GENERAL AGREEMENT ON

TARIFFS AND TRADE

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Committee on Balance-of-Payments Restrictions

1989 CONSULTATION WITH BRAZIL (SIMPLIFIED PROCEDURES)

Background Paper by the Secretariat

1. This paper has been prepared in accordance with paragraph 7 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes (BISD, 26S/205) to assist the Committee in taking the decision referred to in paragraph 8 of the Declaration.

I. Brazil's previous consultations with the Committee

2. Full consultations have been held with Brazil in 1971, 1976, 1978, 1981, 1983 and 1987, and simplified consultations in 1978, 1980 and 1985.

3. At the last full consultation, held on 25 November 1987, the Committee recognized that Brazil had continued to experience balance-of-payments difficulties and associated debt servicing problems since the last consultation, and that the level of foreign exchange reserves had fallen sharply in 1986 and was projected to remain broadly unchanged at the end of 1987. It welcomed the recent improvement in Brazil's current account position, and in particular the improvement in export performance in 1987 which it viewed as largely a consequence of the adoption of a more appropriate exchange rate policy. It also welcomed the introduction of measures in August 1987 to contain public sector expenditure and reduce the growth of monetary aggregates. The Committee viewed the introduction and maintenance of comprehensive demand management policies to restore internal balance and reduce inflation, as well as to increase investors' confidence in the prospects for the Brazilian economy, as being necessary to bring about an improvement in Brazil's balance-of-payments situation. Views were expressed that an improvement in the external trading environment would be beneficial for export growth, and particularly welcome in the light of Brazil's balance-of-payments situation. However, views were also expressed that this should only be seen as one element in the overall evolution of exports and that more basic elements of a domestic character would play a more fundamental rôle in the balance-of-payments adjustment process.

II. Development of Brazil's trade policies since the last consultation

4. The Brazilian authorities have notified to GATT in document L/6476 the text of Communiqué 204 of 2 September 1988 which sets out in consolidated form the rules governing imports into Brazil as of that date.

5. All importers must be registered with CACEX, and goods can only be imported by registered firms or persons. The great majority of imports into Brazil are subject to import licences which must in most cases be issued before goods are shipped from abroad. Import licences are not

required for goods listed in Annex A of L/6476: this list comprises mainly books, journals etc., certain medical products and goods for handicapped people, various collectors' items, samples, returned goods and articles for personal or sporting use. Some items, including luxury pleasure craft, the defoliant "Agent Orange" and narcotics, are subject to permanent prohibition. For some other products (Annex B of L/6476), while import licences are required, these may be issued after the goods have left the foreign source but before entry into Brazil; this list comprises immuno-suppressive drugs, newsprint and other printing paper, parts for agricultural and mining machinery, labels for goods to be exported, imports under temporary régimes and imports for foreign airlines operating in Brazil.

6. The annual import budgeting system operated by CACEX as a means of controlling total imports has been relaxed in 1989. In 1988 all enterprises with over US$50,000 in annual imports (or $25,000 if imports were for resale) were required to submit their annual import budget to CACEX. On this basis CACEX issued approval for a global dollar value of imports for the year, set at the 1987 actual import level for each importer. In general, importers were permitted to draw on one-twelfth of their allowance per month on the basis of individual licence applications, with exceptions for capital goods and seasonal imports. Exempted from the limits were imports for the Manaus free-trade zone, wheat and petroleum, imports under the drawback scheme, and those included in trade agreements concluded with ALADI member countries.

7. In July 1988 this system was eased to allow all import licence applications within annual limits to be granted automatically. For capital goods, licences were granted automatically even if they went beyond the annual limit.

8. The regulations governing the 1989 import programmes allow imports of up to (S$100,000 ($50,000 for resale) to enter without CACEX approval, outside the import budgets. Increases of 30 per cent above the 1988 import budget levels were allowed for products for the importer's own use and 20 per cent for goods for resale. No limits were set on imports of capital goods.

