1. In accordance with its terms of reference, the Committee has conducted a consultation with Brazil under Article XVIII:12(b). The Committee noted that a consultation under the simplified procedures (L/3772/Rev.1) had been held in May 1978 (BOP/R/100) when it had been decided that a full consultation would be held under the applicable procedure. The previous full consultation with Brazil under the provisions of Article XVIII:12(a) had been held in May 1976. In conducting the present consultation the Committee had before it a basic document supplied by the Government of Brazil (BOP/192 and Add.1), notification of import restrictions (L/4713) and a background paper provided by the International Monetary Fund, dated 27 October 1978.

2. The Committee generally followed the plan for such consultations recommended by the CONTRACTING PARTIES (BISD, 18th Supplement, pages 52-53). The consultation took place on 14 and 15 November 1978. 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 International Monetary Fund had been invited to consult with the CONTRACTING PARTIES in connexion with this consultation with Brazil. In accordance with the agreed procedures, the representative of the Fund made a statement concerning the position of Brazil, as follows:
"In 1977 the rate of increase in real GDP slowed to 4.7 per cent, down from more than 9 per cent in 1976; manufacturing output rose by only 3 per cent compared with about 13 per cent in 1976. This deceleration in the rate of economic growth was in line with the policy objective of tightening demand management in order to lower the rate of inflation and reduce the deficit of the current account of the balance of payments.

"In the first half of 1978 industrial production recovered from its sluggish behaviour in the second half of last year. A drought in the southern part of the country in the early months of the year caused substantial damage to agricultural crops, particularly soybeans and corn. Because of shortfalls in agricultural production the growth of real GDP in 1978 is not expected to be significantly different from that of last year.

"In regard to fiscal policy, expenditures by the Federal Treasury have been expanding approximately in line with the rate of increase in prices and the information available on the public sector as a whole suggests that public investment will show little change in real terms over last year.

"In the first half of 1978 monetary expansion exceeded that contemplated in the targets of the monetary budget, mainly because of substantial capital inflows from abroad. The heavy resort to foreign borrowing can be attributed not only to relative conditions in domestic and foreign credit markets, but also to an official response to the deterioration of the current account of the balance of payments in 1978. Moreover, the introduction of a freeze on the use of the cruzeiro proceeds from foreign loans spurred additional borrowing from abroad in anticipation of even more stringent measures of this kind in the future.

"Wage policy in Brazil has been guided mostly by the adjustments called for by the official wage formula. Wage adjustments exceeded the rate of inflation from late 1974 until early 1976. During the following 12 months, however, wage adjustments ran some 4 percentage points below the rate of inflation. Starting in mid-1977, wage adjustments again exceeded the rise in prices, but this margin has narrowed considerably in recent months.

"The annual rate of inflation, which increased from a low of 16 per cent at the end of 1973 to a peak of 46 per cent by late 1976, decelerated to 39 per cent by the end of 1977. Little or no progress is expected to be made in reducing the rate of inflation during 1978, in part because of the effects of the drought on agricultural supply."
With regard to the external sector, the large merchandise trade deficit that developed in 1974 (US$4.8 billion) was gradually eliminated over the next three years. This improvement in the trade account stemmed from a 5½ per cent increase in the value of exports during 1974-77 and a 4 per cent decline in the value of imports. Contributing to the strong performance of exports was the rise in manufactured exports, which increased at an average annual rate of 28 per cent over this period. However, the trade balance in the first half of 1978 shifted to a small deficit, mainly because of reduced exports and additional imports of agricultural goods owing to the drought conditions referred to above.

In contrast to the improvement in the trade account, the deficit on services account has continued to widen in recent years. This deterioration is explained largely by rising interest payments on a growing external debt; there was also a substantial increase in reinvested profits in Brazil. Including reinvested profits, the deficit on current account narrowed from US$7.6 billion in 1974 to US$4.8 billion in 1977.

Net capital inflows during 1974-75 were not sufficient to finance the deficit on current account, and net international reserves declined by about US$2 billion over this period. The situation changed in the next two years, and there was a buildup of foreign reserves of more than US$2 billion in 1976 and another US$0.5 billion in 1977. During the first half of 1978 net capital inflows amounted to almost US$4.0 billion, compared with US$1 billion in the same period of 1977, and the overall balance of payments shifted from a deficit of US$0.9 billion in the first half of 1977 to a surplus of US$0.7 billion in the corresponding period of 1978. Gross official reserves increased in the first half of this year by almost US$1 billion and reached a level of US$9.2 billion by end June 1978, equivalent to nine months' 1977 merchandise imports. To neutralize the domestic liquidity impact of the large capital inflow experienced during the first half of 1978, the authorities introduced in June 1978 a 30-day freeze on the cruzeiro proceeds of foreign loans; the period of sterilization was subsequently increased, and is now 150 days.

