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Working Paper for Discussions on the Economic and Financial Program for 1970

Prepared by Fund Mission

December 17, 1969

1. Introduction

This paper provides background material for the policy discussions that will be taking place this week, outlines the mission's understanding of certain policy aims of the authorities, and presents the mission's preliminary views on the major policy questions that will be dealt with in the preparation of a letter of intent requesting a new stand-by arrangement.

2. Macro-economic relationships

Brazilian officials consider it feasible to aim for a rate of growth of 7-8 per cent in 1970, notwithstanding the impact of the projected decline in coffee production. To obtain the afore-mentioned rate of growth would require that the noncoffee sector expand by around 9 per cent next year. Such a growth rate is considered feasible by Brazilian officials because of the favorable prospects for agricultural production other than coffee (based on information on plantings, seed and fertilizer purchases by the agricultural sector, etc.), and the capacity situation in industry. On the latter, the mission finds it difficult to form a judgment on the basis of the data available. Since the trough in economic activity early in 1967, industrial production may have expanded by as much as 40 per cent, which by itself would suggest that excess capacity has been reduced sharply. However, the degree of underutilization of capacity at the beginning of this expansionary phase is not known (it may have been very large), and, moreover, there is evidence that substantial investments have been made in the industrial sector in the last two to three years. Obviously, these observations do not point to any clear conclusion on how rapidly industry may be expected to grow in 1970, but rather they raise enough doubts about the underlying situation in the industrial sector to caution against making a particular industrial growth rate a major objective and bending all policies to that end.

Brazilian officials have indicated that they wish to frame policies for 1970 that would be consistent with limiting the price rise to 15 per cent during the course of the year. In response to a question from the mission as to whether it would not be possible to try to secure a sharper deceleration in the rate of inflation in 1970--reducing the targeted price rise to, say, 10 per cent--the Brazilian authorities observed that with the wage formula in use such a price goal would imply a fairly sizable shift in the distribution of income and/or a dampening of the rate of growth, bringing in their wake additional problems that could even lead to the demand for corrective measures that would result in higher rates of inflation in subsequent years. According to the official projections, a price rise of 15 per cent is compatible with an increase in remuneration per employee of 20 per cent from late 1969 to late 1970 (this states in another way the Minister of Finance's projection of a 23 per cent yearly average rise in wages from 1969 to 1970), and, at the same time, such a price increase would be compatible with the aforementioned path of wage changes as determined by the formula. That is, the price and wage movements would be mutually consistent taking into account their interaction through the wage formula, assuming that one of the constraints is to avoid any noticeable changes in the distribution of income. Implicit in the official estimates is an over-all increase in productivity of 4.5 per cent in 1970, with virtually all of this coming from industry and agriculture, which together represent approximately three fifths of value added in the economy.

Regarding pricing policies, Brazilian officials indicated that they plan to introduce greater flexibility in the control over industrial prices, to aim at bringing minimum prices under the agricultural support program in line with those prevailing in international markets, and to achieve some changes in relative prices by modifications of industrial protection arrangements (this last-mentioned item is taken up again below). Apparently, the most importan~~ce~~t divergence between domestic minimum prices and international prices is that for wheat, but it would be of interest to the mission to have the comparison between the two sets of prices for all of the major commodities.

3. **Fiscal policy**

Uncertainties as to the outturn of Treasury fiscal operations in 1969 introduce some complications in making projections for 1970. These uncertainties are largely on the side of expenditures, but they also exist in revenues.

Beginning with revenues, final results for the first ten months of the year and the preliminary estimate for November indicate that the revised projection NCr $ 13.8 billion will be met easily, and it could be exceeded by as much as NCr$ 300 million. A figure in the range of NCr$ 13.8 billion and NCr$ 14.1 billion would be 5-8 per cent higher than the original forecast contained in the cash fiscal program. Finally, the excess over the initial projection would have been higher by an amount equivalent to 1-1.5 per cent of total revenues if certain scheduled income tax payments had not been postponed to 1970.

On cash expenditures, there are two kinds of uncertainties on the outcome for 1969. They relate to the probable over-all level of spending and to the division of expenditures between what might be termed the "normal" flow and the catching up with the backlog of payments due from the past. As regards the over-all level, the latest official estimate is NCr$ 14.6 billion, or about 7 per cent higher than originally planned. The mission would not be surprised, however, if the final figure turned out to be as low as NCr$ 14.2 billion. Taking into account the revenue figures noted in the previous paragraph, the deficit for the year could range from NCr$ 100 million to NCr$ 800 million; these figures compare with a known surplus of NCr$ 80 million through October and an estimated deficit of NCr$ 165 million through November.

The second problem confronted in interpreting expenditure data is to obtain a meaningful discrimination between "normal" Treasury spending and the once-and-for-all expenditures that seem to have taken place this year. The mission understands that the estimates for this second category of expenditures range from NCr$ 400 million to NCr$ 700 million; the staff of the Ministry of Finance is trying to secure a single best estimate of such nonrecurring expenditures.

Turning now to the fiscal plan for 1970, it is first necessary to narrow the range of the afore-mentioned figures for 1969 in order to have adequate basis for the projections for the coming year, and, second, it is necessary to make the policy objectives explicit. An example of how these problems might be approached may be helpful. Suppose that the best estimates of the results for 1969 are as follows:

(In billions of new cruzeiros)

Revenues	13.9	
Expenditures		
Normal	14.0	
Once-and-for-all	0.5	
Total	14.5	
Deficit	-0.5	− 0.6
"True" (?) deficit	-0.1	(normal expenditures minus revenues)

Suppose further that it is decided as a matter of long-term policy that the ratio of expenditures to GDP should remain fairly stable, exempting from this rule expenditures based on earmarked taxes such as the ones on petroleum and electricity which are channeled to sector investment programs. Assuming that GDP in current prices will rise about 23 per cent in 1970, the foregoing policy aim would mean that "normal" expenditures would be permitted to rise by NCr$ 3.2 billion, plus the projected increase in certain earmarked expenditures over and above the standard 23 per cent rate of increase; this latter adjustment would add about NCR$ 400 million to the permissible level of spending, raising the planned total for 1970 to NCr$ 17.6 billion. On the basis of the preliminary revenue projection for 1970 (NCr$ 17.4-17.5 billion), it would appear that the deficit would be virtually eliminated, which may well be what actually will occur in 1969 if the figure on the "true" deficit in the above table is approximately correct. It should be noted that in the foregoing nothing was said separately about the wage increase for public employees and there was no special provision in expenditures for a wage increase in excess of 15 per cent that had been contemplated when the budget for 1970 was drawn up earlier this year. The reason for this is that according to the logic of the above way of looking at things, so long as the Federal Government's wage bill does not rise by more than 23 per cent (and we understand that the authorities are hoping to keep the increase to less than this), it only maintains its share in total spending and does not give rise to special difficulties.

Another approach to planning expenditures for 1970 would be to start with the budget approved for 1970 earlier this year, that called for total spending of NCr$ 17.65 billion,

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and then add to this the additional amounts needed for the special salary payment increase that went into effect during the second half of 1969 and for the general wage increase (over and above the budgeted 15 per cent) for 1970. This would indicate a cash expenditure plan for 1970 in the range NCr$ 18.2-18.3 billion, and taken in conjunction with the revenue projection for next year would imply a deficit of NCr$ 800 million. The doubts we have about this approach is that even though the 1970 budget was drawn up much more realistically than in the past, it still did not represent a complete union of the budget and cash approaches to fiscal programing. Comparing the original fiscal cash program for 1969 with the budget for 1970 shows a potential expenditure increase of close to 30 per cent, notwithstanding the fact that wages--which have been representing more than 45 per cent of Treasury spending--were scheduled at that time to go up only 15 per cent from 1969 to 1970; executing such a budget would mean that nonwage expenditures would show a rise of close to 40 per cent, and even when adjusting the base for the rise in spending in 1969 above the amount indicated in the original program the increase in nonwage expenditures would still be at least 35 per cent.

Such an increase would not be in line with the approach of trying to keep the public sector from growing in relation to the rest of the economy. It might be noted that the figure of NCr$ 17.6 billion suggested above (as being compatible with the public sector expenditure policy of the authorities as we understand it) would imply an increase of 26-27 per cent for the nonwage expenditure categories.

Reducing the planned deficit for 1970 from NCr$ 800 million to a rather small figure would open up considerable room for additional private investment, in keeping with the policy objectives of the authorities of achieving and sustaining a rate of growth considerably higher than has customarily been regarded as adequate. In this vein, the view of the mission is that it would be desirable to reduce the deficit as much as possible in the short run, and in the longer run it may even be appropriate to strive for a surplus that could be channeled to private investment.

