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# WORLD TRADE ORGANIZATION

**Committee on Balance-of-Payments Restrictions**

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## NOTIFICATION UNDER PARAGRAPH 9 OF THE UNDERSTANDING ON THE BALANCE-OF-PAYMENTS PROVISIONS OF THE GENERAL AGREEMENT ON TARIFFS AND TRADE 1994

The following communication, dated 13 July 1995, has been received from the Permanent Mission of Brazil.

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On 13 June 1993, the Brazilian Government enacted Provisional Measure 1024 (published in the Official Gazette in 14 June 1995) that establishes a set of rules applicable to the imports of inputs, capital goods, intermediate and final products for the automotive sector. An English version of the next of the Provisional Measure was circulated as document WT/L/73.

The measures that will be introduced by the above mentioned legal text are included in the broader context of the economic stabilization plan (Plan "Real"), whose implementation was initiated in June 1994. Besides inflation control, the Plan's objectives contemplate privatization measures and monetary, fiscal and structural reforms. Such reforms aim at productivity increase and reduction of production costs, thus allowing for a greater insertion of the Brazilian economy in international economic flows.

Brazil has been conducting a trade liberalization process since 1988. That process is an essential component of the economic stabilization programme. The continuity of the Plan's success requires an equilibrium of the external accounts. If a current account deficits occur, the Government should finance it in a sustainable long lasting way, preferably through medium and long term capital inflows such as productive investments. Recent events in financial markets have already demonstrated the fragility of attempts to reach balance of payments equilibrium through the inflow of highly volatile short term capital. At its present stage, the stabilization programme requires an optimum use of the financial sources available and stimuli to long term capital inflows.

Brazil has been reducing import tariffs on the import of capital goods, inputs and current consumption goods, with the objective of reducing production costs and inflationary pressures on essential goods. As a result of the tariff reduction programme initiated in 1990, the highest tariff was reduced from 105 to 32 per cent, the modal tariff from 40 to 20 per cent and the average tariff from 32 to 14 per cent. In addition, Brazil virtually eliminated non-tariff barriers. It reduced tariffs within MERCOSUL and included temporary import tariff reductions on essential goods in its exceptions to the Common External Tariff, with a view to meet occasional price stabilization needs for those goods in the domestic market.

After significant surpluses in the last five years, the Brazilian trade balance has shown, from January to May 1995, however, a US$3.5 billion deficit. From November 1994 to May 1995, the trade deficit reached US$4.9 billion. In the first five months of this year, while Brazilian exports grew only 5.9 per cent as compared to the same period of last year, imports rose 95.7 per cent. In the 12 months from May 1994 to May 1995, exports grew 11.8 per cent, while imports increased by 59.5 per cent.

As a direct consequence of the negative evolution of the trade balance, from January to May 1995, foreign reserves decreased by US$5.1 billion. Such figure would have been even higher if significant amount of short term capital had not flown in during that period.

These inflows, however, mislead the analysis of the composition of the reserves, which cannot be assessed only by taking as a basis its absolute value. This is especially the case of Brazil that needs an adequate level of reserves for the economic stabilization process.

The repeated monthly deficits in the trade balance led the Government to temporarily increase up to 70 per cent import tariffs on some durable consumer goods, as notified in document WT/L/66 and Addendum 1. The Brazilian Government is conscious of the need to adopt macroeconomic policies compatible with the general situation of the Brazilian economy. To that end, it also took fiscal, monetary and credit domestic measures, such as a public spending control and a flexible exchange rate band. It reduced the level of economic activity through credit restrictions and an increase of real interest rates.

The importers' access to foreign financial sources, however, offset the tariff increase and its effects on the price of goods. These foreign sources offer terms that are more favourable than those prevailing in the domestic market. In the specific case of the automotive sector, despite the tariff increase, imports reached, in the first five months of this year, US$1.830 million. That amount represents 8.8 per cent of the total Brazilian imports and 89.9 per cent of the imports of automotive products in 1994. From January to May 1995, Brazil imported about 300,000 vehicles, whereas during the whole year of 1994 it imported 197,180. In 1994, the number of imported vehicles corresponded to 12.5 per cent of the domestic production. That ratio increased to 37 per cent from January to May 1995.

An analysis of the evolution of the Brazilian trade balance clearly shows the impact of the import surge in the automotive sector on Brazil's total imports. From January to May 1995, automobile imports increased 412.7 per cent as compared to the same period of last year, while total imports grew by only 55.3 per cent.

In order to avoid a short term deterioration of the balance of payments and to ensure equilibrium of the trade balance in the medium and long term, the Brazilian Government has decided to resort to the provisions of Paragraph 9 of Article XVIII of the General Agreement on Tariffs and Trade 1994. It allows developing countries to adopt import restrictive measures to safeguard its external financial position and ensure a level of reserves adequate for the implementation of its economic development programme.

In compliance with the provisions contained in letter (a) of Paragraph 9, the restrictions introduced by Provisional Measure 1024 do not exceed those necessary to offset the negative effects of the import surge -- mainly vehicles -- on the balance of payments. The intention of the measures is also to prevent any erroneous interpretation that Brazil will incur on a current account deficit that cannot be financed. Likewise, in compliance with Paragraph 10 of Article XVIII, restrictions were designed not curb the imports of goods essential for the implementation of the economic development programme. Notwithstanding, they take into account the significant expansion of vehicles' imports in the last months. In this connection, the sum of actual imports in the first semester of this year plus the quota established for the second semester will represent more than 225 per cent of the total imported in 1994.

To comply with Paragraph 11 of Article XVIII, the Brazilian Government aimed at adequately managing eventual current account deficits by financing them in a long lasting basis and by making optimum use of the restrictions to allow for their progressive elimination. To that purpose, the Provisional Measure created mechanisms that will enable the Executive Power to stimulate cost reduction, investment and export capacity increase. Since this is one of the most internationalized industries, competitiveness in this sector requires economies of scale, low cost inputs and optimum use of the production processes. This has justified the existence of special measures and régimes in a great number of developed and developing countries.

The automotive industry is responsible for 11 per cent of the Brazil's GDP. It employs directly about 700 thousand people. It is at the center of a complex industrial production network. Its performance has well-known chain effects on other sectors and on the economy as a whole. The automotive sector is, therefore, vital for the "Real" Plan. The Plan has had undeniable success in inflation control and economic stabilization and is a fundamental element for the resumption of economic growth and even for the constitutional reforms aimed at modernizing and liberalizing the Brazilian economy within a solid institutional framework that will ensure Brazil's full insertion in the international economy.