Since 1974 the authorities have taken a number of steps aimed at improving Brazil's external position. These have included demand management measures, export incentives, measures designed to encourage import substitution, and import restrictions. On the export side, the authorities maintained - and to a minor degree extended - the system of export incentives for manufactured products that was introduced in 1969-71. These incentives include exemptions from income and indirect taxes and, in some cases, tax credits related to the amount of the afore-mentioned exemptions, as well as an export credit insurance scheme and the extension of credit to exporters at preferential interest rates. On the import side, the authorities granted a number of fiscal and credit incentives to encourage the domestic production
of import substitutes and reversed earlier reductions on import taxation. In addition, they introduced during 1975 and early 1976 certain direct and indirect import controls of a cost and quantitative nature. These included the establishment of an advance import deposit requirement (applicable to 22 per cent of imports in 1977) on some imports, the implementation of a comprehensive program to reduce imports by the public sector, a prohibition on imports of selected commodities, and a stricter application of the rules relating to "national similars"; the last-mentioned rules refer to the procedure whereby imports of goods for which an equivalent product is produced locally may be ineligible for certain tax and credit concessions.

"The measures just described have, in general, been maintained in 1977 and 1978. While no major changes have been made during this period, there appears to have been some relaxation in the application of certain of the restrictions on imports.

"The exchange rate policy of depreciating the cruzeiro by small amounts at irregular intervals, adopted in August 1968, has been continued. Over the last few years these adjustments have kept approximate stability in the (price-corrected) relationship between Brazil's currency and that of its principal trading partner, the United States. Because of the recent decline in the U.S. dollar in terms of other major currencies, this stability has involved a (price-corrected) depreciation of the cruzeiro in relation to the currencies of the countries that are Brazil's principal sources of imports (other than petroleum).

"The Brazilian authorities recognize the need to review the measures relating to import restraints and export incentives with a view to eliminating inefficiencies in resource allocation. However, they have found it difficult to make major unilateral moves on this front in the light of recent developments in the current account of the balance of payments, and especially at a time when other countries have been resorting increasingly to protectionism. Nevertheless, they have indicated that, if external circumstances and prospects permit, the various restraints and special incentives to trade could be phased out gradually.

"Notwithstanding a projected increase in 1978, the deficit on current account of the balance of payments has been narrowed significantly in recent years and present prospects are that it may decline by US$1.5 billion in 1979. The improvement in the current account position has been achieved through a combination of policies, including measures designed to restrain imports and give special incentives to exports. The Fund believes that a reduction in the reliance on import restrictions in the management of the balance of payments would benefit Brazil and contribute toward the goal of liberal international trade."
Opening statement of the representative of Brazil

4. In his opening statement, the full text of which is annexed to the report, the representative of Brazil explained the difficulties which the Brazilian authorities still faced in coping with the management of Brazil's balance of payments. He described the objective of attaining surpluses in the trade balance in the short and medium terms with a view to substantially reducing the deficit in the current account. He went on to analyze and describe developments in the trade account and in the services account. Finally, in the light of different constraints the Brazilian economy faced and on the assumption that there would be moderate and uncertain economic growth rates in the developed countries, an upsurge of industrial protectionist measures in developed countries and a probable price increase for imported petroleum, it was clear that Brazil's short- and long-term possibilities of import liberalization would be slim. He described the different measures in force and said that the duration of these measures would be dictated by the levels of deficits accrued in Brazil's current account. He recalled that traditionally Brazil had had a liberal import policy. Interruptions in this policy had occurred for force majeure reasons brought about by the international economic situation that left no alternative in the administration of the foreign account other than attempting to limit the overall expenditures in the purchase of merchandise abroad.