9. During 1987-88, Brazil used temporary suspension of import licences as a main instrument for regulating imports for balance-of-payments reasons. The previous background paper (BOP/W/114) referred to the evolution of the suspensions up to 21 September 1987 (CACEX Communiqué No. 177, notified to GATT in L/6225). It was noted that the number of tariff lines affected by the suspensions had been increased in early 1987 from 1,200 to 2,000 and then reduced in September 1987 to 1,200 once again. The trade coverage of the September 1987 list in terms of 1985 trade (the year in which suspensions were first introduced) was, however, estimated to have doubled from US$716 million to US$1,494 million (10.4 per cent of 1985 imports), when compared to the list at the beginning of the year.

10. Since the last consultation, Brazil has notified to GATT three further CACEX Communiqués (Nos. 204 of 2 September 1988, 208 of 21 November 1988 and 214 of 11 January 1989) in which the number of items subject to import licence suspension has been further considerably reduced (documents L/6441,

Corr.1 and Add.1 and L/6476). On this basis, it is estimated that the number of tariff lines affected is 595 and the US dollar value of trade affected, in 1985 terms, $201 million, or only 1.4 per cent of imports (Table 1). Conditions for the application of the temporary suspension of import licences, including the classes and sources of goods to which the suspensions do not apply, are set out in Section 1.2 of L/6476.

11. The United States has requested consultations with Brazil, under Article XXIII:1, on its import licence suspensions (DS 8/1 of 11 October 1989).

12. In July 1988, a tariff reform was implemented under which the maximum rate of duty was reduced from 105 to 85 per cent. Average nominal tariffs on consumption, capital and intermediate goods were reduced from 100, 84 and 70 per cent to some 50,50 and 32 per cent. The number of special régimes of tariff exemptions was reduced. The financial operations tax (IOF) was eliminated. Supplementary taxes remain in force for the renovation of the Brazilian merchant shipping fleet (50 per cent of the insurance and freight component of goods on first landing in Brazilian harbours, and 20 per cent on subsequent landings) and for improvement of harbours (50 per cent and imports).

TABLE 1

BRAZIL

Coverage of import licensing suspensions by major product showing major foreign suppliers in 1985

NBM[1]	Product and foreign suppliers	Coverage of 1987(Sept) suspensions[2]	Coverage of 1988 (Nov) suspensions[3]
		Value of 1985 imports (c.i.f.) in US$ million	
02.	Meat and edible meat offals	41.9	1.1
	(Uruguay)	(31.6)	(Hungary) (1.1)
04.	Dairy produce	24.2	23.8
	(United States)	(11.3)	(11.3)
	(Uruguay)	(10.6)	10.2)
07.	Edible vegetables	15.8	15.6
	(Argentina)	(8.0)	(5.9)
	(United States)	(1.8)	(1.7)
	(Spain)	(5.5)	(5.5)
12.	Oil seed and oleaginous fruit	8.5	-
	(United States)	(4.2)	
16.	Fish preparations	3.8	3.6
	(Peru)	(2.7)	(2.7)
28.	Inorganic chemicals	0.2	3.5
	(United States)	(0.1)	(EC) (3.0)
29.	Organic chemicals	52.0	29.8
	(United States)	(12.6)	(7.5)
	(Switzerland)	(10.2)	(5.8)
39.	Artificial resins and plastic materials	7.8	0.3
	(United States)	(2.8)	(0.2)

TABLE I (cont.)

NBM	Product and foreign suppliers	Coverage of 1987((Sept) suspensions	Coverage of 1988 (Nov) suspensions
		Value of 1985 imports (c.i.f.) in US$ million	
53.	Wool	5.2	3.0
	(Uruguay)	(4.8)	(2.7)
55.	Cotton	26.2	1.1
	(Paraguay)	(24.1)	(Colombia) (0.6)
61.	Woven garments	2.4	2.4
		(1.2)	(Panama) (1.2)
84.	Boilers, machinery and mechanical appliances	21.9	18.6
	(United States)	(9.9)	(7.0)
85.	Electrical machinery and equipment	151.0	64.7
	(United States)	(43.2)	(7.3)
	(Japan)	(51.0)	(19.3)
87.	Vehicles	221.2	5.6
	(European Community)	(92.4)	(3.9)
	(United States)	(40.3)	(1.1)
	(Argentina)	(32.8)	(-)
91.	Clocks and watches	40.8	2.0
	(Switzerland)	(20.3)	(0.4)
	(Japan)	(11.0)	(1.1)
All products		1,494.2	201.4

[1] Nomenclatura brasileira de mercadorias (Brazilian Commodity Nomenclature).