Concluding on fiscal policy, the discussion on expenditure control mechanisms and the strategy behind them was very interesting and useful. Summarizing very briefly, in recent years there has been progress toward bringing the budget and fiscal cash program closer together and in establishing global cash plans that are based on realistic estimates of resources available. It appears, however, that the decentralization achieved in the expenditure process has introduced considerable uncertainty as to possible flow of spending. It was explained that it will take some time for spending agencies to become accustomed to the fact that they are not captives of the calendar, but the authorities are confident that this aspect of their expenditure mechanism should not cause trouble in the longer run. Moreover, they pointed out that they still have available enough control levers to make modifications rather speedily in the rhythm of spending if needed.

However, the mission is not sure that the control mechanism is sufficiently precise, particularly in the light of the new arrangements whereby credits of ministries and agencies may be carried over from one year to the next. First, it is our understanding that once the fiscal cash program is approved, the ministries and agencies can commit the full amount alloted to them for the year. Thus, control over liberations during the course of the year means that cash spending could be regulated but not total spending, including in the latter any buildup of unpaid bills. Second, with the new provision for the carryover of credits, the control over liberations by the Financial Programing Commission may not even mean much control over cash spending, at least not over a period that is sufficiently long to create problems for the financial authorities. This last observation takes on added force when due account is taken of the apparent large size of credit balances in relation to the variable expenditures of the Federal Government.

Apart from some doubts we have on the decentralized control mechanism in terms of what it implies with respect to the capability of maintaining total spending within some specified level, it seems to the mission that an equally pressing question concerns the efficacy of present arrangements in controlling the quality of expenditures. This concerns the whole process of setting priorities, translating them into budgetary programs, and then seeing that the priorities are indeed reflected in actual expenditures.

4. Coffee policy

Coffee operations are expected to yield a substantial surplus in 1970, but this surplus is not projected to rise very much in relation to the cruzeiro value of exports. In view of the decline in the size of the crop, this limited rise in the surplus appears to reflect plans for large-scale assistance (of the order of NCr$ 700 million) to the coffee sector for relief, rehabilitation, and expansion.

While the case for assistance can be made on several grounds, there is a question as to whether the scale on which it is being contemplated, joined to the improvement in the price of coffee relative to other agricultural products that has recently taken place, will not provide too much stimulus to the expansion of coffee production. The mission is putting these remarks forward as queries because it does not pretend to have any special knowledge of the economics of the coffee sector.

It is the mission's understanding that the authorities intend to continue the policy of gradually adjusting upward the price at which coffee is sold for domestic consumption. This problem would seem to require immediate attention in view of the sharp rise in international and domestic support prices.

5. Over-all financial policy

On the basis of firm figures through October, preliminary estimates for November, and projections for December, it appears that the change in the net domestic credit of the monetary authorities will be negative this year. After allowing for the expansionary impact of the reduction in reserve requirements and the possible downward adjustment of the cash ratio for banks which follow specified interest rate policies, the over-all change during 1969 would appear to be virtually zero.

For the banking system as a whole, monetary liabilities to the private sector will probably end up showing an increase of around 24 per cent, moderately higher than had been expected but considerably below the rise in GDP in current prices over this period; the latter probably will show a rise of 30-32 per cent. The net foreign reserve gain of the entire banking system will probably be around $500 million over the whole year, or roughly $375 million more than had been programed. This latter difference is very close, when valued in cruzeiros, to the amount by which the net credit of the monetary authorities has been held below the limit stipulated in the monetary budget for 1969.

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Regarding the plan for 1970, the first draft of the monetary budget contemplates an increase in the net domestic credit of the monetary authorities of NCr$ 2.4 billion, envisages a growth in monetary liabilities of around 22 per cent, and forecasts a net foreign reserve gain of $56 million. The preliminary estimates for 1969 and the plan for 1970--for the whole banking system--may be compared in the following way:

(Changes Measured as Per Cent of Monetary Liabilities to Private Sector at Beginning of Period)

	1969	1970
Net foreign reserves	9	1
Net domestic credit	15	21
Money and quasi-money of private sector	24	22

Our first observation is that it would seem prudent to count on a smaller growth in money and quasi-money in conjunction with the projected growth in GDP in current prices of around 23 per cent (15 per cent price rise and 7-8 per cent growth in output). In 1969 there has been a decline in the ratio of private money and quasi-money in relation to GDP, and it would seem safe to plan on this basis for next year, particularly if an important policy objective is to ensure insofar as possible that the rate of inflation is brought down to 15 per cent next year. The second observation is that with an 11 per cent projected rise in exports it would not seem unreasonable to plan on a net foreign reserve gain sufficient to cover the debt payments of the monetary authorities in the coming year; a planning figure of about $100 million (compared with $56 million in the draft monetary budget) would not appear inappropriate.

On these bases, the mission would suggest the following general outline for the monetary budget; the table below compares this suggestion with the draft presentation of the Economic Department of the Central Bank.

Changes in Principal Accounts of Monetary Authorities, 1970

(In millions of new cruzeiros)

	DEPEC	Mission
Net foreign reserves	240	430
Net domestic credit	2,392	1,750
Monetary liabilities	2,632	2,180

In the DEPEC presentation the monetary liabilities are projected to grow by a little less than 21 per cent while in the mission's plan they would rise by a little more than 17 per cent. If there should be a further cutback in 1970 in the desired ratio of liquid asset holdings to GDP similar to the one that appears to have occurred in 1969, the mission's projected growth in monetary liabilities would be consistent with a rise in GDP in current prices of around 23 per cent. It might be noted that the mission's suggested increase in net domestic credit for 1970 would be the same as the original plan for 1969, an approach consistent with a general scheme of gradually reducing the rate of inflation.

If the desired growth in monetary liabilities in 1970 should recover to match the projected rise in GDP, then the increase in net foreign reserves would be larger than shown in the above table, a development which we understand would be very much welcomed by the authorities. Indeed, we understand that the DEPEC monetary budget contains, in effect, unallocated margins under the net domestic credit category for the purpose of fitting into the plan the possibility of net foreign gains larger than are shown explicitly in the plan. Thus, the two approaches are essentially similar, but the mission considers it better from the planning standpoint to leave these margins outside the credit concept.

Taking into account the SDR allocation that will come on January 2, 1970, the mission's suggested monetary plan for the monetary authorities would look as follows, taking into account the fact that the SDR holdings will be part of net foreign reserves and the contra-entry of the first SDR allocation would be equivalent to negative credit:

Changes in Principal Accounts of Monetary Authorities, 1970

(In millions of new cruzeiros)

	On January 2, 1970	Ordinary Operations Rest of Year	Total for Year
Net foreign reserves	250[1]	430	680
Net domestic credit	-250[1]	1,750	1,500
Monetary liabilities	--	~~400~~ 2180	2,180

[1] This figure is rounded crudely since the precise SDR allocation will not be known until end of this year.

6. Exchange policy

It is the mission's understanding that the authorities are not contemplating any changes in the system of exchange rate adjustments.

On other exchange policies, the mission does not have any queries, and it is assuming that the authorities will continue the policy of not introducing any new restrictions or multiple currency practices. Regarding the remaining bilateral payments agreements with Fund members, the mission is supposing that it would not be inappropriate to indicate again in the letter of intent Brazil's readiness to participate in meetings organized by the Fund with a view to terminating bilateral payments agreements.

7. Foreign debt policies

In the letter of intent, the mission plans to record the changes in policies with respect to foreign borrowing under Resolution 63 and SUMOC 289 foreign credits, and the modification of registration procedures for 4131 credits. These will also be a general description of what the authorities are aiming at in terms of foreign debt control, including the creation and organization of CEMPEX. References to the control of suppliers' credits to the public sector with a maturity of less than eight years will be dropped, inasmuch as this is not a procedure that is operative in practice.

Data on K-inflow & L. on indebtedness

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8. Foreign trade policies

Foreign trade policies are currently under review in Brazil, with the general objective being to reduce the degree of protection, and in particular to eliminate some of the specific disadvantages that have hampered the agricultural sector. With respect to the latter, it is planned to lower the costs of certain agricultural inputs by reducing tariffs and by cutting back "nationalization" requirements.