Parts I and II

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

5. The members of the Committee noted the general improvement in Brazil's balance of payments since the last consultation; but recognized that petroleum prices and the recent drought had adversely affected the 1978 current account. However, these elements had to be seen in the light of other factors such as the very large foreign debt, the rate of inflation, the impressive growth of exports and the very high level of reserves. Generally, while it was clear that some corrective measures were needed, the members of the Committee felt that there might be alternative means to restore functional equilibrium in the balance of payments preferable to the continued maintenance of severe import restrictions coupled with export incentives, which were trade distorting. They noted with interest the International Monetary Fund's view that, assuming normal weather conditions, the 1979 prospects for economic growth and the balance of payments appeared favourable.
6. Several questions were asked concerning the foreign debt. It was noted that the level of foreign indebtedness was very high at $29 billion (net indebtedness estimated for 1978) and that there had been an increase in borrowing in 1978 of some $4 billion; from a 1977 level of $8 billion to some $12 billion by the end of 1978. It was remarked that given the effect of debt-servicing on the current account and the fact that the majority of the debt was not contracted to cover deficits on the trade account, it might be in the interest of Brazil to control the level of foreign indebtedness. It was also suggested that less recourse to foreign borrowing would moderate inflationary pressures thus allowing a quicker pace of import liberalization. More generally, it was pointed out that foreign debt-servicing contributed heavily to the deficits on services account. The representative for Brazil explained that one of the elements in Brazil's development strategy was the option of absorbing foreign savings, the corollary of which was a deficit on current account. He emphasized that severe climatic conditions since 1975 as well as the 1978 drought, together with petroleum price increases, had played a large role in the deficit on current account; these factors also had a negative influence on the behaviour of domestic prices and were out of the Brazilian authorities control. Furthermore, the representative of Brazil stated that it was the intention of the Brazilian authorities to maintain the present debt administration system - that was to say, to avoid concentrating amortization on the periods immediately after loans were contracted, while endeavouring to maintain foreign exchange reserves at a level consistent with the country's commitments on the international financial market.

7. Members of the Committee asked for comments on Brazil's short and medium balance-of-payments strategy aimed at achieving and maintaining a surplus on the trade account in order to restore equilibrium on the current account. In particular, it was asked whether quantitative indications could be given of the trade surpluses aimed at before any import liberalization could be undertaken. The representative for Brazil replied that achieving a surplus on the trade account was a fundamental element of Brazil's balance-of-payments strategy which aimed at restoring a functional equilibrium to the balance of payments. To achieve this it was necessary to contain imports and to expand exports. Members of the Committee stated that the object of maintaining a trade surplus could not be accepted as justification for trade restraints. In the absence of additional or strengthened measures to bring the foreign debt under control, or alternative policies of a more fundamental nature, they thought that this argument, if sanctioned by the Committee, was an open-ended invitation to maintain import controls indefinitely.

8. In reply to questions concerning the administration of the foreign debt, the representative of Brazil said that the extension of the amortization of debt terms was encouraged; lately, operations had been made which involved amortization payments within eight, ten, twelve and fifteen year periods. There were no debts of less than five years registered in the Central Bank.
In reply to questions concerning the composition of the debt the representative of Brazil said that it was both public and private. The public foreign debt was controlled through government agencies' budgets taking into account priority governmental programmes. The level of private borrowing was dictated by the investment opportunities offered by the Brazilian economy. The monetary impact of external borrowing taken as a whole was, as necessary, neutralized by measures which had contractionist effects. The most recent measure of this kind adopted by the Brazilian Government was the freezing for 150 days of the cruzeiro equivalent of foreign borrowing. One member of the Committee pointed out that the bulk of the foreign debt is not contracted to cover deficits on current account. In this respect, the representative of Brazil reiterated that foreign borrowing by Brazil has aimed at covering the deficits in current transactions and maintaining adequate levels of reserves, which would be compatible with the country's involvement in foreign financial markets. He further stated that, in fact, a country's indebtedness is all the more reasonable to the extent that its accumulated reserves are greater, that the average repayment period for loans contracted is longer and, above all, that foreign exchange earnings from exports are higher.

9. Members of the Committee pointed to the fact that a considerable inflow of foreign funds was caused by relatively favourable interest rates abroad. In this context it was asked how the Brazilian authorities determined interest rates and whether the government took into account the effect of its interest rate policy on foreign borrowing. It was also suggested that with respect to foreign loans the decision to freeze the proceeds of these loans for increasing periods of time may have stimulated further borrowing abroad. The representative for Brazil explained that the government normally set interest rates according to market forces. There also were rates lower than market rates for some sectors, such as the agricultural one. It was a fact that when measures had been taken to freeze the cruzeiro counterpart of foreign loans for 150 days it had had in the very beginning the effect of increasing the demand for foreign loans.