[2] Source: CACEX Communiqué No. 117 of 21 September 1987. For a complete list of the items for which import licences were temporarily suspended, see L/6225.

[3] Source: CACEX Communiqué No. 208 of 21 November 1988. For a complete list of items for which import licences are temporarily suspended, see L/6441.

(-) = zero or not significant.

III. Economic and trade developments

13. As inflation accelerated at a rate of 450 per cent per annum in the first two months of 1986, the cruzado plan was introduced at the end of February. It created a new currency and implemented a price and exchange rate freeze, a temporary de-indexation of most financial assets, and a change in wage indexation procedures. Initially the rate of inflation was reduced and production stimulated, but by the latter part of the year the plan came under pressure due to the lack of coordination of fiscal, monetary, and wage policies.

Aggregate supply and demand

14. Expansionary policies accompanying the cruzado plan pushed consumption up by more than 12 per cent in 1986, and gross fixed capital formation by almost 22 per cent. Real GDP recorded a 7.6 per cent growth (Graph 1). The nominal public sector borrowing requirement (PSBR) declined in 1986 to 11.1 per cent of GDP due to the decline in monetary correction expenditures brought about by the reduced domestic inflation (Table 2). The operational PSBR (which excludes borrowing for the maintenance of the value of the domestic public debt) fell to 3.6 per cent of GDP due to an improvement in the performance of federal public enterprises (Table 3). In contrast, the position of the central administration deteriorated due to increases in transfers to States, municipalities and federal public enterprises. Brazil's external accounts also deteriorated during 1986. The merchandise trade surplus, on a customs basis, declined to $6.8 billion (down almost 40 per cent) and the current account moved to a deficit of $5.7 billion. Brazil continued to accumulate debt arrears. Gross international reserves excluding gold fell to $4.4 billion in December 1986, as against $8.3 billion in the same month of the previous year.