More broadly on tariff policy, Brazilian officials have noted the burdens excessive protection has placed upon certain domestic and export-oriented sectors, and the general objective, as we understand it, is to eliminate (or at least reduce considerably) the protection offered to industries that probably can never hope to be competitive by international standards. As we understand it, the basic strategy that it is hoped to be able to implement over time might best be described as "dynamic" infant industry protection. That is, on a case-by-case (or industry-by-industry) basis, ground rules will be established on the term for which industries may expect to receive protection, reflecting an estimation of the (reasonable) period for which protection is needed to demonstrate whether the affected industries can prove themselves viable.

It is easy in principle to see merit in and to accept guidelines such as those just described. However, the mission wonders whether it is in practice possible to implement an effective infant industries policy that is sufficiently "dynamic" to prevent giving protection to industries long after they have had a reasonable time period to demonstrate their long-run viability. A policy that would be considerably easier to administer and that does not appear unreasonable would be somewhat like the following: embark on a policy of cutting tariffs by a fixed percentage, year-after-year, for a period as long as ten years, with a view to bringing tariff rates down to the levels approximating those of the so-called advanced countries. With its flexible exchange rate policy, Brazil could easily counter undesirable balance of payments and employment effects stemming from such a tariff policy. Given the blossoming of a nontraditional export sector that is now evident, such a policy of reducing protection may be expected to lead to much higher exports and imports in relation to GDP, but it is hardly likely that this would in any sense damage Brazil's long-term growth prospects, as is so often feared.

Table . Exchange Rate and Domestic Price Movements

	Exchange Rate				Wholesale Prices (Corresponding Month)	
Date Effective	Buying Rate (In NCr$ per US$)	Selling Rate	Index	Days from Previous Change	(Aug. 1968=100)	(Sept. 1968=100)
1964						
December	1.825	1.850		--		
1965						
November 13	2.200	2.220		--		
1967						
February 9	2.700	2.715		--		
1968						
January 4	3.200	3.220		--		
August 27	3.630	3.650	100.0	--	100.0	--
September 24	3.675	3.700	101.4	28	102.5	100.0
November 19	3.745	3.770	103.3	56	106.7	104.1
December 9	3.805	3.830	104.9	20	106.9	104.3
1969						
February 4	3.905	3.930	107.7	56	110.1	107.4
March 19	3.975	4.000	109.6	43	109.3	106.7
May 13	4.025	4.050	110.9	55	111.5	108.8
July 7	4.075	4.100	112.3	55	116.1	113.2
August 27	4.125	4.150	113.7	51	118.7	115.7
October 3	4.185	4.210	115.3	37	...	...
November 14	4.265	4.290	117.5	42	...	...

Sources: Central Bank of Brazil; Getúlio Vargas Foundation; and staff estimates.

Office Memorandum

TO : Mr. Finch and Mr. Beza

DATE: December 24, 1969

FROM : S.J. Anjaria SJA

SUBJECT : Brazil - Changes in the Exchange System During 1969

The following is a summary of information relating to the more recent developments in the Brazilian exchange system collected on the recent stand-by mission to Brazil.

1. Exchange tax on exports of cocoa derivatives

A 5 per cent exchange tax on proceeds of exports of cocoa derivatives continues to be levied. However, according to Resolution No. 126 of the Central Bank, of October 17, 1969, this tax was temporarily suspended for exports of the derivative equivalent of 250,000 bags of cocoa beans. The cocoa derivatives are cocoa butter and cocoa cake, and for the purpose of establishing the equivalence between one 60-kilogram bag of cocoa beans and its derivatives, it was assumed that 20 per cent of cocoa beans are lost in the processing and it was provided that the other 80 per cent be divided between butter and cake in the ratio 43:57. On this basis, proceeds from exports of 684,000 kilograms of cake and 516,000 kilograms of butter were exempted from the 5 per cent tax. It was stated that this was a once-and-for-all measure designed to enable Brazilian exporters to compete more effectively with certain African exports of cocoa derivatives. However, the authorities indicated that this was not the first time that such an exemption from the exchange tax had been made, and that a similar resolution had been applied in 1964 and 1965.

2. Contribution quota on proceeds from exports of green coffee

The system as described in Part II of the latest consultation report remains unchanged. During 1969 the fixed cruzeiro return to exporters of green coffee was changed seven times, as compared with four times during 1968. The minimum registration prices were changed five times in 1969, as compared to only once during 1968. These changes were approximately in line with movements in the official exchange rates of the monetary authorities; since August 1968, when the policy of frequent exchange rate adjustment was introduced, the proportion of effective rates for coffee exports to the monetary authorities' buying rates has varied between 56 per cent to 60 per cent,1/ reflecting the policy of the authorities to maintain the tax burden of the contribution quota at more or less constant levels.

1/ Refers to sales of green coffee, washed, any port, at applicable minimum registration prices.

3. Deviations in sale price of exports of green coffee from the minimum registration price

According to Resolution No. 478 of the Brazilian Coffee Institute, dated October 16, 1969, the price at which the sale of green coffee is registered may not be lower than the minimum registration price by more than $0.01 per pound for exports of coffee free of "Rio Zone taste" and by more than $0.015 per pound for exports of coffee with "Rio Zone taste." Previously, these limits had been $0.02 and $0.03 per pound, respectively. It appears that the change in the maximum permissible downward deviations from the minimum registration price is designed to improve the control of the Coffee Institute over the marketing of coffee. The previous limits of $0.02 and $0.03 had been in force since 1967.

4. Tax on exports of soluble coffee to the United States

GECAM Announcement No. 122 of October 29, 1969, regulates a tax equivalent to $0.13 per pound on exports of soluble coffee to the United States in accordance with the agreed text of the draft resolution discussed between the Western Hemisphere, Legal, and Exchange and Trade Relations Departments, and the Brazilian authorities during the 1969 Annual Meeting in Washington, D.C. Decree Law No. 557 of April 29, 1969 established the tax on exports effected after April 30, 1969.

5. Imports destined to the Manaus Free Zone

In accordance with Central Bank Resolution No. 127 of October 23, 1969, imports destined to the Manaus Free Zone may be paid for only in that Zone and through banks authorized to carry out exchange transactions. In response to questions from the staff, the authorities stated that this measure was designed to exercise a better control over duty free imports into that Zone by channeling payments through local banks and not meant to restrict payments for imports in any way.

6. Bilateral payments agreements

With the exception of the payments agreement with the U.S.S.R., which was terminated on April 30, 1969, Brazil continues to maintain the agreements which had been in force in 1968. Of the nine existing agreements, four are with Fund member countries (Iceland, Israel, Greece, and Yugoslavia). In previous years the authorities had undertaken switch transactions involving sales of accumulated bilateral balances which gave rise to multiple currency practices. The Brazilians said that no switch transactions were undertaken in 1969. Regarding the claim of the Israeli authorities that the Foreign Trade Department of the Bank of Brazil gives preferential treatment to imports under bilateral agreements, the authorities denied once again any knowledge of such preferential treatment, either to imports from Israel or to imports from bilateral partners in general.

cc: Mr. Nicoletopoulos
Mr. Silard
Mr. Restrepo

SEC-54,465
Translated by F.Neter
Reviewed by E.M.Robinson
125100

cc: ERD

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INTERFUND FOR JORGE DEL CANTO WASHINGTON DC

WE INFORM YOU BANCENTRAL, THROUGH GECAM ANNOUNCEMENT 130 OF TODAY, FIXED FOLLOWING RATES EFFECTIVE BEGINNING DECEMBER 18 BUYING AND SELLING US DOLLAR OR EQUIVALENT OTHER CURRENCIES 4.3250 AND 4.3500 RESPECTIVELY. REGARDS

MAURICIO FERREIRA BACELLAR, EXECUTIVE OFFICER PRESIDENCY

Received in Cable Room
December 18, 1969

Orig: WHD
cc: MD
DMD
Mr. Kafka
ETRD
LEG

cross filed
Brazil - Israel TPA

Mr. Finch September 4, 1969

Maria O. Tyler

Brazil--Bilateralism

During this year's consultation/stand-by missions to Brazil and Israel the following points arose regarding the possibility of terminating the bilateral payments agreements between the two countries.

The Brazilian representatives stated that there were no difficulties on the Brazilian side in terminating the agreement. They said, however, that Israel was not willing to go ahead with the termination. When this information was relayed by the Fund staff to the Israel authorities during the mission to Israel in May, the Israel representatives replied that the operation of Brazil's exchange and trade control system resulted in preferential treatment to imports from Israel, and that in these circumstances Israel could not see its way clear to abolish this agreement. Upon return to Washington Mr. Evensen, after consultation with other members of the staff, sent a letter to Israel confirming the staff's understanding that Brazil did not discriminate in favor of bilateral payments agreement countries. The issue was raised again, however, with the Brazilian authorities during the recent stand-by review, and, as on previous occasions, the staff was told that the Brazilian exchange and trade system did not grant preferential treatment to any imports from bilateral payment agreement countries.