10. Turning to the question of the level of reserves members of the Committee noted that foreign exchange reserves of Brazil had grown consistently since 1976 and were projected to reach more than $10 billion by the end of 1978. This represented some ten months import coverage and it was asked why such a high percentage of reserves was needed, especially when a good part of these were borrowed. It was also asked whether the level of reserves did not have an inflationary impact. The representative of Brazil replied that the level of foreign exchange reserves held in Brazil was determined in the light of Brazil's involvement in foreign financial markets. He added that the Brazilian authorities had an established policy as regards the level of the country's reserves, in the context of its balance-of-payments strategy.
11. Several questions were asked concerning anti-inflationary measures in Brazil and the rate of monetary growth which had consistently exceeded original estimates. It was asked what policy tools were used to co-ordinate monetary policies and what the government's goal and projections were regarding inflation in 1979 and 1980. It was also suggested that an accelerated import liberalization would contribute to the fight against inflation. The representative of Brazil emphasized that it was not possible in Brazil to apply any shock anti-inflation policy. He added that public spending had been very careful. The different means used in the fight against inflation had often been frustrated by extraneous factors such as climatic set-backs and imported inflation. In reply to a specific question the representative for Brazil added that despite the use of classical monetary tools, such as central bank open market operations and bank reserve ratios, the problem of inflation could not be fully mastered as long as external factors beyond the Brazilian authorities control intervened.

12. Several questions were raised concerning the exchange rate policy and in particular the process used by the government in administering its crawling peg system, and the factors that were taken into account in determining when and by how much to change the value of the cruzeiro. It was noted that a parallel exchange market existed on which the cruzeiro was exchanged at some 15 per cent less than the official rate. The representative for Brazil explained that the parallel market handled only a negligible part of exchange operations. The exchange rate differential did not reflect an overvaluation of the cruzeiro. The policy of frequent small changes to the exchange rate was preferable to sudden devaluation which would have negative effects on the income from primary products exports.

13. Asked to comment on the relation between exchange rate policy and trade liberalization and also on what constituted an adequate level of reserves, the representative of the International Monetary Fund said that the improvement in recent years of the Brazilian balance of payments should facilitate the liberalization of restrictive measures, provided the Brazilian authorities followed appropriate exchange policy supported by other internal measures. In reply to another question concerning debt ratios, the representative of the Fund said that there was no such thing as an optimum debt ratio that could be used for all countries at all levels of development. He pointed out that Brazil had immense potential for economic development and therefore was able to absorb a great amount of foreign financing. The conventional debt service ratio for Brazil showed a very high figure. However, this ratio included all debt, much of which was rolled over. An alternative indicator of the level of debt (i.e. as a ratio of GDP) was provided in the Fund report. With respect to level of reserves, the representative of the International Monetary Fund pointed out that historically some countries managed with low reserves (equivalent to a few weeks' imports) while others maintained a high level of reserves. The reserve equivalent of two to four months of imports were held to be the minimum desirable by many countries. The level of reserves considered adequate depended on many factors including exports and imports, invisible payments, the variability of these factors, and access to borrowing.
Parts III and IV

System and method of the restrictions and effects of the restrictions

14. Members of the Committee pointed out that the cumulative effect of Brazil's import restrictions had resulted in many cases in their own countries' trade balance with Brazil having moved from a surplus or balance to a deficit. The measures seemed very severe and had certainly been successful in curbing total imports into Brazil. Some members of the Committee said that their principal concern was the absence of regularity of trade regulations. Exporters felt that a relaxation of the discretionary powers of Cacex would contribute to reducing the climate of insecurity of trade that prevailed. The representative of Brazil justified the restrictions as measures aimed precisely at containing imports, in the context of the country's balance-of-payments strategy. These measures were adopted from 1974 on in different stages to try to curb increasing imports. The nature of the measures adopted pointed to the fact that Brazil had abstained from resorting to more drastic restrictions and had taken into account the interests of its trading partners. The effects of the measures up to now had been to maintain the general level of imports. The representative of Brazil stressed that trade regulations in Brazil were all made public; periodical modifications, he explained, were only made effective as a result of changed circumstances in the conduct of trade, as was the case with any country. He also underlined that Brazil maintained an automatic licensing system.