Graph 1

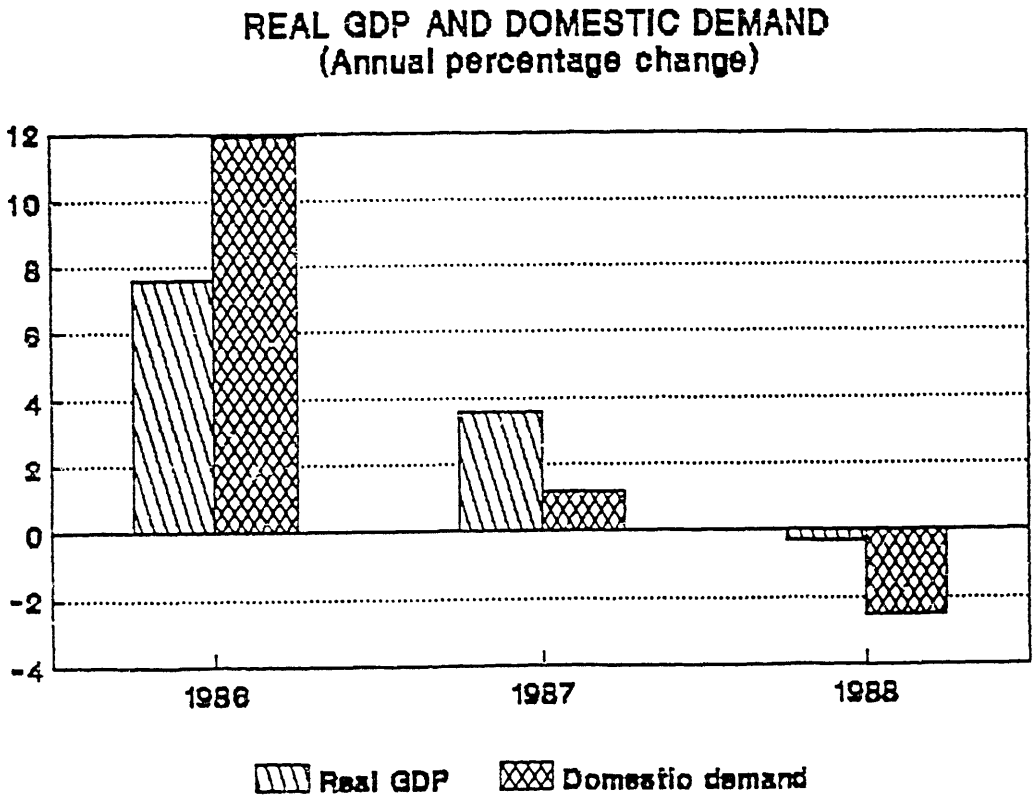


Table 2 - Public sector borrowing requirements, nominal concept
(Percentage of GDP)

	1986	1987	1988	1st.quarter 1989
Central government	5.21	14.05	8.73	1.93
State and local governments	2.71	7.91	12.95	0.91
Federal public enterprises	3.51	9.82	24.81	1.06
Decentralized agencies	0.10	0.26	2.09	0.08
Social security system	-0.40	-0.67	-0.04	-0.03
TOTAL	11.13	31.37	48.54	3.95

Table 3 - Public sector borrowing requirements, operational concept
(Percentage of GDP)

	1986	1987	1988	1st.quarter 1989
Central government	1.57	3.00	3.35	0.06
State and local governments	0.95	1.56	0.15	0.01
Federal public enterprises	1.35	0.86	0.37	0.08
Decentralized agencies	-0.01	-0.14	-0.02	0.00
Social security system	-0.26	0.24	0.41	-0.01
TOTAL	3.60	5.52	4.26	0.13

Source: Brazil-Economic Program, Central Bank of Brazil, various issues.

15. Following the failure of the cruzado plan in 1986, economic growth slowed to 3.6 per cent in 1987. The decline in industrial activity and the drop of overall and average wages in real terms were reflected in a decrease of consumption expenditures (including changes in stocks) of 1.5 per cent of GDP. Gross fixed capital formation declined by 0.7 per cent of GDP, affected by the rekindling of inflationary expectations. Capacity utilization remained at about 78 per cent on average, against 83.2 per cent the previous year. The average unemployment rate for the year was 3.7 per cent (3.4 per cent in 1986) according to official statistics.

16. Estimates of the Brazilian economic performance during 1988 show a decline in output of 0.3 per cent. Economic activity was intense only in the export sector. Despite regular adjustments of wages and salaries to

inflation, real declines were registered in payrolls and in the average wage in 1988. Consumption expenditure continued to decline, with a drop of 2 per cent, while gross fixed capital formation is estimated to have declined by 4.4 per cent.

17. For the twelve-month period ending in May 1989, industrial production is estimated to have been down 2.2 per cent relative to the preceding twelve months. Anticipating modest growth in the agricultural sector, forecasts point to a modest rise of 1 per cent of GDP for 1989.

18. Inflation, as measured by the consumer price index, increased by almost 396 per cent during 1987, and nearly 994 per cent last year. The Government concluded a 'social pact' with representatives of employers and employees to set slightly declining monthly inflation rates in the second part of 1988, while it pursued its efforts to de-index the economy.

Public finances

19. Brazil's public finances consist of the central administration, States and municipalities, public enterprises and the social security system. In 1987, the nominal PSBR showed a deterioration from nearly 11 per cent in 1986 to more than 31 per cent. The operational PSBR increased to 5.5 per cent of GDP in 1987, from 3.6 per cent of GDP in 1986, largely due to the deterioration in the position of the central administration, States and municipalities. The deficit of the States and municipalities declined in 1987, partly due to new regulations limiting their access to credit. Net domestic debt of the non-financial public sector was equivalent to 20.7 per cent of GDP in 1986 and 22.7 per cent in 1987.

