1. In accordance with its terms of reference, the Committee has conducted the consultation with Brazil under Article XVIII:12(b). The Committee had before it a basic document for the consultation (BOP/44) together with a document circulated to members of the Committee entitled "Brazilian Proposal for Development Finance", a decision of the Executive Board of the International Monetary Fund, dated 8 June 1964 (see Annex II) and background documentation supplied by the Fund as mentioned in paragraph 3 below.

2. In conducting the consultation the Committee followed the Plan for such consultations recommended by the CONTRACTING PARTIES (BISD, Seventh Supplement, pages 97-98). The consultation was completed on 13 November 1964. The present report summarizes the main points of the discussion.

Consultation with the International Monetary Fund

3. Pursuant to the provisions of Article XV of the General Agreement, the CONTRACTING PARTIES had invited the International Monetary Fund to consult with them in connexion with this consultation with Brazil. In accordance with the agreed procedure, the representative of the Fund was invited to make a statement supplementing the Fund's documentation concerning the position of Brazil. The statement made was as follows:

"The International Monetary Fund has transmitted to the CONTRACTING PARTIES the Executive Board decision and background material from the last consultation with Brazil under Article XIV of the Fund Agreement.

"The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of June 8, 1964, taken at the conclusion of its latest consultation with Brazil."
Subsequently, the Brazilian authorities have introduced various measures affecting the exchange system, of which the most important are:

(a) simplified treatment of coffee export receipts, effective July 1, 1964;
(b) the introduction of a tax on all purchases of foreign exchange subject to advance deposit requirements (the initial rate of 20 per cent, effective August 1, 1964, was increased to 30 per cent by an Instruction issued September 22, 1964); (c) a reduction of the advance deposit requirements, previously 100 per cent or 200 per cent, to 60 per cent (effective August 1, 1964), and then to 50 per cent (effective October 1, 1964), in the case of import payments not exempt from deposit requirements; (d) a reduction in advance deposit requirements from 100 per cent to 90 per cent (effective October 1, 1964) in the case of most invisible payments; and (e) a requirement (effective September 10, 1964) that commercial banks obtain, in connexion with contracts to purchase convertible foreign currency, guarantee deposits amounting to 100 per cent of the value of each contract (previously, the legally required deposit had been 10 per cent, but banks generally had been collecting substantially higher percentages). The authorities have also placed before Congress measures in the fiscal and monetary field. These include income, stamp and consumption taxes to take effect in 1965, and a banking reform bill to provide more effective control of credit. Brazil is engaged in negotiations with individual countries aimed at securing rescheduling of external obligations, along lines agreed upon in principle in Paris in June 1964. Other internal measures in a programme of monetary stabilization are under consideration.

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

Balance-of-payments position and prospects

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

5. The Committee welcomed the description of Brazil's immediate plans to overcome its difficulties through a short-term stabilization programme. They were pleased to note the Government's intention to allow the exchange rate to respond to supply and demand pending the establishment of a realistic unified exchange rate. They also expressed appreciation of the declaration by the representative of Brazil that these moves are to be regarded as first steps toward liberalization and expansion of foreign trade. The Committee wished Brazil well in its ambitious and comprehensive stabilization programme.
6. With respect to capital movements, the representative of Brazil said, in response to a question, that the adoption of the new foreign-remittance law but had the effect of providing a basis for a revival of confidence. It would naturally be essential, he realized, that domestic stabilization be assured before a renewed flow of investment capital could be expected, but once that was accomplished, he believed that the long-run prospects for a revival of foreign investment were good. A member of the Committee called attention to the fact that net inflow of capital had been negative by a large margin when remittances had been restricted, positive when they were relatively free, and again negative in a stage beginning in September 1962, when restrictions on profit remittances had again been tightened. In reply, the representative of Brazil said he thought the new law was a reasonable one and that when its administration had been worked out it would provide no more than the necessary control of remittances. He added that the control of remittances would not as a rule bother normal industrial investors.

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

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

9. The Committee recognized that Brazil's comprehensive stabilization programme had only just begun and that it might be difficult to give much report, at this stage, on its effects. The representative of Brazil stated that while the immediate reaction to announcement of the programme had been some sharp increases in prices of wheat and petroleum products, it appeared that the overall rate of increase in prices had been slowed to something like 2 or 3 per cent per month. As indicated in the document "Brazilian Proposal for Development Finance", which contains an authoritative description of current policies, the Government is fully aware that inflation must be checked as soon as possible.

System and methods of the restrictions

10. Members of the Committee welcomed the reductions in the percentages of the value of imports required to be deposited in advance but noted that the effects of this appeared to have been offset by the new exchange tax. In view of the substantial obstacle to trade which the advance deposits represent they enquired when it was expected that they could be removed. They also noted the statement in the paper "Brazilian Proposal for Development Finance" to the effect that all compulsory deposits were to be eliminated (Chapter IV, page 2, under heading III(c)). They welcomed the statement by the representative of Brazil that the recently imposed exchange tax would be temporary and would be removed as quickly as possible. At present members found it difficult to be sure that there was a net easing of the burden on importers. One member doubted whether the advance deposits were useful in combatting inflation since funds were tied up over long periods of time so that importers were forced to charge correspondingly higher prices.

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

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

13. In response to a question concerning prevailing limits on the amounts of foreign exchange which an importer may purchase during any one week, the representative of Brazil stated that the limit is $30,000 for convertible currencies and $20,000 for inconvertible currencies, mostly for trade under bilateral agreements; these limitations were however of no great practical importance since the Bank of Brazil usually waived the limitation in case an importer's needs exceeded these amounts.

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

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

General

16. In summary, the Committee appreciated the difficulty of the problem facing the new Government of Brazil and noted that some measures in the right direction have been taken. One member noted that his own government's view was reflected in the fact that it was sharing in the discussions looking towards a refinancing of Brazil's medium-term debt. They felt, at the same time, that even if temporary curtailment of imports were necessary, it should be placed on a basis of equal
opportunity for all supplying countries; some felt that the regulations made it
difficult and expensive to import into Brazil and that even if the quantity of
imports had to be limited temporarily the various financial charges constituted
an unnecessary inflationary pressure and burden on import trade, which was thus
confined to importers having very great resources in cash or credit. It was,
they repeated, the requirement that 50 or 100 per cent of the value of the import
be kept on deposit for 210 days, the 30 per cent financial charge and the weekly
limits on exchange purchases which created these unnecessary burdens. In addition
there is a requirement for commercial banks to obtain guarantee deposits in
connexion with contracts to purchase convertible currency, amounting to
100 per cent of the value of the contract.

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

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