in this Committee in November 1978 our BOP situation again deteriorated, mainly as a result of the relaxation of the measures then in force. Both in 1979 and 1980 our external accounts showed a deficit of 2.8 billion dollars in the trade

balance. The deficit on current account rose from 10.7 billion dollars in 1979 to 12.9 billion in 1980. This year has seen an improvement in the trade balance, with a surplus expected to approach 1 billion dollars by the end of the year. This surplus, however, is far from sufficient to compensate for an expected deterioration in the services account, arising from a further increase in interest payments. As a result, the deficit on current account is likely to remain at roughly the same level as last year. If added to payments for amortization of the external debt, the deficit will reach an estimated figure of US$ 17.7 billion dollars for 1981. To make up for it, a capital inflow of the order of 16 billion (excluding net investments) will be required.

The persistent need to borrow financial resources abroad in the amounts indicated explains why the ratio of net external debt to exports, after having improved from 2.64 in 1979 to 2.33 in 1980, will probably show little if any improvement at all in 1981.

Behind the difficulty in correcting these imbalances on a sound and lasting basis lie some well known external variables affecting the position of an oil-importing developing country like Brazil. One is the continued increase, until recently, of the cost of imported fuels. In Brazil's case, the dollar value of imports of oil rose from 6.8 billion

in 1979 to 10.2 billion in 1980, representing a staggering increase of 50% from one year to the next.

Another important variable, over which Brazilian authorities of course have no control, is the low rate of growth in the economies of our major trading partners in the developed world. In addition to the consequent slackening of demand for imports in these countries, their depressed level of economic activity tends to be utilized as a pretext for giving in to mounting protectionist pressures.

The third type of variable is to be found in the international capital markets. Here the problems range from the excessive cost of loans as compounded by large spreads, and fees of various kinds, charged by the international banking community, to steep rises in the interest rates prevailing on the market. Brazil's external position has been seriously undermined, of late, by such increases in interest rate. Given the level of our total outstanding debt, it is estimated that each hike of 1% in Libor or the U.S. prime rate over a period of one year represents an additional debt-servicing cost to Brazil of at least 400 million dollars, which is more, for instance, than our total exports of footwear in 1980.

The increase in interest rates has had still two significant - if indirect - negative effects on the

performance of Brazil's exports. One is the effect of depressing the level of stocks of primary commodities in developed countries, due to the higher cost of financing such stocks, and thus reducing in the short term the volume of purchases and, therefore, export receipts. The other is the loss of competitiveness of our exports to destinations other than the U.S. market, caused by the appreciation of the U.S. dollar relative to the currencies of other developed countries which are substantial importers of Brazilian products.

The analysis of Brazil's BOP situation and its determining factors has to be carried out against the background of the country's pressing development needs. We are dealing with a country of 120 million people, of which nearly 1,5 million arrive each year at the market place demanding employment. Such needs require a permanent effort to tap the external markets for additional savings, at levels consistent with the maintenance of a minimum, socially viable, rate of growth of the economy. This is not uncommon for developing countries, which for this reason generally tend to show a structural imbalance in their external sector.

Brazilian authorities, therefore, were left with no choice but to adopt a strategy which consisted of influencing the variables, internal and external, over which they could exercise some control, and thereby bring about the

necessary adjustment of the economy to the new situation. Their main objective was to reduce the BOP deficit on current account, in particular by improving the trade balance, while preserving the possibility to draw on financial resources generated abroad, for the continuation of current development programs.

The objective of adjusting the economy is being pursued through the utilization, in a conjugated manner, of several tools of economic management. Monetary and fiscal policies have undergone further tightening, and ever greater austerity is being exercised in the control of government spending, including spending by state enterprises. Access to subsidized credit has been increasingly restricted. The exchange rate policy consisting of frequent, small devaluations continues to be geared to maintaining the competitive position of Brazilian exports, while at the same time encouraging the private sector to tap the external financial markets. In the field of energy, the broad range of measures adopted over the past few years, and explained in greater detail in document BOP/223, substantiate a policy of stepping up the development of both domestic oil resources and alternative sources of energy, such as alcohol, coal, hydro-electric power and vegetable oils. These, as well as stringent conservation measures, have resulted in a reduction of the volume of imported oil from slightly over 1 billion