20. The PSBR during 1988 was 4.3 per cent of GDP on an operational (indexed) basis and 48.5 per cent in nominal terms (almost 80 per cent of the operational PSBR was accounted for the central government; State and local governments and public enterprises reduced their financing needs to 0.5 per cent of GDP). At the end of 1988, the domestic component of the net debt of the non-financial public sector was equivalent to 23.6 per cent of GDP.

21. Preliminary data for the first quarter of this year show that the PSBR on an operational basis accounted for 0.13 per cent of GDP (3.95 per cent on a nominal basis) or 0.5 per cent on an annual basis (similar figures for the rest of 1989 would amount to a major reduction in the relative size of the budget deficits). The principal component of the PSBR continues to be credit to public sector companies. During the first quarter of 1989, expenditures on personnel, charges on the federal security debt and the servicing of the internal and external debts absorbed about 62 per cent of Treasury revenues.

22. During 1987 and 1988, the Government enacted various regulations designed to reorganize the public sector, increase transparency and restrict central bank activities to monetary and exchange rate policies. In December 1987, measures were taken to reduce the public deficit for 1988 including actions to increase tax revenues, cutbacks in subsidies and restrictions on expenditures. With the aim of reducing State involvement

in the economy and the budget deficit, the Federal Privatization Programme was initiated in 1988. Significant changes in personal income tax legislation were introduced in order to reduce tax evasion and cut costs of tax administration.

23. With the main aim of avoiding hyperinflation, the new stabilization plan of January 1989 sought to implement a restrictive fiscal policy by limiting spending to the revenues collected; freezing borrowing by public sector companies, States and municipalities; restricting personnel outlays to 65 per cent of total fiscal revenues; dismissing public employees with less than five years of service and reducing the number of government entities; abolishing official monetary indexing; and accelerating the privatization process.

Money and credit

24. As a result of the 1986 stabilization programme, the growth in broad money (M2) in the 12 months to April 1987 slowed to 73 per cent. However, in May it resumed its rapid rise and for 1987 as a whole the increase was nearly 309 per cent. Although the decrease in inflation in July 1987 proved to be temporary, the interest rates on major financial assets were positive during most of the period. The rekindling of inflationary expectations in the second half of 1977 caused a decline in the private sector demand for real M1 and led to a rise in income velocity (GDP/M1) of 77 per cent with respect to 1986. However, as a result of interest rate policy, the demand for broad money declined less, to a level of 87.7 per cent of its value the previous year. In 1988, broad money grew by 1,056 per cent in nominal terms. Increasing inflation reduced the real stock of M1 to less than a third of its value at the end of 1986, and income velocity (GDP/M1) continued its upward trend. As interest rates rose in real terms during 1988, the private sector demand for certificates of deposit, time deposits and so forth, recovered to almost its end-1986 level. As in 1987, the Government goal was to tighten monetary policy and maintain positive real interest rates. However, the trade surplus, budget deficit and debt-to-equity swaps boosted monetary expansion. During 1988, the Government continued its policy of daily devaluations of the currency to take into account changes in relative inflation rates. The cruzado was devalued by 940 per cent against the dollar in the course of 1988 (the comparable figure for 1987 was a devaluation of 383 per cent).

25. As a result of the stabilization programme implemented in mid-January 1989, the first five months of 1989 show a decline in the rate of growth of broad money to an annualized rate of about 507 per cent. However, despite the price and salary freeze, inflation grew again after a sharp decrease in February. The broad money stock in real terms dropped to 94 per cent of its value at the end of 1986. Following a monthly inflation rate of almost 29 per cent in July 1989, another plan intended to fight hyperinflation and promote economic recovery was agreed upon in August. Many prices were liberalized early in that month. In September and October, the authorities began to negotiate sectoral agreements that would allow automatic price increases in those sectors up to a fixed percentage of the previous month's inflation rate.