Prior import deposits

15. A number of questions were posed on the Brazilian prior deposit system: how it was administered, how its coverage was determined and changed, whether the measure affected items also subject to a surcharge, what relationship it had to the rate of inflation, and whether it would be reduced as inflation decreased, whether the measure was aimed at reducing liquidity or only imports and finally, on the selection of exempted products. The representative of Brazil replied that the deposit was a refundable levy deposited in the Bank of Brazil in cruzeiro equivalent of 100 per cent of the f.o.b. value of imports. The deposit was then transferred to the Central Bank where it was retained for 360 days, at the end of which it was then refunded without monetary correction and with no interest. The measure was designed to restrict imports but did not apply to all products. Imports essential to development and to the maintenance of development projects were exempted from the measure; e.g. petroleum, fertilizers, disinfectants, wheat, coal, printing paper, aircraft parts etc. The measure had always provided for exemptions, and these had increased so that the deposits covered in July 1978 some 21 per cent of imports compared to some 51 per cent in May 1976. This decline in the coverage of the import deposit was a
liberalization. The criteria for exemption was essentiality of the products for development projects. The deposit did affect some items which were also subject to a surcharge. The difference between the three main import restrictive measures was that the import deposit was the most comprehensive tool; the surcharge was more selective in terms of product coverage and the licensing suspension was the most restrictive but also the one with a very small coverage. The representative of Brazil recalled that not all these measures had been introduced at the same time but had had to be adopted between 1974 and 1976 to face the growing balance-of-payments problems.

16. The Brazilian authorities were aware that there was an inflationary disadvantage to the prior deposit system. The prior deposit increased the price of imports and as such was inflationary. However, from an internal point of view it did absorb some excess liquidity and therefore restrained somewhat inflation. These were conflicting trends and it was not possible to measure the final impact on inflation. He recalled that the measure had been adopted for balance-of-payments purposes and that its reduction or elimination would not be related to the level of inflation.

17. In reply to a remark that the 40 per cent deposit really amounted to an 80 per cent non-refundable surcharge in so far as the deposit bore no interest and no monetary correction and that the final cost of it was some 40 per cent in foregone interest plus some 40 per cent loss on monetary correction, the representative of Brazil explained that the prior deposit had the effect of a surcharge of around 40 per cent. The inflation factor of 40 per cent would apply to both the deposit value immobilized for one year and to an alternative domestic investment. What remained, then, was the 40 per cent factor of foregone investment mentioned above.

18. In reply to a question, the representative of Brazil confirmed that capital goods were exempted from prior deposits if their import was approved by government for a project with a minimum of five years' financing. Regarding the termination of the measure he said that no date had been fixed and that termination would only be considered when the policy aims of a functional equilibrium in the balance of payments had been achieved.

19. In reply to a specific question the representative of Brazil said that Brazilian importers could use foreign loans to finance the import deposit. Some members of the Committee questioned Brazil concerning the exemption of LAFTA members from the prior deposit and other balance-of-payments trade restraints. The representative of Brazil replied that LAFTA was exempted because of Brazil's commitments in the LAFTA Agreement. The same members of the Committee pointed out that Brazil had obligations for non-discriminatory application of balance-of-payments measures and that Brazil's participation in a regional trading group did not exempt Brazil from these GATT obligations.
20. The views of the International Monetary Fund's representative were asked concerning the efficiency of prior import deposits as a tool for restoring balance-of-payments equilibrium. The representative of the Fund replied that a prior deposit was a double-edged instrument; on the one hand it increased the cost of imports, on the other hand it absorbed excess liquidity and therefore indirectly restrained imports. As a tool of monetary control, prior deposits were effective only in the first basic period; after that they lost their absorptive effect as they could be reused for further imports. Furthermore, when the measure was eliminated unless other appropriate measures were taken, it tended to release liquidity and add to inflationary pressure. As for the efficiency of the measure in terms of restoring balance-of-payments equilibrium, he reiterated the Fund's general view that restrictions of any type were not considered efficient tools for this purpose, except on a very temporary basis.