In the meantime the Israel authorities followed up this matter through their Embassy in Rio and informed Mr. Evensen of their findings in a letter dated August 21, 1969, copy of which is attached. In it, the Israel authorities claim that preferential treatment is given in general to imports paid for out of bilateral clearing balances.

It may be noted that trade between Brazil and Israel has been insignificant. Imports from Israel have consisted mainly of potassic fertilizer, while exports to Israel have included lumber, meat, and iron and steel; Brazil does not export coffee to Israel. The small credit balance which Brazil has maintained on this account at the end of each year during 1965-1968 has reverted to a minor debit balance in 1969. It has always been our understanding--confirmed during numerous discussions in recent missions--that the guia de importacao (import certificate) which is required for the bulk of imports into Brazil, is issued by the Foreign Trade Department of the Bank of Brazil freely and without discrimination.

The forthcoming annual meeting may offer an opportunity to clarify the issue with the Brazilian delegation.

Attachment

cc: Mr. Beza
Mr. Evensen
Mr. Hughes

MINISTRY FOR FOREIGN AFFAIRS
JERUSALEM, ISRAEL

משרד החוץ
ירושלים

Jerusalem, 21 August 1969

Mr. Rolf Evensen
Assistant Director
European Department
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Evensen,

Thank you for your letter of 16 July concerning Brazil's trading arrangements, receipt of which was acknowledged during my absence.

I have asked our Embassy in Rio de Janeiro to look into this matter and have now been informed that the Foreign Trade Department of the Bank of Brazil accords priority to imports paid for out of clearing balances.

Yours sincerely,

A. Chelouche,
Assistant Director-General

Mr. Kafka August 26, 1969

Sterie T. Beza, C. David Finch, and George Nicoletopoulos

Brazil--Tax on Exports of Soluble Coffee to the U.S.

Decree-Law No. 557 of April 29, 1969 imposes a tax on the export of soluble coffee to the U.S. (Art. 1), and provides that "the payment to the exporter shall be contingent upon proof that the tax was paid in full" (Art. 3). As the staff understands the existing practice with respect to which the reference to "payment" is made in the Decree, the payment of the Brazilian currency equivalent is made to the exporter by the commercial bank which is the collecting agent for the exporter of the foreign exchange which the exporter must surrender to the commercial bank. Art. 5 of the Decree provides that the implementing regulations are to be issued by the Central Bank.

In the staff's view this Decree does not in itself give rise to a multiple currency practice, but it raises the question whether the method of its implementation conforms to what appears to be the legislative intent of levying an export tax rather than to introduce a multiple currency practice.

A draft of the Central Bank's implementing regulations has been provided for the staff's examination by the Brazilian authorities with a request for comment in the light of the stated desire of the authorities to avoid creation of a multiple currency practice. The draft regulations provide that "the tax shall be fixed in the instrument constituting the exchange contract" and that it "must be collected by the intervening banking establishment on or before the date on which it acts to settle the exchange operation" (Sec. 2). It is also provided that "cancellation of the exchange contract as a result of nonshipment of the merchandise extinguishes the obligation to pay the tax" (Sec. 8).

The draft regulations interweave so closely the transactional and the exchange aspects of the tax that it would be difficult to conclude that they implement the tax on exports rather than a tax on the surrender of exchange which is obtained from the export transaction.

The staff considers that the unwanted implication of an exchange tax, and hence a multiple currency practice, would be avoided if the draft regulations were to be reformulated along the following lines:

1. The regulations should clearly state that the tax is levied on the export transaction. This would be supported by the requirement that evidence be presented before the shipment of soluble coffee may be made to the

U.S. that the tax has been paid or that appropriate arrangements for its payment in the future have been made. For example, an undertaking by the intervening commercial bank to pay the tax out of the proceeds on behalf of the exporter would be appropriate for this purpose. The regulations should make it clear, however, that the tax obligation exists independently of payment to the exporter. Exemption from the requirement to pay the tax may be provided for certain categories, as for example promotional exports or gifts.

2. The tax should be fixed in an instrument or form which is formally independent of the exchange contract, and it would be desirable to avoid any reference to the exchange contract in the regulations.

Attachments

SASilard/vh

Translated by C. Ernst
Reviewed by K. Magurn

Rio de Janeiro,

GECAM ANNOUNCEMENT NO.

EXPORT TAX ON SOLUBLE COFFEE

We inform those concerned that, in virtue of the provisions of Decree-Law No. 557 of April 29, 1969 and in accordance with a decision of the National Monetary Council, taken at its meeting of , exports of soluble coffee to the United States of America, carried out under exchange operations contracted after April 30 of this year, are subject to payment of the tax referred to in the said legal instrument, to be paid to the Bank of Brazil, in a special account, to the credit of the National Treasury, in the form and conditions established in this Announcement.

2. The tax shall be fixed in the instrument constituting the exchange contract, for the amount in effect at the time the contract is entered into, and must be paid by the intervening banking establishment on or before the date on which it acts to settle the exchange operation, whether it be effected prior to the export or by means of delivery of the relevant shipping documents.

3. The payment of the tax shall be made by means of a tax form (specimen attached) which may be obtained from this Department--GECAM/DIVEX--or from the RECON offices at the agencies of the Bank of Brazil in the other coffee trading centers. When the settlement of the contract precedes the export, the notation "to be issued" shall be made in the space on the tax form reserved for the number of the bill of lading.

4. The agency of the Bank of Brazil that receives the tax shall retain the first and second copies of the tax form, and shall send to the local body responsible for the execution of exchange control services the copy intended for this Bank (GECAM/DIVEX in Rio de Janeiro, or a RECON office in the other trading centers).

5. In view of the provisions of Articles 1, 2, and 6 of Decree-Law No. 557, the following system shall be observed for application of the export tax in exchange operations of this type that are contracted:

I. on or before April 30, 1969, if covered by Sales Declarations registered with the Brazilian Coffee Institute on or before April 30, 1969--exempt from the tax;

II. between May 1 and May 12, 1969--NCr$0.51675 per 0.45359 kilograms;

III. between May 13 and July 6, 1969--NCr$0.52325 per 0.45359 kilograms;

IV. from July 7, 1969 until such time as a further variation of the exchange rate occurs--NCr$0.52975 per 0.45359 kilograms.

6. For purposes of execution and control of the payment of the tax due, the formalities and procedure set out below shall be observed for exports of this type:

(a) The Sales Declaration to be registered with the Brazilian Coffee Institute shall contain the clause:
"EXPORT SUBJECT TO THE TAX REFERRED TO IN DECREE-LAW NO. 557 OF APRIL 29, 1969."

(b) The exchange contract shall contain the note:
"EXPORT SUBJECT TO THE TAX REFERRED TO IN DECREE-LAW NO. 557 OF APRIL 29, 1969, IN THE AMOUNT OF NCr$................ PER POUND OF SOLUBLE COFFEE, TO BE PAID TO THE BANK OF BRAZIL ON OR BEFORE THE DATE OF SETTLEMENT OF THIS CONTRACT."

(c) The bill of lading to be submitted to the Central Bank--GECAM/DIVEX in Rio de Janeiro, or the RECON office at the agencies of the Bank of Brazil in other trading centers--shall contain the following statement, signed by the bank intervening in the exchange operation:
"WE ASSUME THE COMMITMENT OF APPLYING THE AMOUNT OF THE MERCHANDISE ACTUALLY SHIPPED TO THE SETTLEMENT OF THE CONTRACT(S) SPECIFIED IN THIS BILL OF LADING ONLY AFTER PAYING THE BANK OF BRAZIL, IN BEHALF OF THE EXPORTER, THE

AMOUNT OF NCr$................, RELATING TO THE EXPORT TAX CORRESPONDING TO .... POUNDS OF SOLUBLE COFFEE, ON THE BASIS OF NCr$........... PER POUND."

Note: When the bill of lading corresponds to an exchange contract settled previously, the above statement shall be replaced by the following:

"THE EXPORT TAX WAS PAID TO THE BANK OF BRAZIL, ON ...., IN THE TRADING CENTER OF ...., IN BEHALF OF THE EXPORTER, IN THE AMOUNT OF NCr$............., CORRESPONDING TO............. POUNDS OF SOLUBLE COFFEE, ON THE BASIS OF NCr$...........PER POUND, AT THE TIME OF SETTLEMENT OF THE RELEVANT EXCHANGE CONTRACT."