Balance of payments

26. Brazil's overall balance-of-payments position turned into a surplus of US$0.6 billion in 1987 from a deficit of $5.3 billion in 1986 (Table 4). It was financed partly by foreign bank disbursements and partly by an increase in interest arrears on foreign debts. In 1988, the balance of payments recorded a sizable surplus of almost $7 billion (about 2 per cent of GDP), allowing Brazil to reduce its debt with the IMF and the liabilities to the Paris Club countries associated with the refinancing of debt due in 1987. According to national sources, international reserves rose last year to $8.1 billion from $6.8 billion in 1987. Preliminary data reveal that the overall balance continued to show a sizable surplus of almost $2 billion, with international reserves at about $9.8 billion at the end of April 1989.

Table 4 - Balance of Payments, 1986-1st. quarter 89
(US$ million)

	1986	1987	1988	1st.quarter 1989
Trade balance	8,305	11,173	19,180	4,343
- Exports (f.o.b.)	22,349	26,225	33,787	7,875
- Imports (f.o.b.)	-14,044	-15,052	-14,607	-3,532
Services (net)	-14,043	-12,672	-15,083	-3,177
Unrequited transfers	87	70	93	17
Current account balance	-5,651	-1,435	4,190	1,183
Capital account balance	320	2,522	3,608	187
- Direct investment	185	1,148	2,981	339
- Debt operation	-176	-336	-2,096	...
- Long-term capital	-984	1,890	3,446	...
- Brazilian tending abroad	537	-333	-133	...
- Short-term capital	758	153	-590	928
Errors and omissions	49	-481	-821	601
Deficit(-) or surplus(+)	-5,282	606	6,977	1,971

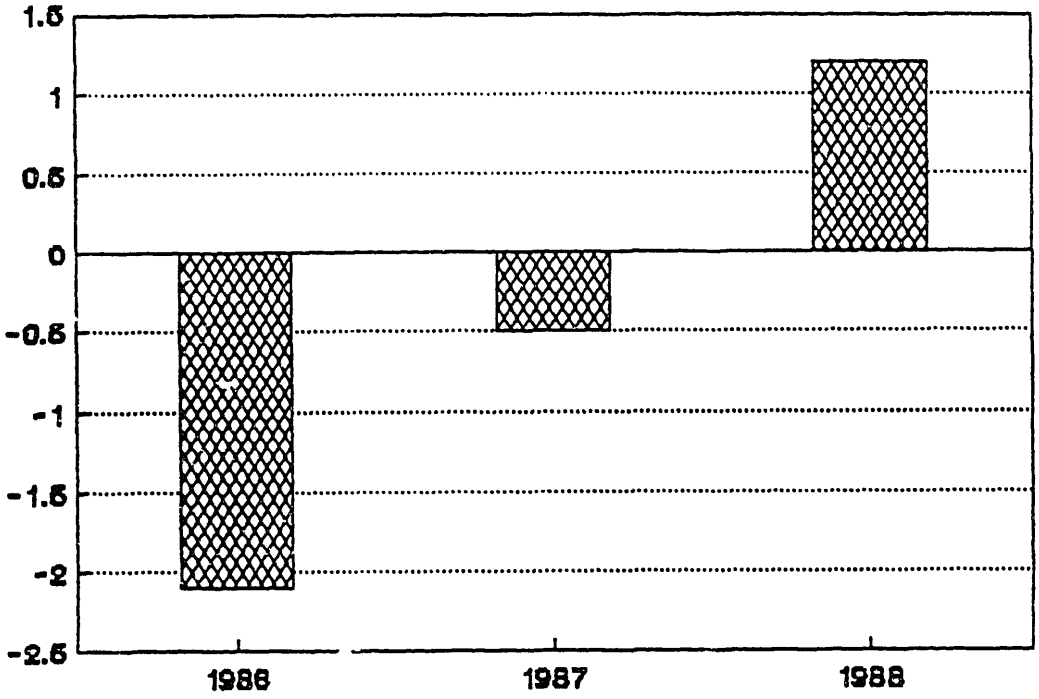
Source: IMF.