barrels/day in 1979 to 887.000 barrels/day in 1980, to 840.000 barrels/day in 1981, at the half-year point. We aim at bringing oil imports down to the level of 750.000 barrels/ /day by the end of this year, which will mean a reduction of 25% in two years. Not many countries in the world can claim to have done as much in this field. In agriculture, a two--pronged approach is being followed. Priority is being given, on the one hand, to the production of foodstuffs for domestic consumption, as a means of contributing to reduce inflationary pressures and eliminating the need for food imports; and on the other hand, to increased production of exportable crops as an important factor in achieving and maintaining a positive trade balance.

As regards trade measures, the documentation before us provides evidence that the Brazilian authorities have only resorted to restrictive action in the degree and to the extent that this was rendered necessary, at certain points in time, by a serious worsening of our BOP situation. It will be recalled that, in December 1979, in an effort to rely less on trade policy measures than on exchange rate, monetary and fiscal policy instruments, the Brazilian authorities had taken significant measures of trade liberalization. On 14 October 1980, when this Committee held a simplified consultation with Brazil, it was recognized that Brazil had "taken measures to simplify and liberalize its import regime,

among them the termination of the import deposit scheme of 7 December 1979" (para. 5 of document BOP/W/56).

Thereupon, from among the measures notified by Brazil as balance of payments restrictions, only two remained in force, namely the suspension of issuance of import licenses and the import surcharges. However, the year 1980 witnessed a recurrence of the sizeable trade deficit of 2.8 billion dollars I have already referred to. This situation was further aggravated by an acceleration of the rate of inflation in the course of 1980, severely affecting the competitiveness of our exports.

In view of the weakening of Brazil's external position, the authorities were then compelled to introduce on May 29, 1980 a new measure for balance of payments purpose, namely the extension of the financial transaction tax (IOF) to the purchase of foreign exchange to pay for imports. It is an indication of the favourable expectations we held at that time that the initial rate of 15% was to be lowered to 10% on September 1st of that year. Once again, renewed difficulties prevented the attainment of this objective and eventually led, instead, to the need to raise that particular tax to the present level of 25%.

The trade policy measures recently adopted have to be seen in the light of the limitations of our exchange rate policy as an instrument for promptly restoring the

the competitive position of Brazilian exports. The present exchange rate policy deliberately avoids penalizing the private enterprises which borrow on the external financial markets.

The effort to obtain in the medium term a resolution of the deficit on current account entails an increase in exports, through diversification of products and markets, and necessarily a containment of imports. On the import side, the sheer magnitude of the oil bill already represents a considerable limitation to this contairment effort. Another "natural" limitation is the fact that the process of economic development itself generates new demands for essential imports which have to be met, lest one compromises those very development projects and programmes that, among other things, are geared for breaking through present external bottlenecks. This fact is fully recognized in Article XVIII:10 of the GATT, which speaks of the "priority to the importation of those products whice are more essential in the light of its policy of economic development".

As to the modalities of the restrictive measures adopted by Brazil, the "Declaration on Trade Measures Taken for Balance-of-Payments Purposes" adopted in the MTN recognizes that "the less-developed contracting parties must take into account their individual development, financial and trade situation when selecting the particular

measure to be applied". Brazil's BOP measures are just this: policy responses tailored to our own individual needs and objectives. The two older measures - the licencing suspensions and the import surcharges - refer to lists of specific products and are simple and fully transparent trade measures. The lastest measure - the financial transaction tax - is only conceptually more complex, in the sense that it is complementary to the exchange rate policy. But its application to imports is, nonetheless equally simple, since it applies to all imports not explicitly exempted, at a uniform rate. The financial transactions tax was recently approved by the IMF under Article VIII of the Articles of Agreement.

