

GENERAL AGREEMENT ON TARIFFS AND TRADE

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REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS
ON THE CONSULTATION UNDER ARTICLE XVIII:12(b) WITH
B R A Z I L

1. In accordance with its terms of reference, the Committee has conducted the consultation with Brazil under Article XVIII:12(b). The Committee had before it a basic document for the consultation (BOP/44) together with a document circulated to members of the Committee entitled "Brazilian Proposal for Development Finance", a decision of the Executive Board of the International Monetary Fund, dated 8 June 1964 (see Annex II) and background documentation supplied by the Fund as mentioned in paragraph 3 below.
2. In conducting the consultation the Committee followed the Plan for such consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation was completed on 13 November 1964. The present report summarizes the main points of the discussion.

Consultation with the International Monetary Fund

3. 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 and background material from the last consultation with Brazil under Article XIV of the Fund Agreement.

"The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of June 8, 1964, taken at the conclusion of its latest consultation with Brazil.

"Subsequently, the Brazilian authorities have introduced various measures affecting the exchange system, of which the most important are: (a) simplified treatment of coffee export receipts, effective July 1, 1964; (b) the introduction of a tax on all purchases of foreign exchange subject to advance deposit requirements (the initial rate of 20 per cent, effective August 1, 1964, was increased to 30 per cent by an Instruction issued September 22, 1964); (c) a reduction of the advance deposit requirements, previously 100 per cent or 200 per cent, to 60 per cent (effective August 1, 1964), and then to 50 per cent (effective October 1, 1964), in the case of import payments not exempt from deposit requirements; (d) a reduction in advance deposit requirements from

100 per cent to 90 per cent (effective October 1, 1964) in the case of most invisible payments; and (e) a requirement (effective September 10, 1964) that commercial banks obtain, in connexion with contracts to purchase convertible foreign currency, guarantee deposits amounting to 100 per cent of the value of each contract (previously, the legally required deposit had been 10 per cent, but banks generally had been collecting substantially higher percentages). The authorities have also placed before Congress measures in the fiscal and monetary field. These include income, stamp and consumption taxes to take effect in 1965, and a banking reform bill to provide more effective control of credit. Brazil is engaged in negotiations with individual countries aimed at securing rescheduling of external obligations, along lines agreed upon in principle in Paris in June 1964. Other internal measures in a programme of monetary stabilization are under consideration.

"The Fund is presently studying the significance of the various measures taken and proposed by Brazil since the conclusion of its consultation on June 8, 1964."

Balance-of-payments position and prospects

4. In his opening statement, the text of which is contained in Annex I to this report, the representative of Brazil gave a resumé of the balance-of-payments position and prospects. Brazil had had a deficit on her balance of payments in every year since 1957, with the exception of 1961, and a considerable part of the financing of the deficit has taken the form of short-term credits and commercial arrears, so that figures for Brazil's present gold and exchange reserves tend to be very misleading. Inflation, which he recognized as the central problem, had hampered the movement of exports to the point where the Brazilian deficit in the first half of 1963 reached \$304 million. As a first step toward restoration of external balance, the effort to maintain a fixed rate of exchange was abandoned early in 1964, when most import and export exchange operations were placed on the basis of free negotiation of the rate of exchange. Later, the free market rate was extended to remaining imports. It is hoped that this reform will substantially benefit the export trade, and other measures of export promotion are contemplated, including the eventual establishment of a realistic fixed exchange rate which would enable exporters to price their products competitively without need to hedge against the risk of loss on exchange. But this goal must await internal stabilization. Increased stability in the prices of major Brazilian exports would also contribute to an improvement in Brazil's balance-of-payments prospects. This objective is being sought both through efforts to stabilize coffee prices and through efforts to diversify exports, so as to reduce dependence on a single product. Brazil realizes that no solution can be found in restriction of imports, which need rather to grow in order to foster development, but that she must seek instead to promote and diversify exports.

5. The Committee welcomed the description of Brazil's immediate plans to overcome its difficulties through a short-term stabilization programme. They were pleased to note the Government's intention to allow the exchange rate to respond to supply and demand pending the establishment of a realistic unified exchange

rate. They also expressed appreciation of the declaration by the representative of Brazil that these moves are to be regarded as first steps toward liberalization and expansion of foreign trade. The Committee wished Brazil well in its ambitious and comprehensive stabilization programme.