7. Exchange operations of this kind may only be contracted under Sales Declarations registered with the Brazilian Coffee Institute and extensions will be permitted only if the said document is also extended by the Institute.

8. Cancellation of the exchange contract as a result of nonshipment of the merchandise extinguishes the obligation to pay the tax.

9. In no event shall it be permitted to modify exchange contracts relating to exports of soluble coffee insofar as changing the country of destination of the merchandise is concerned, nor shall it be permitted to include a clause for transshipment in a North American port when the merchandise is bound for other countries.

10. Any requests for refund of the tax must be addressed to this Unit (GECAM/DICOC) through the office responsible for exchange control in the locality concerned.

11. Underpayment of the tax, or failure to pay it, as well as failure to pay it within the period set, imposes on the banking establishment intervening in the exchange operation the application of the penalties provided for in Art. 44 of Law No. 4595 of December 31, 1964, without prejudice to the fiscal sanctions permitted by the existing tax legislation.

EXCHANGE OPERATIONS DEPARTMENT

Joseph d'Ávila Mendonça
Manager

COMUNICADO GECAM Nº

IMPÔSTO DE EXPORTAÇÃO SÔBRE CAFÉ SOLÚVEL

Levamos ao conhecimento dos interessados que, em face do que preceitua o Decreto-lei nº 557, de 29 de abril de 1969, e consoante deliberação do Conselho Monetário Nacional, tomada em sessão de , as exportações de café solúvel para os Estados Unidos da América, realizadas ao amparo de operações de câmbio contratadas após 30 de abril dêste ano, ficam sujeitas ao pagamento do impôsto de que trata o referido diploma legal, a ser recolhido ao Banco do Brasil S/A, em conta especial, a crédito do Tesouro Nacional, na forma e nas condições estabelecidas neste Comunicado.

2. O tributo será fixado no instrumento de contrato de câmbio pelo valor vigorante no ato de sua celebração e deverá ser recolhido pelo estabelecimento bancário interveniente até a data em que êste promova a liquidação da operação cambial, quer esta se efetive antes da exportação ou mediante a entrega dos respectivos documentos de embarque.

3. O pagamento do impôsto será processado através de guia de recolhimento (modêlo anexo), que poderá ser adquirida nesta Gerência — GECAM/DIVEX — ou nos Setores RECON junto às agências do Banco do Brasil S/A nas demais praças cafeeiras. Quando a liquidação do contrato anteceder a exportação, no espaço da guia de recolhimento reservado ao número da guia de embarque será consignado "a ser emitida".

- continua -

4. A agência do Banco do Brasil S/A que receber o tributo reterá a 1a. e 2a. vias da guia de recolhimento, enviando ao órgão local responsável pela execução dos serviços de contrôle cambial a via destinada a êste Banco (GECAM/DIVEX, no Rio de Janeiro (GB) ou Setor RECON, nas demais praças).

5. Tendo em vista o estabelecido nos artigos 1º, 2º e 6º do Decreto-lei nº 557, será observado o seguinte critério para aplicação do impôsto de exportação nas operações de câmbio da espécie contratadas:

I - até 30.4.69, desde que cobertas por Declarações de Venda registradas no Instituto Brasileiro do Café até 30 de abril de 1969 — isentas do tributo;

II - entre 1º e 12 de maio de 1969 — NCr$ 0,51675 por 0,45359 quilogramas;

III - entre 13 de maio e 6 de julho de 1969 — NCr$ 0,52325 por 0,45359 quilogramas;

IV - a partir de 7 de julho de 1969, até que ocorra nova variação da taxa cambial — NCr$ 0,52975 por 0,45359 quilogramas.

6. Para fins de execução e contrôle do recolhimento do tributo devido, serão obedecidas nas exportações da espécie as formalidades abaixo e respeitado o procedimento a seguir:

a) na Declaração de Venda a ser registrada no Instituto Brasileiro do Café constará a cláusula:

"EXPORTAÇÃO SUJEITA AO IMPÔSTO DE QUE TRATA O DECRETO-LEI Nº 557, DE 29.4.1969."

- continua -

"EXPORTAÇÃO SUJEITA AO IMPÔSTO DE QUE TRATA O DECRETO-LEI Nº 557, DE 29.4.1969, NO VALOR DE NCr$ ...... POR LIBRA-PÊSO DE CAFÉ SOLÚVEL, A SER RECOLHIDO AO BANCO DO BRASIL S/A ATÉ A DATA DA LIQUIDAÇÃO DÊSTE CONTRATO."

c) na guia de embarque a ser submetida ao Banco Central — GECAM/DIVEX, no Rio de Janeiro (GB), ou Setor RECON junto às agências do Banco do Brasil S/A, nas demais praças — constará a seguinte declaração assinada pelo banco interveniente na operação cambial:

"ASSUMIMOS O COMPROMISSO DE SÓ APLICAR O VALOR DA MERCADORIA EFETIVAMENTE EMBARCADA NA LIQUIDAÇÃO DO(S) CONTRATO(S) ESPECIFICADO(S) NA PRESENTE GUIA, APÓS RECOLHERMOS AO BANCO DO BRASIL S/A, EM NOME DO EXPORTADOR, A IMPORTÂNCIA DE NCr$ ...., RELATIVA AO IMPÔSTO DE EXPORTAÇÃO CORRESPONDENTE A .... LIBRAS-PÊSO DE CAFÉ SOLÚVEL, NA BASE DE NCr$........ POR LIBRA-PÊSO."

Nota - Quando a guia de embarque corresponder a contrato de câmbio prèviamente liquidado, a declaração supra será substituída pela seguinte:

"O IMPÔSTO DE EXPORTAÇÃO FOI RECOLHIDO AO BANCO DO BRASIL S/A, EM ...., NA PRAÇA DE ...., EM NOME DO EXPORTADOR, NA IMPORTÂNCIA DE NCr$......, CORRESPONDENTE A ......LIBRAS-PÊSO DE CAFÉ SOLÚVEL, NA BASE DE NCr$ .... POR LIBRA-PÊSO, QUANDO DA LIQUIDAÇÃO DO RESPECTIVO CONTRATO DE CÂMBIO."

7. As operações de câmbio da espécie só poderão ser contratadas ao amparo de Declarações de Venda registradas no Instituto Brasileiro do Café e só serão admitidas prorrogações se o referido documento também vier a ser prorrogado por aquela autarquia.

8. O cancelamento do contrato de câmbio que resultar da não efetivação do embarque da mercadoria extingue a obrigatoriedade do recolhimento do tributo.

- continua -

tratos de câmbio referentes a exportação de café solúvel, no que concerne à mudança do país de destino da mercadoria, e nem será permitida da cláusula do transbôrdo em pôrto norte-americano quando destinada a outros países.

10. Eventuais pedidos de restituição do impôsto deverão ser encaminhados a esta Unidade (GECAM/DICOC), através do setor responsável pelo contrôle cambial da localidade.

11. A insuficiência ou falta de recolhimento do tributo, bem como o seu processamneto além do prazo, impõe ao estabelecimento bancário interveniente na operação cambial a aplicação das penalidades previstas no art. 44 da Lei nº 4.595, de 31.12.64, sem prejuízo das sanções de natureza fiscal admitidas pela legislação tributária em vigor.

GERÊNCIA DE OPERAÇÕES DE CÂMBIO

Joseph d'Ávila Mendonça
Gerente

ETR-53,136
Translated by C. Ernst
Reviewed by K. Magurn

BRAZILIAN COFFEE INSTITUTE

CIRCULAR No. 88/69

In order that it may be fully known, we copy below the text of Decree-Law No. 557 of April 29, 1969, published in the Diário Oficial (Section I--Part I) of the same date, on page 3,625:

DECREE-LAW No. 557 OF APRIL 29, 1969

Providing for a Tax on Exports of Soluble Coffee

The President of the Republic, in exercise of the powers conferred upon him by paragraph 1 of Article 2 of Institutional Act No. 5 of December 13, 1968, and considering the provisions of Article 22, item 11, paragraph 2 of the Constitution, decrees:

Art. 1. There is established, with effect from May 1, 1969, a tax of NCr$0.51675 per 0.45359 kilograms on the export of soluble coffee in any form to the United States of America.

Art. 2. The Central Bank of Brazil shall readjust the tax referred to in this Decree-Law in the light of variations in the exchange rate, the proportion laid down in the preceding article being maintained.