In the light of externally induced unbalancing factors, the present measures are those that have "the least disruptive effect on trade", in the sense of the MTN Declaration, among the several policy options placed before the Brazilian authorities. Brazil's trade measures form part of a larger integrated set of economic measures meant precisely to ease a domestic adjustment process which is made even more difficult by an adverse international economic environment. The current world economic crisis certainly affects all contracting parties, but an oil--importing developing country with an increasing degree of openess to the international financial, monetary and trade

markets would be hardest hit - as we have been in the past - in the absence of temporary trade measures. Experience has taught us that a short-term view of those difficulties can be misleading and that, therefore, it is better policy to strive for solutions which are effective over the medium and longer term. In fact, Mr. Chairman, the more effective temporary trade measures are, the quicker they can be dispensed with. Such an approach is also embodied in the General Agreement, in a note to Article XVIII.11, where it is said that a contracting party should not be required to relax or remove restrictions if such relaxation or removal would thereupon produce conditions justifying the intensification or institution of further restrictions.

We believe, therefore, that our BOP measures are fully compatible with the pertinent provisions of the General Agreement. But we would like this Committee, in reaching its conclusions, to take a broader view of our difficulties to adjust to adverse international economic conditions. Given these severe external constraints, the process of adjustment implies deep changes in the very structure of the economy. The recent decline in industrial activity provides, in fact, the best explanation for the slower increase in the level of our imports.

This year, the Brazilian economy will experience one of the lowest growth rates in its history. I

don't have to dwell on the far-reaching impact that this will have on the warp and weft of society. The slow growth rate has already begun to take its toll, swelling to unprecedented levels the ranks of the unemployed. The country must promptly resume higher levels of growth as an imperative of social, political and economic development. And the correction of the present balance of payments situation through the accumulation of positive trade balances over a period of time, at increasingly higher levels of trade, is the key variable in this process.

ANNEX II

Statement by the Representative of the International Monetary Fund

In response to a weakening of Brazil's economic situation in 1979, the authorities adopted in late 1979 and early 1980 substantive policy actions that included a major depreciation of the cruzeiro, fiscal and monetary measures, and an important liberalization of the foreign trade system.

The overall rate of growth of the Brazilian economy in 1980 was high by international standards, increasing to 8 per cent, up from 6 1/2 per cent in 1979. This reflected a good performance both of agriculture--aided by the freeing of agricultural prices and good weather--and of industrial output, which was stimulated by the effects of the devaluation on manufactured exports and, subsequently, by a strengthening of domestic demand. Inflation accelerated sharply in 1980 (from 77 per cent at the end of 1979 to 110 per cent in December 1980), partly reflecting the large devaluation of December 1979, sizable adjustments of domestic fuel prices, and the initiation of a process of general price liberalization.

In the first nine months of 1981 there was a significant slowdown in the growth of domestic demand which had particularly pronounced effects on industrial output. Because of the continued favorable development of the agricultural and service sectors, real GDP is projected to increase by about 3 per cent in 1981. After reaching a peak of over 120 per cent in March of this year, the 12-month rate of inflation declined to about 110 per cent by August. It is expected that by the end of this year inflation will have decelerated to two-digit levels.

Fiscal policy was tightened during 1980. Substantial efforts were made in both 1980 and so far in 1981 to improve the control of the Central Administration over the finances of the state enterprises. During the first eight months of 1981, however, the growth of Treasury expenditure has exceeded that of revenue.

During most of 1980 the rate of monetary correction--which is an important factor in the determination of domestic interest rates--was limited to the projected rate of inflation; however, as the actual rate of inflation substantially exceeded the projection, the resulting negative real interest rates stimulated the demand for bank credit and weakened private saving. In late 1980, the authorities abandoned the policy of prefixing the rate of monetary correction, thereby permitting a substantial rise in interest rates. Monetary policy has been tightened further in the course of 1981 by improving the quantitative control over credit operations of the banking system, by extending this control to the state-owned Bank of Brazil, and by limiting the access of large borrowers, in particular certain agricultural borrowers, to subsidized bank loans. However, large interest subsidies still remain in effect on a sizable volume of credit for priority sectors, such as agriculture and exports. Deviations from both the fiscal and monetary budgets that have occurred so far this year have been offset in part by sales--which have been substantial--of government paper in the open market. This has enabled the authorities to keep the growth of money supply to the trend rate assumed in the monetary budget for 1981.