6. With respect to capital movements, the representative of Brazil said, in response to a question, that the adoption of the new foreign-remittance law had had the effect of providing the basis for a revival of confidence. It would naturally be essential, he realized, that domestic stabilization be assured before a renewed flow of investment capital could be expected, but once that was accomplished, he believed that the long-run prospects for a revival of foreign investment were good. A member of the Committee called attention to the figures given on page 4 of Part V of the Brazilian Proposal for Development Finance which showed that capital inflow and profit remittances were in the ratio of one to three when remittances had been restricted; when remittances were relatively free the flow was reversed in the ratio of four to one, but it fell again in a stage beginning in September 1962, when restrictions on profit remittances had again been tightened. In reply, the representative of Brazil said he thought the new law was a reasonable one and that when its administration had been worked out it would provide no more than the necessary control of remittances. He added that the control of remittances would not as a rule bother normal industrial investors.

7. With respect to Brazil's progress toward a unified exchange rate, a question was asked concerning the rates of the advance deposits on imports and of the new tax on foreign exchange; the Brazilian representative confirmed that the advance deposit for special category imports was still 100 per cent and for general category imports 50 per cent. A tax had been introduced on all purchases of foreign exchange subject to advance deposit requirement; this tax was first set at 20 per cent and later raised to 30 per cent.

8. To an enquiry about Brazil's shipping discrimination, the representative of Brazil stated that of all the invisible items in Brazil's balance of payments, shipping is the one in which Brazil's expenditures over the last ten years have been the heaviest; he felt that it was understandable in the circumstances that Brazil should try to promote shipping in Brazilian vessels by the measure to which reference was made. The member of the Committee who had enquired on this subject welcomed the assurances given to the Hague Club that Brazil intended to reduce this shipping discrimination.

Alternative measures to restore equilibrium

9. The Committee recognized that Brazil's comprehensive stabilization programme had only just begun and that it might be difficult to give a conclusive report, at this stage, on its effects. The representative of Brazil stated that while the immediate reaction to some measures of the programme had been some sharp increases in prices, particularly of wheat and petroleum products, which ceased to be subsidized, it appeared that the overall rate of increase in prices had

been slowed to something like 2 or 3 per cent per month. As indicated in the document "Brazilian Proposal for Development Finance", which contains an authoritative description of current policies, the Government is fully aware that inflation must be checked as soon as possible.

System and methods of the restrictions

10. Members of the Committee welcomed the reductions in the percentages of the value of imports required to be deposited in advance, but noted that the effects of this appeared to have been offset by the new exchange tax. At present members found it difficult to be sure that there was a net easing of the burden on importers. One member doubted whether the advance deposits were useful in combatting inflation since funds were tied up over long periods of time so that importers were forced to charge correspondingly higher prices.

11. Members of the Committee welcomed the statement by the representative of Brazil that the recently imposed exchange tax would be temporary, and would be removed as quickly as possible. They also noted the statement in the paper "Brazilian Proposal for Development Finance" to the effect that all compulsory deposits were to be eliminated (Chapter IV, page 2, under heading III(c)). In view of the substantial obstacle to trade which these measures represent they enquired when it was expected that they could be removed.

12. The representative of Brazil confirmed that advance deposit requirements would be removed as soon as the level of reserves was high enough to permit such action, but he did not think that in the unusual circumstances existing at present these requirements add to importers' costs. With reference to paragraph 10 he explained that in a rapidly moving inflation, it is rather the bank depositors who are the losers for although the banks make a charge for credit advanced it does not cover the depreciation in the real value of the currency which takes place in the interval. The rate of inflation which prevailed formerly was in effect a system which taxed those who were most liquid.

13. The discriminatory application of prior deposit requirements was also raised, and one member noted that the effect of imposing lower requirements on some countries' imports was to make it necessary to maintain restrictions on the trade of other countries at a level higher than would otherwise be required in order to maintain a given level of restriction overall, not to mention the trade diversion which could result. This member noted that LAFTA countries' trade is exempt from prior deposit requirements. The representative of Brazil said that this had in fact given rise to some past difficulties, and he hoped that future difficulty might be avoided through the early elimination of all deposit requirements.

14. In response to a question concerning prevailing limits on the amounts of foreign exchange which an importer may purchase during any one week, the representative of Brazil stated that the limit is \$30,000 for convertible

currencies and \$20,000 for inconvertible currencies, mostly for trade under bilateral agreements; these limitations were however of no great practical importance since the Bank of Brazil usually waived the limitation in case an importer's needs exceeded these amounts.