Art. 3. The payment of the tax shall be effected no later than the moment of settlement of the export operation concerned; the payment to the exporter shall be contingent upon proof that the tax was paid in full.

Art. 4. The tax referred to in this Decree-Law shall be paid to the Bank of Brazil, in a special account, to the credit of the National Treasury.

Art. 5. The Central Bank of Brazil shall issue the instructions necessary for exercising control of the payment of the tax.

Art. 6. The tax shall not fall upon exports of soluble coffee registered with the Brazilian Coffee Institute on or before April 30, 1969, with exchange duly contracted for on or before the same date.

Art. 7. All provisions to the contrary being revoked, this Decree-Law shall enter into force on May 1, 1969.

Brasilia, April 29, 1969; 148th of Independence and 81st of the Republic.

A. COSTA E SILVA
Antônio Delfim Netto.
Rio de Janeiro, May 15, 1969
/s/
JAYME BAPTISTA FERREIRA
General Chief, Administration Department
Acting

INSTITUTO BRASILEIRO DO CAFÉ

CIRCULAR Nº 88 /69

Para amplo conhecimento, transcrevemos , a seguir, o Decreto-lei nº 557, de 29 de abril de 1969, publicado no Diário Oficial (Seção I-Parte I), da mesma data, à página 3 625:

DECRETO-LEI Nº 557 - DE 29 DE ABRIL DE 1969

Dispõe sôbre o impôsto de exportação de café solúvel.

O Presidente da República, no uso das atribuições que lhe confere o § 1º. do artigo 2º do Ato Institucional nº 5, de 13 de dezembro de 1968, e considerando o disposto no artigo 22, item II, § 2º da Constituição, decreta:

Art. 1º. Fica estabelecido, com vigência a partir de 1º de maio de 1969, um impôsto de NCR$ 0,51675 por... 0,45359 quilogramas na exportação de café solúvel, em tôdas as suas modalidades, para os Estados Unidos da América.

Art. 2º. O Banco Central do Brasil reajustará o impôsto de que trata êste Decrero-lei em função das variações da taxa cambial, mantida a proporção prevista no artigo anterior .

Art. 3º. O recolhimento do impôsto será efetuado, no mais tardar, até o momento da liquidação da operação de exportação respectiva, ficando o pagamento ao exportador condicionado à compprovação de que o tributo foi satisfeito.

Art. 4º. O impôsto de que trata êste Decreto-lei será recolhido ao Banco do Brasil S.A., em conta especial, a crédito do Tesouro Nacional.

Art. 5º. O Banco Central do Brasil expedirá as instruções necessárias a exercer o contrôle do pagamento do impôsto.

Art. 6º. O impôsto não incidirá sôbre a exportação de café solúvel que tenha sido registrada no Instituto Brasileiro do Café até 30 de abril de 1969, com câmbio devidamente contratado até a mesma data.

Art. 7º. Revogadas as disposições em contrário, êste Decreto-lei entrará em vigor em 1 de maio de 1969.

Brasilia, 29 de abril de 1969; 148º da Independência e 81º da República.

A. COSTA E SILVA
Antônio Delfim Netto.

Rio de Janeiro, 15 de maio de 1969

/myp.-

JAYME BAPTISTA FERREIRA
Chefe Geral do Departamento de
Administração
Substituto

MEMORANDUM FOR FILES: August 26, 1969

Subject: Chile: Review of the Exchange System since 1961

I. Background

In the fac~~t~~e of mounting balance of payments difficulties averaging $50 million deficit per year for the years 1958-1961 the Central Bank, with its foreign exchange holdings virtually depleted, was forced to suspend all exchange operations for almost three weeks from December 27, 1961. The operations were resumed on January 15, 1962 under a dual market mechanism, marking the return by Chile to multiple currency practices after a three-year experience with a unified exchange rate which, however, had become increasingly unrealistic.

Under the exchange system established on January 15, 1962, exchange operations were divided between an official exchange market--the Banking Free Market--with the same exchange rate of E°1.05 per U.S. dollar that had been in effect for about three years, and a free market--the Brokers' Market--with a fluctuation exchange rate. Export receipts, exchange sales of foreign-owned copper companies to meet local expenses and taxes, payments for imports and related costs of those goods not on the prohibited list, all government transactions, and certain specified private capital and invisible transfers were assigned to pass through the Banking Market. All other transactions including nontrade invisibles and major capital transactions and payments for prohibited imports, the entry of which was permitted through free port zones, were channeled through the Brokers' Market. In addition, a compulsory deferement of import payments for a period of 90 days after the date of the bill of lading was introduced.

The staff concluded at the time that the new system was not likely to correct Chile's balance of payments problems because it perpetuated an exchange rate for the bulk of transactions which clearly overvalued the escudo, and because it could not be a stable solution. The staff argued that a large spread between the exchange rates in the two markets was bound to develop, that it was bound to cause serious complications related to the large volume of internal debts denominated in U.S. dollars, and that it was unlikely to restore confidence.

Subsequent developments confirmed that analysis. The demand for the much reduced range of imports that retained the right to exchange allocation at the official rate increased substantially. There were sizable withdrawals of dollar deposits from Chilean banks through the official market. Contractual payments on government and private sector debts placed additional strains on the official exchange position and the Central Bank continued to lose reserves and the brokers' rate which opened in mid-January at about E°1.40 per U.S. dollar, depreciated to as much as E°2.70 per U.S. dollar in mid-November.

The Chilean authorities sought for a time to cope with this situation by successive introduction of additional restrictive measures. Advance import deposit requirements were re-established in June 1962 and later on extended to cover practically all the permitted import items and two prohibitive rates of 5,000 and 10,000 per cent of the c.i.f. rate of imports were introduced on September 20, 1962; the compulsory deferment period for payments of imports was extended from 90 days to 120 days. This action was taken because the Central Bank had, since early August, been unable to provide all the requisite foreign exchange even after the 90-day deferment period had elapsed. On October 4, 1962 additional surcharges were established ranging up to 200 per cent on practically all imports eligible for foreign exchange allocation at the banking rate. On October 15, 1962, the banking rate was unpegged, and it was announced that the level of this rate would, in the future, be determined by the free market forces, except as temporarily modified by the new import surcharges. By December 1962 the rate had depreciated to about E°1.65 per U.S. dollar. A redistribution of transactions between the two markets also took place which relegated all trade and trade-connected transactions to the banking market and the brokers' market was restricted for capital transactions, tourism, and a few residual invisible transactions.

While Chile officially adapted a flexible exchange rate policy, the sources of foreign exchange supply are such that the rate could not be anything but a managed rate. Large amounts of foreign exchange from the foreign-owned copper companies and from proceeds of foreign loans go directly to the Central Bank. In 1963 the foreign exchange receipts from these two sources represent about 60 per cent of the total supply in the Banking Market. The Central Bank feeds them back into the market in amounts and at rates which are set by it.

2. Conclusion

(a) In theory the banking rate is freely determined by the forces of supply and demand which enter the market. However, the Central Bank, being the major supplier of exchange and the authority to control demand through regulations, influences the rate to the point that it virtually sets it through its sales of futures to the commercial banks. The commercial banks, on their part, are always short of foreign exchange (surrender requirement of foreign exchange proceeds) and have to rely on the Central Bank to provide them with the necessary exchange.

(b) In the brokers' market, the rate is supposed to move freely. However, access to this market is controlled in order to check capital outflows and Central Bank authorization is required before remittances could be made. All invisible transactions are made subject to limits beyond which Central Bank authorization is again needed.

(c) Over time, steps have been taken to unify the two markets. The spread between the two rates have been narrowed (about 11 per cent at the time of writing) by means of depreciating the banking rate faster than the brokers' rate. Furthermore, a greater bulk of Central Bank transactions has been channeled through the Banking Market. Total transactions of the Central Bank in Brokers' mkt 1968 was less than 4 per cent of its total exchange transactions for the year.

(d) Chilean system of exchange is one of control on supply, demand, and price of exchange. Separation of transactions into two markets is only of academic interest. There are three rates, Banking rate, the Brokers' rate and the Brokers' rate plus a 10 per cent exchange tax on certain transactions, all three set by the Central Bank.

HAM

H.A. Mehran

cc: Mr. Mohammed
Mr. Makdisi

HAM/ms
8-26-69

Office Memorandum

TO : Mr. Palmer

DATE: August 25, 1969

FROM : Samir Makdisi

SUBJECT : Preliminary Note on Financial Policy under the Prospective Stand-by Arrangement for Morocco

As agreed, the following outlines some preliminary observations conconcerning financial policy in Morocco in connection with the prospective stand-by arrangement. The figures cited below are subject to revision, and the assumptions used are tentative. It is assumed that (a) the mission will discuss with the authorities the implementation of financial policies aiming at a balance of payments surplus in 1970, and (b) for the current year the mission will examine the possibilities of whether an equilibrium can be achieved and if this should appear unrealistic to attempt to limit the size of the deficit to the smallest possible level.