Brazil's external position weakened during 1980. The growth in the value of merchandise exports by more than 30 per cent (to US$20 billion) was fully offset by a 27 per cent growth in imports (to US$23 billion); almost three fourths of this in rease in imports resulted from the sharp rise in the oil bill (to US$10 billion) that occurred in spite of a 10 per cent reduction in the volume of such imports. The deficit on services account has continued to widen in recent years, mainly because of rising interest payments. As a result, the deficit on current account of the balance of payments (including reinvested profits) rose to almost US$13 billion in 1980.

The net inflow of long-term capital slowed down in 1980, and this made it necessary to make net use of about US$3 billion of short-term financing and to draw down net official international reserves by a similar amount in order to finance the deficit on current account. At the end of 1980, Brazil's gross official reserves stood at nearly US$7 billion, and the medium- and long-term external debt of both the private and public sectors reached US$54 billion.

The policy of prefixing the rate of monetary correction on the basis of the target rate of inflation was accompanied by a similar policy in regard to the rate of depreciation of the cruzeiro, with allowance made for projected inflation in Brazil's major trading partners; this policy resulted in a substantial appreciation of the cruzeiro in real terms. With the abandonment of the policy of prefixing the exchange rate in late 1980, the authorities turned to a policy of frequent and small depreciations of the exchange rate at a pace geared to domestic inflation. The effect of this policy will be to achieve a real depreciation of the cruzeiro and thus to recover some of the ground lost during 1980.

As this exchange rate policy will produce its full effects only gradually, Brazil introduced in April 1981 tax credits to be made available to exporters of manufactured goods; these had been suspended at the time of the major depreciation of the cruzeiro in December 1979. A schedule for the gradual phase-out of these tax credits, currently provided at the rate of 15 per cent of the f.o.b. value of exports, and for their termination by June 1983, has been announced. The new measure, which is related to the exchange system, gives rise to a multiple currency practice. In a related development, a tax was later imposed on the export of some products to the United States; the rates of this tax are equivalent to the applicable rate of tax credits and subject to the same schedule of termination.

On the import side, the 15 per cent tax on financial transactions, which had been extended in April 1980 to imports of goods and services, was raised to 25 per cent from January 1, 1981. In early 1981 the import licensing scheme was supplemented by a system of sector specific annual programs, which has facilitated the issuance of licenses and avoided the recurrence of administrative delays so far in 1981. A number of other changes introduced recently in Brazil's restrictive system contributed to the liberalization of the exchange system. In November 1981, the Fund, under Article VIII of the Articles of Agreement, approved the exchange restrictions and multiple currency practices arising, inter alia, from the 15 per cent export subsidy scheme and the 25 per cent exchange tax on imports of goods and services, until December 31, 1982, or the completion of the 1982 Article IV consultation with Brazil, whichever is earlier.

As a result of the measures introduced since late 1980, Brazil's external position strengthened considerably in 1981. In the first half of 1981, the value of Brazil's exports rose by 18 per cent in relation to the corresponding period of the previous year, while the value of imports declined moderately. The performance of exports was particularly strong when account is taken of the decline in the export prices of coffee and sugar and the depressed level of economic activity in Brazil's major trading partners. The decline in industrial output in the first half of 1981 contributed to a relatively sharp fall in the demand for imports; oil imports increased by 9 per cent in value despite a further decline of 11 per cent in volume. During the third quarter of this year a trade surplus was registered in each month, and this brought the trade balance into a small surplus (US$200 million) for the first nine months of this year. The current account deficit in the first half of 1981 was US$5.9 billion, compared with US$6.9 billion in the corresponding period of 1980. The resumption of a faster pace of long-term capital flows, together with the redu ed current account deficit, made it possible for Brazil to effect a moderate improvement in its short-term capital position and to limit the overall balance of payments deficit to US$700 million in the first half of 1981 (compared with a deficit of US$3.7 billion in the first half of 1980).

In summary, the recent pursuit of restrictive financial policies has helped the authorities reverse the deterioration in Brazil's balance of payments, and the overall balance is now expected to be in approximate equilibrium in 1981. The adoption of a more realistic exchange rate policy involving frequent, small depreciations at a pace linked to domestic inflation will result in a real depreciation of the cruzeiro. The Fund hopes that a further strengthening of Brazil's external position would enable it to reduce substantially its reliance on restrictive practices.