15. The question of the bilateral payments arrangements maintained by Brazil was raised by several representatives, including one representative who attended in the capacity of observer. The bilateral payments agreements were felt by these representatives to give rise to discriminatory trade practices; trade in salted dried codfish, in particular, was being diverted by the specially favourable conditions accorded to bilateral agreement partners. Brazil's importers were forced to pay more for codfish purchased for convertible currencies because lower guarantee deposits are required for purchases in bilateral currencies and a 5 per cent discount is also given in the exchange rate when certain bilateral currencies are bought; according to one speaker's calculations, the differential was 14 per cent. Members of the Committee also recalled that earlier recommendations by the CONTRACTING PARTIES had urged Brazil to reduce reliance on bilateralism. The representative of Brazil took note of these comments, which he promised to transmit to his Government. He said that his Government does intend to terminate bilateral payments agreements with other contracting parties to the GATT but said that it was difficult for Brazil to proceed alone. He noted that Brazil does import codfish from certain contracting parties other than the bilateral agreement partners but he hoped that it would soon be possible to import it from all countries, including traditional suppliers, on a single non-discriminatory basis.

16. Members of the Committee also enquired further about the foreign-exchange discount accorded to importers buying exchange for purchases from bilateral agreement countries. They wished especially to know to which countries the discount now applies, recognizing that it had been withdrawn for trade with some countries. They also enquired as to when it was proposed to terminate the discount, hoping that it might be soon, and whether the discount would be eliminated for trade with all bilateral payments agreement countries, including the centrally-planned economies. The representative of Brazil replied that the intention is to eliminate the discount for all countries and to do so soon, even though it may not be possible to terminate all agreements with non-GATT countries. He noted that the foreign-exchange discount currently applies only to Denmark and Iceland of all the GATT countries not having planned economies.

General

17. In summary, the Committee appreciated the difficulty of the problem facing the new Government of Brazil and noted that some measures in the right direction have been taken. They felt, at the same time, that even if temporary curtailment of imports were necessary, it should be placed on a basis of equal opportunity for all supplying countries; some felt that the regulations made it difficult and expensive to import into Brazil and that even if the quantity of imports had to be limited temporarily the various financial charges constituted an unnecessary

inflationary pressure and burden on import trade, which was thus confined to importers having very great resources in cash or credit. It was, they repeated, the requirement that 50 or 100 per cent of the value of the import be kept on deposit for 210 days, the 30 per cent exchange tax and the weekly limits on individual importers' exchange purchases which created these unnecessary burdens. In addition there is a requirement for commercial banks to obtain guarantee deposits in connexion with contracts to purchase convertible currency, amounting to 100 per cent of the value of the contract; it amounts to 20 per cent on purchases of inconvertible currencies, mostly bilateral agreement currencies.

18. The representative of Brazil recognized in his reply that the net effect of the above requirements is to create some inflationary tendency, but unfortunately Brazil was obliged to limit imports and did not have the reserves which would be required to fight inflation by running a deficit in its balance of payments. In the circumstances this appeared to be a condition which would simply have to be endured for a time.

19. The representative of Brazil was thanked by the Committee for the full, frank and informative answers which he had given and he, in turn, promised to see that the views expressed in the Committee were brought to the attention of his Government.

ANNEX I

OPENING STATEMENT BY THE REPRESENTATIVE OF BRAZIL

The Brazilian balance-of-payments problem cannot be isolated from the more general framework of our struggle for stabilization, and from the behaviour of the market for certain commodities.

The fast pace of Brazilian inflation, together with attempts to keep the exchange rate fixed, has worked as a deterrent to exports. This situation, plus other negative factors, caused large deficits in our balance of payments, which reached a peak of US\$304 million in the first semester of 1963.

In the beginning of this year, the first step to abandon rate fixing was taken by the monetary authorities, through Instruction 263, under which most imports and exports had their exchange operations negotiated at the free market rate. Later, the first measure of the new government was to extend the free market rate to all other imports, through Instruction 270.

These measures, as it has been indicated, are just part of a comprehensive policy towards stabilization. Concerning the foreign sector, the first step of this policy is to keep the exchange rate free so that exports are not discouraged by the over-valuing of the currency. By the same token, other steps have been taken in order to help the exporter, who is now much less dependent on bureaucracy.

We do recognize, however, that these are just the very first moves in a policy of export promotion. The export activity needs also exchange stability, for the existence of an exchange risk supported by the exporter obliges him to have a greater margin over his production costs, which in many cases overprices his products in the stiff competition of the international market. Thus, a real export promotion policy will not be implemented before the inflation is overcome, and a parity for the currency can be safely declared.

