REPORT OF THE COMMITTEE ON BALANCE-OF-PAYMENTS RESTRICTIONS
ON THE CONSULTATION UNDER ARTICLE XVIII:12(b) WITH
BRAZIL

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/57 and addenda), a decision of the Executive Board of the International Monetary Fund, dated 2 February 1966 (see Annex I) and a background document 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 26 March 1966. 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. 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 its last consultation with Brazil under Article XIV of the Fund Agreement.

"With respect to Part I of the Plan for Consultations, relating to balance of payments position and prospects, and with respect to Part III, relating to system and methods of the restrictions, the Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of February 2, 1966, taken at the conclusion of its recent consultation with Brazil, and particularly to paragraph 5 which reads as follows:
The Fund welcomes the simplification of the Brazilian exchange rate system and the reduction of restrictions and discrimination in foreign payments. Some of the remaining exchange practices are still complex and the Fund urges Brazil to take steps toward their simplification. The Fund also considers that the Brazilian economy would benefit considerably from the implementation of the announced policy to reduce trade restrictions. In the meantime, the Fund does not object to the maintenance on a temporary basis of Brazil's multiple currency practices and restrictions on payments for current international transactions as described in SM/66/11, Part II.

"On February 2, 1966, the Fund also approved a stand-by arrangement authorizing Brazil to draw up to the equivalent of $125 million over a period of 12 months beginning February 1, 1966.

"With respect to Part II of the Plan for Consultations, relating to alternative measures to restore equilibrium, the Fund invites attention to the decision taken at the conclusion of its recent Article XIV consultation with Brazil. The Fund has no additional measures to suggest at this time."

Opening statement by the representative of Brazil

4. In his opening statement, the full text of which is contained in Annex II to this report, the representative of Brazil gave an analysis of the balance-of-payments position summarized in the tables contained in BOP/57/Add.2/Rev.1. He noted first that the significant improvement in the balance of payments was to an important extent the result of a record level of exports, thanks chiefly to increases in exports of ores, manufactures and goods other than traditional basic products, combined with an exceptionally low level of imports. On services, there was a very large net deficit, notwithstanding a sizeable increase in receipts. Autonomous capital movements resulted in a deficit as compared with a surplus in 1964 but the net gain on current transactions more than covered this deficit, so that there was a net surplus of $137 million on the accounts as a whole. This surplus and the grant of large compensatory credits, amounting to $450 million, helped make it possible to repay part of accumulated commercial arrears and to arrange a funding of the balance. Swaps were also reduced; Brazil was able to end the year with net exchange reserves increased by $300 million.

The representative of Brazil also described various measures taken during 1965, including the adoption of procedures for stimulating exports. He also noted the issuance of a regulation (Instruction No. 289) which brought about an inflow of capital inconvertible currencies and mentioned the external depreciation of the cruzeiro, the encouragement of the sound and economic development process through long-term foreign financing of imports of capital goods, special incentives to exporters who undertake to maintain price stability, elimination of advance deposits, removal of the financial charge on payments for imports and its reduction on financial transfers and a reduction of guarantee deposits.
The representative of Brazil emphasized that the policies adopted for the economic and financial sectors aimed at economic development and neutralization of the inflationary pressures, which produced such positive results in 1965, would be continued.