Licensing suspensions

21. Several questions were posed concerning the licensing system and suspension of licences. Members of the Committee wished to know how the system operated, what information was required of importers and the relationship between the licensing suspensions and the balance-of-payments measures. The representative of Brazil explained that import licensing was automatic in Brazil. The aim of the system was not to restrict imports but to exercise a measure of surveillance on import prices for exchange control reasons. The surveillance of import prices was a useful instrument to prevent over and under invoicing. In practice importers applied to the CACEX for import permits. CACEX is a department of the Bank of Brazil which has more than fifty branches throughout the country; therefore, application for import permits was facilitated. Provided importers filled the request form correctly, CACEX would promptly issue the import licence. The information requested was the basic data asked in most countries i.e. country of origin of the goods, the names of the supplier, the unit prices, total value, ports of embarkation and destination, tariff classification, description of the product etc. There was no basic relationship between the import licensing system and the balance-of-payments measures. When balance-of-payments measures were introduced it was found preferable by the authorities to use the vehicle of the import licensing system to help administer these measures, so as to avoid the need to create additional administrative mechanisms which would have placed a burden on the importer. When CACEX issued an import licence it also charged the import deposit in the same operation thereby simplifying import procedures. Members of the Committee noted that Brazil continued to prohibit the importation of certain goods deemed as non-essential and that the determination of goods considered to be non-essential was at the discretion of the Brazilian authorities and that these prohibitions did not conform with Article XVIII:10 concerning minimum commercial quantities.
Asked whether there were administrative procedures used to identify essentiality the representative of Brazil said that there were no special administrative procedures but rather general criteria used by the Government. Asked to comment further the representative of Brazil explained that the import prohibitions concerned only 2 per cent of total imports in 1977, down from 4 per cent in 1976 when the measure was adopted. Therefore this measure had been liberalized. Suspended products were superfluous goods such as toys, pleasure boats, certain agricultural products produced in Brazil - tea, tobacco, flowers, fruits and certain industrial products etc. He also confirmed that import licensing suspension was linked to the law of national similars as a balance-of-payments measure.

**Surcharges**

22. The Committee noted that surcharges were levied at the rate of 30 and 100 per cent. They asked what determined whether a product was in one category rather than another and why some products were prohibited as non-essential and others were subject to a surcharge and still others subject to a prior deposit. Taken together what percentage of trade was subject to the different measures? The representative of Brazil said that the surcharges were levied as a balance-of-payments import restriction. Products were placed in one or the other surcharge rate category according to their degree of relative essentiality. Some products were more superfluous or less essential. It was exact that a product moved from one category to another but only from the higher rate to the lower rate. The CPA had no authority to add products to the surcharge list. He added that since the measure was first taken in 1974 some seventy-eight products had been withdrawn from the list and that since 1975 no new product had been added to the list. In reply to the question of the percentage of trade subject to the different measures the representative of Brazil said that 16 per cent of imports were affected by the surcharges. As to the prior deposit, in principle all imports were subject to it, with the exemptions indicated in Central Bank Resolution No. 443 and subsequent resolutions containing amendments thereto, but the trade value of imports covered was only 21.2 per cent of total authorized imports in July 1978. As to the suspensions, they affected some 300 products when the measure was adopted in 1976; since then, CACEX communications had effected both inclusions and exclusions in the suspension list but, on balance, exclusions had outnumbered inclusions, with the liberalizing result already pointed out.

**Minimum prices**

23. Members of the Committee remarked that several products were subject to minimum pricing and asked how the minimum prices were established. It was also noted that import licences on most products would not be granted if the importers' quoted prices did not conform to prices practised in
world markets. The representative of Brazil said that minimum pricing was not a balance-of-payments measure. The measure applied only to some products and its objective was to correct certain import prices and to verify whether they conformed to market prices. He added that the measure was more liberal than what was allowed under the GATT.

Law of national similars

24. Members of the Committee remarked that Brazil had used a law of national similars for many years as part of its import substitution effort and asked whether, now that Brazil appeared to be more export orientated, the authorities had given any thought to liberalizing this system. The representative of Brazil said that the law of similars was a flexible and efficient development instrument which did not create any obstacles to trade or grant any special privileges. An importer had the choice of paying the tariff or of subjecting his import goods to the test of law of similars, in which it had to be proved that in terms of price, quality and delivery there was no national similars. If the product passed this test, it could be imported totally or partially free of customs duties. He added that government entities' imports were all subject to the law of similars i.e. had to go through the test, because by law those imports were duty free. He observed that this was a liberal feature of the Brazilian import régime and that the main objective of the measure was to reduce the cost for priority projects imports.

25. Turning to the question of export competitiveness the representative of Brazil explained that Brazil had a drawback system. Imports destined for export production could obtain tariff and other exemptions such as from surcharges and prior deposit. There was no link between the balance-of-payments restrictions in force since 1971 and the export incentive policies adopted at the end of the 1960's, which the Brazilian Government consider legitimate measures taken in the context of its economic development policy.