1. While the necessary projections for constructing the appropriate monetary ceilings (including those pertaining to the balance of payments), would have to await the findings of the mission in the field, it would not be out of place to work on the basis of a financial plan that aims at attaining equilibrium in 1969 and a net foreign reserve improvement of $15 million (DH 76 million) in 1970 to serve as guidelines for permissible credit expansion.

2. To achieve balance of payments equilibrium in 1969, the magnitude of domestic credit expansion in that year for the whole of the banking system may have to be confined to no more than roughly DH 200 million, i.e., a 4 per cent projected increase in money and quasi money (other liabilities assumed unchanged).[1] This calculation is predicated on (a) a projected 2.5 per cent rise in money income in 1969[2] and (b) the observed relation between the growth of money and quasi money and of that of money income in the previous three years. On this basis the projected growth of currency in circulation and commercial banks' desposits under reserve requirements, would amount to about DH 80 million during the year; this in turn sets the limit (the level of other liabilities remaining unchanged) to the expansion of domestic assets of the Central Bank if the level of its net foreign reserves is to remain stable over the year as a whole. This projection of domestic liabilities is preliminary; upon the availability of additional data in the field the projected figure may have to be revised substantially, and the level of permissible credit expansion modified accordingly.

IFS data reveal that in the first quarter of 1969 money and quasi money rose by DH 70 million while other liabilities fell slightly; domestic credit remained uncha

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1/ In practice projections for these liabilities will also have to be made, and the magnitude of permissible credit expansion modified accordingly.

2/ In projecting the 1969 money income the authorities appear to have assumed a price rise of 0.5 per cent; recent indications, however (comparing the first quarters of 1968 and 1969), indicate that a price rise in the order of 3 per cent may prevail.

3/ Based on adjusted figures to include Bank of Morocco deposits with the Postal Checking System which IFS excludes from Claims on Government.

and net foreign reserves improved by almost the same amount as the increase in money and quasi money, i.e., DH 69 million. This increase, it may be added, reflects the seasonality of foreign exchange earnings; still, compared with the first quarter for each of the preceeding two years, it represents a distinct improvement in the balance of payments performance. The above implies that if a balance of payments equilibrium is to be aimed at, total credit of the banking system could still expand in the remainder of the year by roughly DH 200 million if nonmonetary liabilities remain at the end-March level.[1/] (see footnote 1 page 1).

3. Looking at available Central Bank data through July 1969, the following picture emerges in the first seven months of the current year:

(a) In the first quarter currency issue plus banks' deposits under reserve requirements increased by DH 89 million while other liabilities (net) declined by DH 15 million. With the expansion in net domestic assets being held to DH 35 million, net foreign reserves rose by DH 39 million. Net assets subject to ceiling under the current stand-by arrangement (statutory advances and mobilization of customs duty bills being excluded) declined by DH 6 million. Within this ceiling (of DH 1782 million) there have been two opposing trends--net credit to Government rose by DH 71 million, standing at DH 804 million at the end of March, while credit to other sectors declined by DH 77 million.[1/] Assets outside the ceiling rose by DH 41 million (see attached table).

(b) In the following four months (April-July) currency issue and deposits under reserve requirements increased by a further DH 104 million and other liabilities (net) by DH 16 million. Domestic assets declined by DH 65 million so that net foreign reserves rose by another DH 185 million bringing their rise in the first seven months to DH 224 million. Net assets subjects to the ceiling had risen by the end of July by about DH 118 million to DH 1729 million, slightly in excess of the ceiling: net credit to Government declined by DH 9 million, but other credit rose by DH 133 million, while credit outside the ceiling declined by DH 189 million.

(c) If we assume that the growth in domestic liabilities would not exceed the projected DH 80 million, then to achieve the foreign reserve target, i.e., no change in the level of net reserves over the year as a whole, net domestic assets of the Central Bank should not grow by more than DH 110 million during the period August 1, - December 31, 1969.

Under the current stand-by arrangement the applicable ceiling from August 1,- January 31, 1970 stands at DH 1878 million permitting an increase from end July of DH 150 million in net domestic assets. If fully utilized such credit expansion would clearly not be compatible with the postulated balance of payments objectives. Moreover, the level of credit outside the ceiling (mainly statutory advances) is likely to rise in the last quarter of the year when Treasury receipts are at their seasonal low and payments are at their peak.

[1/] At the end of March net domestic assets subject to ceiling stood at DH 1605 million. Within the ceiling net credit to Government may not at any time increase by more than DH 200 million from the base figure of end October 1968 (DH 695.9 million).

The revised projection for growth of domestic liabilities (which would have to be undertaken in the field) may turn out to be substantially higher than the figure assumed above. Nevertheless, over-all it would seem that the adoption of certain measures may be required to hold back the permissible growth in bank credit to an amount consistent with the 1969 balance of payments aim. These may include (i) scaling down rediscount paper, (ii) raising reserve requirements, and (iii) establishing a limit on items that are presently outside the ceiling.

4. For 1970 the only available projection for the growth of income is the estimate included in the Five Year Plan. On the assumption of a normal cereal crop, real income is anticipated to grow by about 4 per cent; assuming growth in money and quasi money of about 7 per cent, i.e., roughly DH 370 million (6 per cent on account of income growth and liquidity preference and 1 per cent on account of an assumed rise in prices) and given the targeted improvement in the balance of payments of DH 76 million, net permissible credit expansion for the whole year should be in the neighborhood of DH 295 million. If the whole of the targeted rise in net foreign reserves is assumed to relate to the reserves of the Central Bank, then it is estimated that the permissible increase in the domestic assets of the Bank would amount to about DH 64 million.

5. Under the current stand-by arrangement control of monetary expansion has been exercised through a ceiling on the net domestic assets of the Central Bank with a subceiling on net credit to Government. It was also specified, that the authorities would regulate the amount of credit extended by the commercial banks to the private sector through an agreed change in reserve requirements. The same approach of combining a ceiling on the domestic assets of the Central Bank with an explicit agreement on the level of required commercial bank reserves could be retained, but it would seem desirable also to set a limit on the accumulation of foreign debt with maturities of less than five years. Moreover, to ensure that the global ceiling and the subceiling on net credit to Government are really effective instruments of monetary restraint, it would seem desirable to include statutory advances in these ceilings.

6. Exchange policy has been detailed in the briefing paper.

cc: Mr. Sturc
Mr. Finch
Mr. Qureshi

July 18, 1969

Mr. Merwin
Mr. Waitzenegger

As of June 30, 1969, the net domestic assets of the Bank of Morocco subject to a ceiling stood at DH 1,738 million, slightly exceeding the current ceiling of DH 1,728 million. At the end of the previous month, these net assets stood at DH 1,422 million only. The DH 316 million increase during the month of June was distributed as follows:

1. DH 215 million on account of credit to non-bank institutions, which rose by 50 per cent to DH 645 million.

2. DH 89 million on account of net credit to the Government which rose by 12 per cent to DH 784 million. This amount, however, remained far below the specific ceiling on net credit to the Government of DH 896 million. The rise occurred mainly in the central bank's deposits with the Postal Checking System.

3. DH 12 million on account of credit to commercial banks which rose by 5 per cent to DH 243 million.

Pierre Berthe

Pierre Berthe

(In millions of dirhams; end of month)

	Central Bank's net domestic assets (3)2/	Central Bank's net credit to the Government (5)2/	Central Bank's credit to commercial banks1/ (U less H)2/	Central Bank' credit to other financi institutions1/ (Y less K)
Ceiling	1,582			
Aug. 67	1,111	517	255	400
Sept. 67	1,037	623	214	361
Ceiling	1,198			
Oct. 67	1,068	638	228	379
Nov. 67	1,117	715	246	383
Dec. 67	1,278	919	220	350
Ceiling	1,582			
Jan. 68	1,223	976	113	393
Feb. 68	1,206	960	104	400
March 68	1,230	971	114	405
April 68	1,395	743	100	559
May 68	1,376	733	115	556
June 68	1,462	772	176	552
July 68	1,471	724	260	510
Aug. 68	1,489	694	267	511
Sept. 68	1,337	694	206	419
Oct. 68	1,499	696	234	552
Ceiling	1,778	896		
Nov. 68	1,506	690	306	493
Dec. 68	1,611	733	243	618
Jan. 69	1,595	796	255	528
Ceiling	1,728	896		
Feb. 69	1,640	776	311	535
March 69	1,605	804	248	536
April 69	1,499	749	209	528
May 69	1,422	696	231	430
June 69	1,738	784	243	645
July 69				
Ceiling	1,878	896		
Aug. 69				

1/ Since August 1968, rediscounts of Treasury bonds are included in the Central Bank' net claims on Government, instead of in Central Bank's claims on commercial banks.