**Balance-of-payments position and prospects**

5. Members of the Committee expressed satisfaction at the considerable improvement in import treatment which had resulted from the Brazilian reform measures and congratulated Brazil on the striking improvement in Brazil's reserve position. Brazil's efforts to move towards a single realistic exchange rate were also noted with approval. With respect to 1965, the question was raised as to the extent to which lower imports resulting from a lower level of economic activity than could be expected in 1966 might have brought about an improvement in the trade balance which could not be relied upon as a continuing source of improved net foreign exchange earnings. The representative of Brazil was asked to comment on prospects for development of imports and exports in the present year. In reply the Brazilian representative agreed that imports had been at a lower level in 1965 than would be likely in 1966. Moreover, he noted that at the end of 1965 and early in 1966 some 600 items had been transferred from the special to the general category; this would make it easier than heretofore to import, so that imports could certainly be expected to increase. This action had been notified in the context of the Kennedy Round. So far as exports were concerned, Brazil would continue to promote actively the export of manufactured goods, in which great success had been achieved in 1965, not only on a world-wide basis but also in particular within the Latin American Free Trade Association and in trade with less-developed countries in other regions. Notwithstanding problems in some semi-manufactures, notably cotton textiles, there was better hope, he felt, for further expansion in the manufactures sector than in respect of traditional exports which were to some extent hampered by difficulties which could be overcome only in the long run. Though he could give no precise estimate of results expected for 1966, more nearly balanced trade was certainly in prospect and another surplus like last year's was not in view. In response to a query whether Brazil should not be more optimistic both about increasing consumption and achieving conditions permitting higher unit returns on traditional exports, the representative of Brazil affirmed that Brazil was of course co-operating in all efforts to achieve these objectives for such products as coffee, cocoa and sugar, but that as world-wide problems were involved, solutions would depend on more than Brazil's own efforts, and experience showed that co-operative action would be slow, so that his authorities could not count on immediate results in that sector. One member stressed that considerable help could be given to countries like Brazil by the removal of tariffs and internal charges on some of these products. Recent enquiry had shown, for example, that sugar as well as coffee is subject to high rates of internal taxation in many countries although it cannot be regarded as in any way a luxury like tobacco or alcoholic beverages, the products normally subject to heavy fiscal charges.
6. Another member asked how Brazil expected to achieve overall balance in its external payments if trade could not be relied upon to produce sizeable surpluses in future years, given the large deficit on other accounts to which the representative of Brazil had referred in his statement. The representative of Brazil acknowledged that this prospect might give rise to misgivings, especially in view of the heavy load of debt still overhanging. Brazil does not underestimate the difficulties ahead but hopes that the recent funding of foreign indebtedness will give some relief for a period of a few years during which Brazil can pursue its efforts to develop exports. The continuation of fiscal and monetary policy measures of the stabilization programme should also help to create underlying conditions that will maintain overall balance in external payments. In this connexion, another member of the Committee expressed sympathy with Brazil in the problem of servicing foreign debt and urged that project assistance be continued to needy countries.

7. Other members noted with satisfaction that Brazil had eliminated certain practices, including some differential rates of exchange and discriminatory requirements such as the advance deposit and the financial charge on payment for imports. They looked forward to the disappearance of the guarantee deposit, which still amounts to 25 per cent on convertible currency imports, and hoped that bilateral agreements would soon be eliminated, as these features still tend to impede trade for other countries. The representative of Brazil assured the Committee that the Brazilian authorities also wish to eliminate the guarantee deposit as quickly as possible, as evidenced by the reduction of the deposit to the present level.

Alternative measures to restore equilibrium

8. From the outset of the consultation Brazil was congratulated on the comprehensive internal stabilization programme which had been undertaken. Its mixture of monetary, fiscal and exchange measures seemed well calculated to improve Brazil's position; members of the Committee viewed with sympathy Brazil's efforts to improve her economic position and wished Brazil success in continuing this reform through the introduction of more rather than less multilateralism. It would, of course, be important that Brazil persevere in application of the internal measures undertaken, whilst moving ahead towards removal of restrictions on trade and payments. Brazil in 1963 had presented a classical case of deficit financing carried to a point where inflation was in full swing. More recent developments presented in very nearly the same classical style an example of how a combination of fiscal and monetary measures could reverse this trend.