26. Finally, in response to queries as to when the different import restrictive measures would be terminated, the representative for Brazil said that his Government was not in a position to give any firm date for termination or elimination of these measures but that it was his authorities' intention to liberalize as soon as the balance-of-payments conditions would permit it, taking into account the country's balance-of-payments strategy. In this connexion, he recalled that prospects were that total exports in 1978 would remain at the same level of 1977 and that, therefore, a deficit in the trade balance was expected of the order of $600-800 million. On the other hand, the growth of foreign debt could not be attributed to the growth in reserves but rather to the considerable deficits in current transactions.
27. A question was raised concerning the special measures applied to the importation of specialty steel products by the State enterprise ACESITA and in particular whether these special measures were part of the balance-of-payments restrictions. It was also asked how these measures operated for the purpose of balance-of-payments objectives and what were the prospects of their elimination. The representative of Brazil explained that indeed in December 1975 measures were taken, in the context of the more general balance-of-payments restrictions, to co-ordinate imports and policies in the steel sector, through a holding company (SIDERBRAS) for the steel State enterprises. These measures were needed, as part of the balance-of-payments strategy, to check significantly increasing imports in 1974-75 and to curb speculative stocking and other distortions in this sensitive sector. The measures in force, as regards imports, did not discriminate as between sources of supply and aimed at regulating the inflow of steel imports at current market conditions. The representative of Brazil could not give any indications as to the prospects for the elimination of such measures.

Conclusions

1. The Committee commended the Brazilian authorities on the performance of the Brazilian economy over the past years, in particular on the impressive growth of manufactured exports. The Committee noted the information presented by the Brazilian delegation to the effect that in 1978 Brazil's trade balance is expected to suffer a sharp deterioration and show a deficit of up to US$800 million. The Committee also noted in this connexion the projection made by the IMF that the deficit on current account of the balance of payments has been narrowed significantly in recent years and the present prospects are that it may decline by US$1.5 billion in 1979. The Committee noted that it was the Brazilian authorities' objective in the short and medium terms to achieve and maintain a surplus on the trade account in order to accommodate deficits on the services account, in particular payments related to the servicing of Brazil's growing external debt. While the Committee appreciated that servicing of the existing foreign debt would continue to place a considerable burden on the balance of payments in the years to come, it noted that the increased reliance on foreign borrowing was only in part tied to the financing of current account deficit, and that it also reflected responses to exchange rate, monetary and interest rate policies. In view of the substantial improvement in Brazil's balance of payments since the last consultation, of the very high level of Brazil's foreign exchange reserves and taking into account the findings of the IMF, the Committee concluded that extensive import restrictions, other than on a very temporary basis were not the appropriate means of restoring equilibrium on the current account, and in the absence of fixed dates for their liberalization, expressed doubts whether they could be fully justified under Article XVIII:B.
2. The Committee therefore urged the Brazilian authorities to adopt alternative and more fundamental policies as indicated in the conclusions of the 1976 consultation: i.e. "an appropriate programme encompassing monetary, fiscal, income and external measures". Such policies should permit the realization of Brazil's economic objectives and an early reduction and the progressive elimination of the import restrictions that affected trading partners' interests.

3. The Committee noted the Brazilian authorities' assurances that the import restrictions in question were temporary measures. However, the Committee expressed concern at the severity and multiplicity of the import restrictions and urged the Brazilian authorities to undertake expeditiously a simplification of the import system with a view to reducing and eliminating the severity, multiplicity and complexity of the restrictions in force.
ANNEX

Opening Statement by the Representative of Brazil

1. At the outset I would like to refer to the documents which this delegation and the International Monetary Fund have put before the Committee.

2. An analysis of these documents clearly points out to the difficulties which the Brazilian economy still faces in coping with the management of its balance of payments, in view of the need for attaining trade balance surpluses in the short and medium terms, with a view to substantially reduce the deficits in current transactions.

3. Taking this very year of 1978, initial expectations that there would be a trade surplus and a resulting improvement in current transactions were subsequently frustrated by adverse weather conditions, mainly droughts, and the resulting sizeable shortfalls in a number of export-oriented crops such as soya, corn and rice, as well as in import substitution products such as wheat and meat. The foreign exchange losses deriving from these shortfalls, will be reflected in this year's trade balance, and can be estimated to reach around US$1.5 billion.

4. As a result of these facts and also because exports have remained at the 1977 level while imports have somewhat increased in nominal terms, Brazil's trade balance will not show a surplus in 1978. Rather, prospects are for a trade deficit of around US$600 to 800 million. This will further aggravate the ongoing deficit on current transactions, raising it to approximately US$5.3 billion. The deficit on current transactions in 1977 was US$3.8 billion.

5. Expenditures with service factors (particularly interest payments) constitute the main component of the deficit on current transactions in the short and medium terms. The upward trend of such expenditures - which jumped from US$495 million in 1969-73 to US$2,250 million in 1974-78 in terms of net payments averages - reflects the increasing volume of foreign debt in which Brazil has had to incur since 1973. While in 1974 payments for such services totalled US$0.9 billion, the figure for 1977 is US$2.8 billion and the estimate for 1978 is 3.4 billion.