The current account

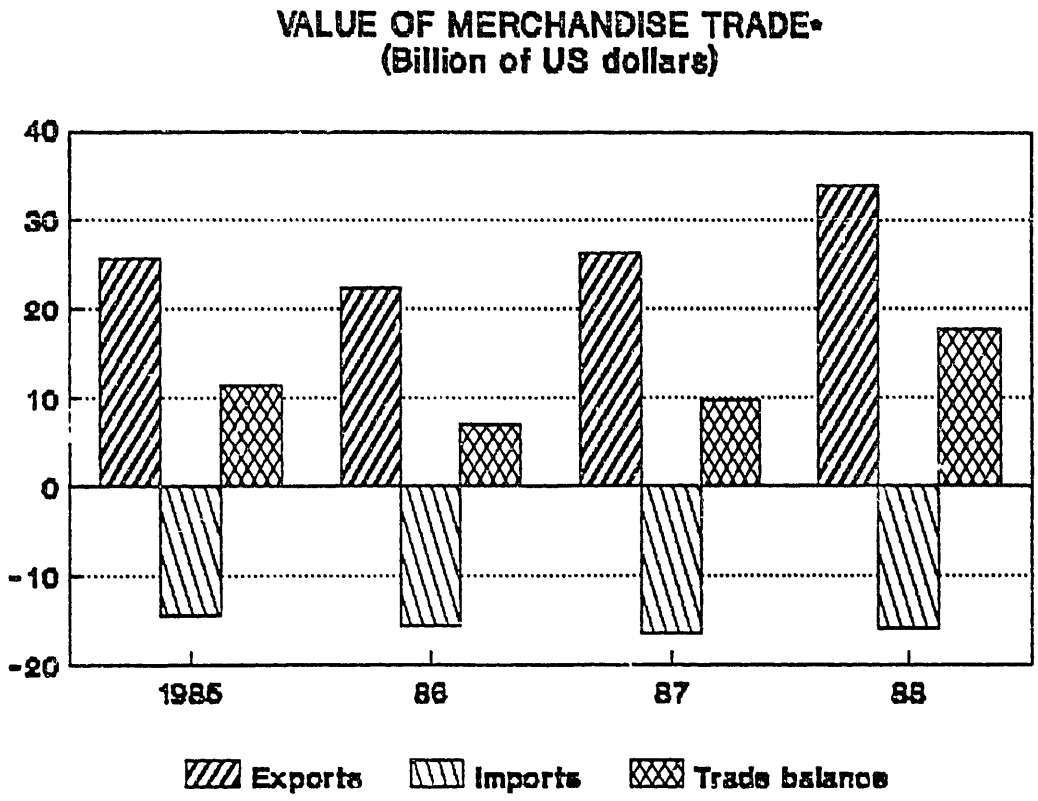
27. During 1987, Brazil's current account deficit declined to 0.5 per cent of GDP from 2.1 per cent of GDP (Graph 2). Last year, the current account recorded a surplus of $4.2 billion, equivalent to 1.2 per cent of GDP. This resulted largely from the rise in the trade surplus and occurred despite a deterioration in Brazil's price competitiveness in 1988 (Graph 3). Preliminary estimates show a current account surplus of $1.2 billion in the first quarter of 1989.

Graph 2

CURRENT ACCOUNT BALANCE
(Percentage of GDP)



Graph 3



*On a customs basis

28. Brazil's merchandise trade surplus grew by almost 35 per cent in 1987 (to $11.2 billion), and by nearly 72 per cent last year (to $19.2 billion), its highest in history. Preliminary figures for the first quarter of the current year show a surplus of $4.3 billion.

29. Merchandise exports rose 17 per cent in 1987 and were up almost 29 per cent last year. In 1987, the export performance reflected the recovery of industrialized products (mainly machinery, steel, transport equipment, oil derivatives, textiles and chemical products) which accounted for almost 60 per cent of total export earnings (Table 5). Among primary products, the rise in the volume of coffee exports of almost 94 per cent nearly offset the effect on earnings of a fall in coffee prices. Earnings from soybean exports rose nearly 42 per cent reflecting both an increase in volume and a recovery of its price. In 1988, the recovery of industrialized exports accelerated with a growth of more than 36 per cent in foreign exchange earnings. The most important sales were steel products, transport equipment and components, and chemical products. Among primary products, the recovery of world prices of coffee more than offset the fall in export volume of almost 15 per cent. Soybean exports grew 31 per cent mainly due to a significant rise in prices. Preliminary information shows that in the first seven months of this year, exports totalled $20 billion.