9. With respect to the overall position, they enquired what had been the trend of economic growth. In reply, the representative of Brazil confirmed that gross domestic product had grown in 1963 by only 1.6 per cent, but in 1964 the real product had risen by 3.1 per cent, and preliminary information suggests that there had been a 4.9 per cent increase in the first half of 1965. Other members of the Committee stressed the prime importance for Brazil of achieving price stabilization. In his reply, the representative of Brazil noted that in the same three years
annual increases in cost of living in Rio de Janeiro had been approximately 81 per cent, 87 per cent and 45 per cent respectively. Whilst this left much to be accomplished it did represent a considerable improvement, and Brazil intends to persevere in its efforts to eliminate the inflationary forces still evident in these figures. It was noted favourably that the budget position had much improved in Brazil and that new tax legislation has been enacted which promises to help maintain reasonable balance between revenue and expenditure by the Government. Delegates expressed interest however in Brazil's further efforts, particularly in the area of control of credit and budgetary expenditures. Concern was also expressed over the possibility that certain agricultural price support policies might interfere with the reduction of overall deficits in the public sector. The representative of Brazil assured the Committee that he would convey these views to his authorities but reminded them that an agricultural support system compatible with domestic needs would have to be retained and that no change could be effected overnight. He promised to see to it that consideration is given by Brazilian authorities to the views that had been expressed on this important question.

System and methods of the restriction

10. When it came to consideration of particular measures in the trade and exchange field members of the Committee again expressed satisfaction over the elimination of many of the measures which had been unfavourably commented upon eighteen months ago. They recognized that further improvement would have to come hand in hand with overall improvement, but looked forward to elimination of the guarantee deposit, and to elimination of the remaining bilateral agreements.

11. In connexion with guarantee deposits, one member noted that imports under AID financing are exempt from the 25 per cent guarantee deposit with the result that exporters in third countries are at a considerable disadvantage in trading with Brazil. The fact that such imports are also exempt from the $50,000 weekly limit on purchases of foreign exchange further increased the disability to exporters in other countries. It was hoped that these requirements could be eliminated under the heading of simplification, as had been urged by the International Monetary Fund. The representative of Brazil affirmed that it is a part of Brazil's longer-term planning to eliminate the guarantee deposit and the weekly limit of $50,000. It may even be possible to increase this limit in the near future. As for the alleged discrimination involved, however, Brazil could not agree that any real discrimination existed. The exemption results from the long-term nature of the financing of the AID imports and Brazil would accord the same treatment to other imports which might be offered on the same terms.

12. Interest was expressed in knowing what percentage of imports enter Brazil under the various systems: the general category versus the special category, from convertible and non-convertible currency areas, and what proportion of imports comes, for example, under AID loans. The representative of Brazil provided the table.
contained in Annex III in reply concerning the proportion of imports under the special and general categories. He stated that in the first nine months of 1965, some 10.2 per cent of imports were paid in inconvertible currencies and that the corresponding figure for 1964 (nine months) was 7.3 per cent. The first AID loan, amounting to US$150 million, has already been utilized and imports under this loan agreement amounted to about 15.5 per cent of total imports in 1965. The second AID loan agreement of the same value as the first, has only recently been signed and it is to be assumed that arrangements for its implementation are now under discussion in Rio de Janeiro. He added that the development of industry in Brazil has naturally involved some substitution of domestic products for imports and that this substitution of domestic products for imports has been taking place at the same time that importation within the special category has been restricted. Now that Brazil's capacity to import is improving, some of these restrictions are being removed, and Brazil hopes to continue to reduce the special category. But it will not be surprising if some products continue to be supplied domestically; to be sure, the Brazilian industries in question would probably be forced to rationalize their production in some cases in order to meet the competition of imports.

13. Members of the Committee enquired about the number of products recently transferred from special to general category. The representative of Brazil confirmed that a list of about 400 items and sub-items liberalized at the end of 1965 had been handed to the secretariat for restricted distribution. Another list of about 190 items and sub-items would be given to the secretariat in due course, and there exists a third list which was issued a few weeks ago; though smaller, it would certainly bring the total to more than 600. Members of the Committee thanked the representative of Brazil and said they looked forward to elimination of the special category, in the not too distant future. As for the timing of elimination of the special category, the representative of Brazil could give no promise, but he stated that he believed a further list would be forthcoming soon as a result of the work of a special working party of the Customs Policy Council.