6. These last figures reflect a gross foreign borrowing flow of the order of US$27 billion, considering a stock of gross foreign debt of US$12.6 billion as of 31 December 1973 and of an estimated 40 billion on 31 December 1978. In net terms (debt less reserves), the debt flow in the same period will be of the order of US$23 billion. Still in the same period, that is 1974-78, one can estimate that the current account will show a deficit flow of US$28.9 billion, for which the trade balance will have contributed with US$10.8 billion (37.2 per cent) and the services account with US$18.1 billion (62.6 per cent), respectively.
7. Consequently, taking into account:

(a) that representative figures for service factors expenditures should increase somewhat in the next few years as a result of the level of indebtedness accrued from 1973 onwards;

(b) also considering that, as regards non-service factors, possibilities of lower yearly negative flows will not materialize immediately, notwithstanding efforts in that direction.

one must conclude that further liberalization of Brazilian imports will depend on export growth in order that the current account deficit may be brought down to levels that will not feed a high growth of foreign debts.

8. In the light of this constraint it should be borne in mind that the following trends might continue, simultaneously:

(a) moderate and uncertain economic growth rates in developed countries, resulting in rising unemployment rates;

(b) an upsurge, provoked by that situation, of industrial protection measures in developed countries, in the form of restrictions and limitations on imports; and

(c) probable price increases for imported petroleum, which would contribute to aggravate the relative trade deficit of Brazil, as has been the case since 1973.

9. Should these trends effectively continue, one will be forced to admit that Brazil's short and long-term possibilities of import liberalization will be accordingly narrowed. Looking at it from another side, it may be said that - considering internal needs of standing inflation control, as well as the constraint of prevailing limitations in the current account situation - the degree of liberalization that could be envisaged for Brazilian imports would be generally dependent on:

(1) developments in the high surplus situation of the trade balances of the OPEC countries, Japan and the Federal Republic of Germany; and

(2) the MTN's, resulting in effective higher export possibilities for Brazil and in a degree of international discipline that succeeds in inverting the protectionist escalation verified in developed countries especially.
10. As it can be inferred from the elements I have just mentioned, the main object of the Brazilian authorities is to attain a slower rate of growth in the country's foreign debt so that conditions can be maintained for Brazil to continue to offer one of the main markets for foreign capital placements, among developing countries, including direct investments.

11. In view of the intention of Brazilian authorities to keep in operation the present foreign administration system (described in paragraph 22 of document BOP/192, page 7), the short and medium-term strategies as regards Brazil's balance of payments has of necessity to aim for surplus in the trade balance. Such strategy is needed for at least the time necessary for the absorption in the national accounts of the large trade deficits obtained in the recent past. From then on, a stage will be reached where the country will be in a position to continue to have tolerable deficits in current account. Within these parameters it is preferable that exports grow in a proportion that allows some growth in imports, without prejudice of a surplus in the total trade being attained.

12. In this context, it should be clearly noted that the worsening of the current account situation in 1978 notwithstanding, the Brazilian authorities did not intensify import restriction measures in force since the last full balance-of-payments consultation in this committee. Much to the contrary, exemptions from the prior deposit requirement were granted to several import products and the trade impact of suspensions of import licences has diminished; the trade impact of the latter measures, calculated in terms of the 1975 import value of those products can be seen in page 25 of document BOP/192/Add.1.

13. Similarly, the amount of products to which a surcharge has been instituted by Decree Laws 1334/74, 1364/74 and 121/75 has not been increasing. As is known, these surcharges do not apply for imports of products bound in GATT (see page 27 in document BOP/192/Add.1).

14. Finally, I have to once more emphasize that these import restrictions adopted by Brazil are non-discriminatory, and that as they have been adopted to remedy balance-of-payments difficulties they are temporary measures, the period of validity of which is solely dictated by the high levels of deficit accrued in current account.

15. One last remark. As this delegation had the opportunity to emphasize when we had our last full consultation in this committee, traditionally Brazil's import policy has been extremely liberal. Data for the first semester of 1978, for instance, reveal that only 18 per cent of imports paid import duties. Interruptions in this policy have occurred strictly for force majeure reasons, brought about by the international economic situation that left no alternative in the administration of the foreign account other than attempting to somewhat limit the overall expenditures in purchases of merchandise abroad.