Even if our economy were stabilized, our balance of payments would still be dependent on the fluctuations in the prices of certain commodities, such as coffee, which are the chief exchange earners for Brazil. This sort of problem has to be dealt with in two ways. The first one is international agreements for price stabilization, in which great effort has been and is being made. The second one is a policy to diversify exports, in order to become less and less dependent upon the larger items of our exports.

We take this opportunity to emphasize that the Brazilian authorities are sceptical as to the efficacy of further import restrictions in our case. In the first place, it is practically impossible to cut down further our imports without

seriously affecting some productive sector, because what Brazil imports today is essential in one way or another. Second, the process of development requires increasing amounts of equipment and raw materials, which will have to be imported. It is in awareness of this fact that the Brazilian Economic Programme states that "what we need is not a curtailment in our imports, but an increment in our capacity to import". And in a prospective study made by Brazilian authorities it is estimated that the need for imports in our country will grow at almost US\$200 million a year, in the next few years.

Summing up, the Brazilian balance-of-payments policy relies on the stabilization of the domestic monetary situation, and consists fundamentally of measures to promote and diversify exports. Thus, we try not only to increase our capacity to import, but also to make that capacity more stable than what has been the rule in our recent history.

We regard this as a realistic approach to the Brazilian balance-of-payments problem. But to remain realistic we must acknowledge the fact that the present situation of our balance of payments is delicate and difficult. Since 1957, every year was a deficit year, with the exception of 1961, when a small superavit of US\$55 million occurred. And a small superavit such as this cannot offset the magnitude of some of the deficits, like the ones of 1962 (US\$340 million) and 1963 (US\$308 million). Since a good part of the financing of this deficit took the form of short-term credits and commercial arrears, the figures for our gold and exchange reserves have become dangerously misleading, and the Brazilian authorities are compelled to act with utmost caution.

It is in the light of these facts that the liberalization measures taken by the Brazilian Government, and described in the basic document for the consultation, can be duly appreciated.

ANNEX II

International Monetary Fund Executive Board Decision
Taken at the Conclusion of the Fund's Consultation
with Brazil on 8 June 1964

The Government of Brazil has consulted the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.

The Brazilian economic and financial situation continued to deteriorate in 1963 and the first quarter of 1964 despite efforts early in 1963 to limit credit expansion and to improve the budget. Despite a growth in real value of tax receipts, the 1963 budget deficit continued to increase in real terms due to the growing personnel costs and increasing subsidies to state agencies. During the full year bank credit to the private sector continued to expand at an undiminished rate though in the first half of 1963 there was a transitory reduction in its rate of growth; there were also increased losses to the Bank of Brazil on exchange operations. Currency issue rose at a record rate and by early 1964 price increases were exceeding 100 per cent per annum. Production was disappointing because of adverse weather and the effects of the inflation, and production per capita may have declined. The balance of payments showed a limited improvement primarily because of, first, an increase in the volume of coffee exports, and later, of an increase in coffee export prices, but a deficit continued and arrears mounted.

The Brazilian authorities believe that the inflation is causing serious economic damage and they are preparing an economic program designed to slow the rate of inflation. Particular emphasis is being placed on the need to reduce the budget deficit and eliminate subsidies. Some important steps in this direction have already been taken, including the virtual elimination of exchange subsidies and the submission to Congress of proposals for increased taxation. On the other hand, the Government has also granted some very substantial salary increases payable from the budget.

Measures to achieve external equilibrium are urgently needed and a strenuous effort should be made to reduce commercial arrears and to meet foreign obligations. To deal with the heavy burden of foreign debt, the authorities plan to resume the approach to creditors to renegotiate schedules of payments. The Fund hopes that a mutually satisfactory debt arrangement can be agreed between all parties in the near future and that effective measures can be taken to avoid the recurrence of excessive debt service.

The Fund welcomes the recognition by the authorities of the damage caused by the inflation and urges that an effective program to bring an early end to the inflation be pursued. Of key importance are the reduction of the budget deficit to a level which can be financed from noninflationary sources, the adoption of an adequate wage policy designed to break the wage-price spiral, and of a credit policy designed to achieve stability of prices.

The Fund considers that the changes in the exchange system in March and May 1964 were important steps forward. The Fund welcomes the plan to reduce the advance import deposits and to eliminate the minor preferential rate for fuel oil and liquid gas. In the meantime, the Fund does not object to the continuation on a temporary basis of Brazil's multiple currency practices and restrictions.

In concluding the 1963 Article XIV consultations, the Fund has no other comments to make on the transitional arrangements maintained by Brazil.