14. A question was raised concerning a 10 per cent surcharge on most imports which had been reported as having come into effect last November. The representative of Brazil confirmed that products bound in the schedules to GATT and to LAFTA are not subject to the charge. The representative of Brazil was unable to say what proportion of imports might be subject to the charge, on the basis of 1965 imports, but he hoped to be able to provide this information when it is available.

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1 This list is available for reference use by interested contracting parties.
15. To an enquiry about the rôle of bilateral trade and payments agreements in Brazil's trading system, the representative of Brazil noted that no new agreements of this kind have been concluded with market economy countries. This should be evidence of Brazil's intention not to rely on bilateralism. There are only five agreements with countries parties to GATT considered to fall in this category: Denmark, Greece, Iceland, Israel and Portugal.

General

16. The Committee thanked the representative of Brazil for the interesting, frank and open exchange of views which he had made possible and for the wealth of information given and the competence with which it has been presented. The representative of Brazil in turn thanked the Committee for the interest displayed in Brazil's programme and promised to convey to his Government the views which had been expressed. He also reiterated his promise to furnish to the secretariat the information referred to in paragraph 14.
ANNEX I

International Monetary Fund Executive Board Decision Taken at the Conclusion of the Fund's Consultation With Brazil on 2 February 1966

1. 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.

2. The comprehensive program adopted by the Brazilian authorities in 1965 has produced beneficial effects on the economic and financial situation. The fiscal and balance of payments positions have improved markedly, the rate of price increases has slowed down considerably and some reduction was obtained in the rate of monetary expansion. After a temporary slow-down, economic activity appeared to have resumed its growth. The restrictive system was liberalized and a number of practices were simplified. There was also a substantial strengthening of the financial institutions. The major factors responsible for the advance made in 1965 were an effective action in regard to increases in wages and prices, fiscal restraints and the maintenance of a realistic exchange rate.

3. The Government has prepared a financial program for 1966 which aims at achieving virtual monetary stability by the end of the year through appropriate monetary measures, further fiscal improvements, other measures designed to check the rise in wages and prices, and the continuation of an adequate exchange rate policy. The Fund urges the authorities to adhere firmly to their program and to adopt such other measures as may be necessary to achieve the objectives of the program.

4. The implementation of the financial program would produce a consolidation of the improvement obtained in 1965 in the balance of payments. The policies of promotion and diversification of exports initiated in 1965 represent considerable progress and the Fund notes the intention of the authorities to continue with them as a means to improve the country's capacity to import. It urges Brazil to consolidate its foreign exchange reserve position and to improve the term structure of its foreign debt.
5. The Fund welcomes the simplification of the Brazilian exchange rate system and the reduction of restrictions and discrimination in foreign payments. Some of the remaining exchange practices are still complex and the Fund urges Brazil to take steps toward their simplification. The Fund also considers that the Brazilian economy would benefit considerably from the implementation of the announced policy to reduce trade restrictions. In the meantime, the Fund does not object to the maintenance on a temporary basis of Brazil's multiple currency practices and restrictions on payments for current international transactions as described in SM/66/11, Part II.

6. In concluding the 1965 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Brazil.
ANNEX II

OPENING STATEMENT BY THE REPRESENTATIVE OF BRAZIL

Balance-of-payments estimates for 1965 show that Brazilian foreign transactions presented a net surplus of about US$131 million. In relation to 1964, also a surplus year, this amount represented an increase of about US$91 million.

The current account transactions played an important role in obtaining that surplus. In 1965 exports attained a level never before reached, while imports were maintained at the lowest level ever registered in the last ten years. As a consequence, the balance of trade showed a US$590 million surplus.