Table 5 - Changes in the pattern of merchandise exports (f.o.b.), 1986-1st. quarter 1989 ($US million)

	1986	1987	1988	1st.quarter 1989	% change 1988 over 1986
Primary products	9,294	10,705	12,604	2,443	35.6
of which:					
Soybeans[1]	1,640	2,325	3,046	324	85.7
Tobacco in leaf	395	416	523	44	32.4
Iron, ore & other ores	1,729	1,723	2,073	503	19.9
Coffee (incl. instant coffee)	2,347	2,185	2,215	580	-5.6
Industrialized products	13,100	15,519	21,182	5,416	61.7
of which:					
Metallurgical products	2,670	2,945	5,699	1,523	113.4
Transport equipment and components	2,103	3,386	3,887	888	84.8
TOTAL	22,394	26,224	33,787	7,859	50.9

[1]Including beans, bran and crude oil and refined oil.

Source: Brazil-Economic Program, Central Bank of Brazil, various issues.

30. Imports (f.o.b.) grew 7.2 per cent in 1987 against 6.8 in 1986, largely due to a rise in the volume and in the price of imports of oil and derivatives and in capital goods (Table 6). Last year, the import bill declined 3 per cent mainly as a result of the drop in oil prices and despite the increases in imports of capital goods and raw materials by more than 3 per cent. Partly as a result of the import liberalization measures introduced earlier this year, imports are expected to increase in 1989. Preliminary information shows that in the first seven months of this year imports totalled $9.4 billion.

Table 6 - Changes in the pattern of merchandise imports (f.o.b.), 1986-1st. quarter 1989
(Million US dollar)

	1986	1987	1988	1st.quarter 1989	% change 1988 over 1986
Capital goods	3,464	3,958	4,195	1,027	21.1
Crude oil and refined products	3,020	4,123	3,515	918	16.4
Raw materials	4,706	5,121	5,355	1,179	13.8
of which:					
Chemicals	2,584	2,681	2,780	575	7.6
Wheat	248	250	97	6	-60.9
Others	2,606	1,600	1,443	416	-44.6
TOTAL	14,044	15,052	14,605	3,547	4.0

Source: Brazil-Economic Program, Central Bank of Brazil, various issues.

31. The deficit on the services account declined slightly in 1987 largely due to the decline in the six-month LIBOR interest rate on US dollar debts (which, according to national sources, reduced gross interest payments by 7.3 per cent). During 1988, an increase in the LIBOR rate and exchange rate developments between the dollar and other currencies in which Brazil's foreign debt is denominated, were responsible for the rise in net interest payments (about 43 per cent of the change in the services balance).

The capital account and international indebtness

32. In 1987, the capital account surplus was US$2.5 billion, as against a surplus of $0.3 billion in 1986. This was mainly due to Paris Club refinancing of arreas. A programme to convert foreign debt into equity was initiated in early 1988. It provided both additional investment and a reduction of foreign debt by $6.2 billion. The rise in direct investment is largely accounted for by the conversion of debt into equity investment and reduced repatriation of funds. In 1988, the capital account had a surplus of $3.6 billion largely due to debt-equity conversions and to a rise in new medium- and long-term financing. About 90 per cent of the inflow of direct investment resulted from the conversion of external debt into equity.

33. According to national sources, Brazil's total external debt reached nearly $121 billion at the end of 1987, an increase of 9.2 per cent for the year. The growth of short-term debt was largely accounted for by interest arrears. Total external debt is estimated to have decreased by some 7 per cent during 1988, with the stock of interest arrears about 28 per cent below the previous year's. In September 1988, Brazil paid past arrears and signed agreements with foreign bank creditors obtaining new credits and a rescheduling of the terms on previous debt. It also negotiated a Paris Club agreement which permitted international export credit agencies to resume financing of exports to Brazil. The ratio of total external debt to GNP improved to 33.3 per cent at the end of 1988, against 41.6 per cent at the end of 1987.