Although "invisibles" presented an extraordinarily large deficit (minus US$400 million), as compared with the previous years, the surplus of US$590 million in the trade balance was sufficient to cover the deficit and still leave a disposable margin for meeting other foreign obligations.

Export estimates indicate that last year the 1964 level was surpassed to a considerable extent. The value of 1965 exports amounted to US$1,560 million. This increase was mostly due to larger exports of ores (hematite and manganese), manufactures and "other products". Export proceeds from coffee, cocoa and its derivatives and cotton, were smaller than those of the previous year by almost US$70 million.

Brazilian imports, in 1965, on the other hand, were estimated at US$970 million (f.o.b.), which represented a decrease of US$116 million, as compared with the year before. Such a reduction is attributed, particularly, to smaller imports of wheat, machinery and manufactures.

As to "services", they showed a significant increase, in 1965, in both directions. Receipts rose by US$118 million, while expenditures increased by US$192 million. The deficit on "invisibles" amounted to US$400 million, which represented an increase of US$74 million, in comparison with the 1964 deficit.

The inflow of autonomous capital during 1965 - investments and loans for the importation of equipment - totalled US$71 million. In 1964, the corresponding inflow amounted to US$121 million.
The utilization of compensatory credits, in the course of 1965, amounted to US$450 million. On the other hand, new swaps were contracted in an amount of US$105 million, while the capital inflow under the terms of Instruction No. 289, of the former Superintendency of Money and Credit - SUMOC - totalled US$174 million.

These inflows plus the surplus obtained, both in current account transactions and in the movement of autonomous capital, have permitted the country to reduce its debtor position regarding commercial arrears, swaps and short-term liabilities to foreign commercial bankers. In spite of a decrease in the gold reserves, it was possible to obtain an increase in the net exchange reserves, in an amount equivalent to US$300 million, at the end of 1965.

As to the external indebtedness, the net aggregate total in 1964, was equivalent to US$3,110 million. At the end of 1965, estimates show that this total was increased to US$3,115 million. It is of interest to register that, in the course of 1965, there took place a massive utilization of compensatory credits, the net total of which, at the end of the year, had increased by US$311 million, as compared with 1964.

In regard to indebtedness resulting from specific projects financing, there occurred, during the period, an increase of US$96 million.

A development of great significance that occurred during 1965 was the big reduction effected in "commercial arrears" and "swaps", due not only to the compensatory credits, but also to the surplus obtained in the "current transactions". The reduction of the debtor balance on these two items amounted to US$420 million, and the "commercial arrears" position was completely liquidated, in an amount of US$229 million. The decrease in the "swaps" position was of the order of US$191 million.

The balance-of-payments surplus obtained in 1965 permitted the liquidation of obligations previously assumed and brought about a significant improvement in the general exchange situation, at the close of the year.

Preliminary estimated data on the general exchange position reveal that, in spite of the rise of US$401 million in medium and long-term liabilities, attributed mainly to the compensatory credits utilization, the reduction in the short-term liabilities and the exceptional increment in the net assets with foreign bankers, contributed to an improvement in the global net exchange situation, to the extent of US$152 million, changing from US$2,717 million, at the end of 1964, to US$2,565 million, on 31 December 1965.
The results achieved by the exchange and trade policy which has been pursued since 1964, with a view to attaining an equilibrated economic development, may be considered auspicious.

Positive results have been obtained from the policies adopted by the Brazilian Government when it took office at the end of the first quarter of 1964. These include: an entire year of exchange rate stability; export growth and diversification resulting in a surplus in the balance of payments; and, without any special intervention in the exchange market, an increase in the net external reserves to a level not attained in many years.

The exchange devaluation effected in December 1964 not only represented one of the export-stimulating factors, but also accounted to a large extent for the relative reduction of imports in 1965. As a consequence, it has been possible to eliminate the chronic disequilibrium observed in the balance of payments, and also to improve the foreign financial position of the country; the latter, at the end of 1965, enjoyed a situation of complete solvency with foreign reserves above US$400 million.

Instruction No. 289, of 14 January 1965, of former SUMOC, contributed to a great extent to this situation, since its primary objective had been to bring in resources in foreign convertible currencies, as a significant contribution to a policy of restoring equilibrium in the balance of payments and at the same time of re-establishing net exchange reserves at an adequate level.

It was expected that after the external devaluation of the cruzeiro, imports would experience contraction, as in fact occurred. In order to stimulate imports, the weekly limit for exchange purchases for imports was raised and, as a result, the volume of imports at the beginning of last year had risen to the level registered in the months prior to the exchange rate increase.

On the other hand, the mechanism of Instruction No. 289, which was made operative simultaneously with the measures referred to above, not only permitted the Monetary Authorities to settle their obligations in foreign currencies arising from current transactions, swaps, interest and payments related to services of various kinds, but also placed them in a position to meet any increases in foreign exchange demand which might occur. Besides enabling the Exchange Department of the Bank of Brazil to buy foreign currencies and assuring the seller the right of repurchase, this Instruction has given Brazilian enterprises the possibility of obtaining financial resources outside the country at interest rates far below those prevailing in the internal market.

The exchange policy adopted in 1965, with a view to improving the economic and social development process of the country, established a special procedure applicable to the authorization of imports of equipment and machinery financed
by external loans for a term of less than eight years and excluded from the weekly limit the acquisition of exchange needed for imports financed with foreign loans repayable in periods of more than twenty years.

In accordance with Governmental economic policy, which has put special emphasis on the elimination of one of the main characteristics of the Brazilian economy in the last decades - the increasing deterioration of the internal value of the currency - exchange incentives were given to the firms which adhered to the price stabilization programme according to the terms of Interministerial Order No. 71. Those firms were permitted to utilize all the exchange proceeds of their own exports of manufactures.

As a part of a major plan of basic reforms in the Brazilian social and economic structure, the Central Bank of the Republic of Brazil was established by Law 4,595, of 31 December 1964 and began operations on 31 March 1965. That same Law terminated the Superintendency of Money and Credit - SUMOC - which had performed the role of a central bank up to that time; it also established the National Monetary Council and introduced modifications in monetary policy as well as in the monetary, financial and banking institutions.

In conformity with the Government's intention of gradually simplifying the exchange system, the Central Bank, through its Resolution No. 9 of 13 November 1965, eliminated advance deposits and the financial charge on payment for imports; at the same time, the financial charge on financial transfers was reduced from 30 per cent to 15 per cent. For firms complying with Interministerial Order No. 71, this charge was lowered to 10 per cent.

On the same date, the Bank of Brazil exchange rate was raised from Cr$1,825-1,850/US$(buying and selling rates respectively) to Cr$2,200-2,220/US$.

With these measures, which were taken simultaneously, the Government has tried to maintain a realistic value for the cruzeiro in relation to the United States dollar, taking into account the new level of internal prices and costs, which had changed since the last previous exchange readjustment effected in December 1964.

The elimination of the advance deposits and of the financial charge on import payments had the effect of lessening the impact of the exchange rate increase on internal prices, notably prices for fertilizers, equipment and raw materials essential to industry.
By means of procedures adopted for the economic and financial sectors, aiming at economic development and neutralization of the inflationary process, the Government is building up the necessary conditions for conducting its exchange policy in such a way as to permit the establishment of a single market for all transactions; as soon as possible it will eliminate the few multiple currency practices still existing.
ANNEX III

BRAZIL

Auctions for "Promises of Licence" for Imports of Special Category

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Note: Total Brazilian imports in 1964 were valued, on an f.o.b. basis, at US$1,086 million. A preliminary estimate, as of 28 February 1966, for 1965 imports on the same basis is US$970 million.

Sources: For 1965 data: IMF - Brazil, Consultation, Part II, pages 82-83 - 1965.
For 1964 data: SUMOC - Annual Report, 1964, Table 29.