2/ Refer to items in basic control table.

DRAFT
HHaumer:pmkg
August 27, 1969

To: Mr. Makdisi
From: Hans Haumer
Subject: Ecuador--dual market

1. Reasons for introduction

The dual market system was introduced in June 1947 (Law No. 1091 of June 5, 1947). Before the reform, the system had been the following: There was a buying rate of S/ 13.40 and a selling rate of S/ 13.50 per U.S. dollar; with a tax of 2 per cent on purchases, and a tax of 4 per cent plus 1 Sucre per dollar on sales of foreign exchange, the effective rates were S/ 13.13 buying and S/ 15.04 selling for most transactions (the government, for instance, was exempt from the tax of 1 Sucre). There was a black market where the rate fluctuated between S/ 17 and S/ 20 per U.S. dollars.

The reform consisted of the following:

The selling rate of S/ 15.04 applied to all essential and semi-essential imports. However, importers of semi-essential goods had to pay a surcharge of S/ 5 per dollar. Importers of luxury goods were permitted to purchase exchange only in the free market; in addition, such imports were subject to the surcharge of S/ 5 per dollar. Besides essential and semi-essential imports, the official market was also used for transfers by the government and public entities, student expenses abroad up to a certain limit, certain other (trade related) invisibles and transactions regarding registered capital. This program was conceived as a temporary and an emergency measure, until the balance of payments could be readjusted. Then, a system would be restored, under which exchange would be freely available to pay for all current transactions at a single rate without surcharges.

The free market was to be fed by inflow of unregistered capital (i.e., capital converted at the free market rate but without transfer guarantees at the official rate), and by proceeds from tourism, foreign grants and pensions, and expenses of foreign diplomats. The exports of newly mined gold could take place at the free rate if the Monetary Board that was to be formed so decided. All other foreign exchange receipts had to be surrendered to the Central Bank.

Among the reasons leading to the introduction of the dual market system were:

"economic situation of emergency";

"abuses of the system of individual import quotas";

"certain transactions had been uncontrolla ble and had given incentive for profit to transgressors"; in other words, capital flight should be curbed by an "equilibrium rate."

Scarcity of foreign exchange was not of an immediate concern. International reserves declined by a relatively modest $4 million, to $27 million at the end of 1947. There was also a view that the reason for the reform really was the breakdown of the import control system due to the ineptitude of political appointees. Furthermore, the quota system had been abolished in February 1947, and importers, overestimating their financial capacities, and underestimating the efficiency of U.S. suppliers (inspite of the postwar periods), had greatly increased demand for imports, thus raising the foreign liabilities of the Central Bank, whereas exports did not increase as anticipated. The free market was to serve as a "moralizer" and as a barometer to measure the exact devaluation of the sucre.

The free rate of exchange declined in the aftermath of the reform, inspite of measures to increaseddemand (e.g., extension of list of luxury imports). In March 1948, the Central Bank started to support the rate at S/16.50 and bought dollars in the free market.

With some modifications this system has remained in effect, despite repeated attempts of unification since 1949.

2. Experience and evaluation

The problem of over-importing and capital flight through the official market has not been totally solved. It seems that the free market gave, however, some leeway to the authorities in times of crisis; that the rate showed no continuous upward trend. The following table contains a few time series:

End of	Official rate selling	Free market rate selling (In Sucres per US$1)
1948	13.50	17.94
49	13.50	18.34
50	15.15	18.25
51	15.15	17.22
52	15.15	17.39
53	15.15	17.40
54	15.15	17.40
55	15.15	17.38
56	15.15	18.76
57	15.15	16.58
58	15.15	16.66
59	15.15	16.96
60	15.15	17.50
61	18.18	21.70
62	18.18	22.10
63	18.18	18.53
	18.18	18.52
64	18.18	18.59
65	18.18	18.70
66	18.18	19.95
67	18.18	20.19
68	18.18	22.26

There was also continuous pressure to move exports to the free market. Exporters of banana succeeded in part since the minimum surrender prices introduced in 1961 were far below effective f.o.b. receipts.

The free market rate usually reacts rather swiftly to political instability, apparently somewhat less to the over-all economic situation. It is probably linked also with the availability of domestic liquidity. Credit expansion beyond a certain extent had a depreciatory effect on the rate. On the other hand, the pressure on official reserves did not subside at all, as might be expected; the free market rate probably tends to settle around the effective import rate. It has certainly had the function of a safety valve, though more under the aspect of a leading indicator.

As a conclusion, the dual market system has worked within the framework of stop-go policy; it has shown a stabilizing effect only over the medium-term, not over the short and the long-term. In the latter instances, other additional measures (devaluation or restrictive measures) always became necessary when balance of payments problems developed.

Office Memorandum

TO : Mrs. Tyler **DATE:** August 19, 1969

FROM : Donald K. Palmer

SUBJECT : Brazil - Tax on Exports of Soluble Coffee to the U.S.

I am attaching a memorandum from Mr. Nicoletopoulos on the subject of Brazil's tax on exports of soluble coffee to the United States. As you know, Mr. Finch has returned and I have briefed him on this matter. I suggest that you work with him on the future action on this.

Attachment

cc: Mr. Finch
Mr. Beza
Mr. Nicoletopoulos

Office Memorandum

TO : Mr. Donald K. Palmer

DATE: August 19, 1969

FROM : George Nicoletopoulos G.P.N.

SUBJECT : Brazil - Tax on Exports of Soluble Coffee to the U.S.

Decree Law No. 557 of April 29, 1969 imposes a tax on the export of soluble coffee to the U.S. (Art. 1), and provides that "the payment to the exporter shall be contingent upon proof that the tax was paid in full" (Art. 3). As we understand it, the payment of the Brazilian currency equivalent is made to the exporter by the commercial bank which is the collecting agent for the exporter of the foreign exchange which the exporter must surrender by selling it to the commercial bank. The implementing regulations are to be issued by the Central Bank of Brazil (Art. 5). This law does not in itself give rise to a multiple currency practice, but an examination of the regulations to be issued under it would be in order.

The draft regulations shown to us provide that "the tax shall be fixed in the instrument constituting the exchange contract" and that it "must be collected by the intervening banking establishment on or before the date on which it acts to settle the exchange operation" (Sec. 2). It is also provided that "cancellation of the exchange contract as a result of nonshipment of the merchandise extinguishes the obligation to pay the tax" (Sec. 8).

The draft regulations interweave so closely the transactional and the exchange aspects of the tax that it would be difficult to conclude that Decree Law No. 557 as it would be implemented would not in fact be an exchange tax, and hence a multiple currency practice. If this implication of the draft regulations is to be avoided, alterations in them along the following lines may be suggested:

1. The tax should be fixed in an instrument which is formally independent of the exchange contract.

2. Evidence of payment of the tax would be required by the intervening banking establishment on or before the date of payment to the exporter.

3. Nonshipment of the merchandise would extinguish the obligation to pay the tax.

cc: Mr. Silard

Mr. Palmer August 12, 1969

Maria O. Tyler

Brazil--Export Tax on exports of soluble coffee to the United States

Decree Law 557 of April 29, 1969 (Attachment 1) imposes a tax of NCr$0.51675 (equivalent to 12.8 U.S. cents) per pound on proceeds from exports of soluble coffee to the United States effective May 1, 1969. The Decree provides that the Central Bank of Brazil will make adjustments in the tax to take account of the changes in the exchange rate, with a view to maintaining the tax at the same percentage level. The Decree further provides that the Central Bank is to prepare regulations for the implementation of controls regarding the tax collection.

The Brazilian representatives explained that since May 1, 1969 no exports of soluble coffee to the United States have taken place; apparently there was a rush to export prior to the entering into force of the tax.

Mr. Paulo Pereira Lira, Director of the Foreign Exchange Department of the Central Bank, supplied the Fund mission with a draft of the Central Bank regulations implementing the above mentioned Decree (Attachment 2); Mr. Lira stressed that this was a preliminary draft. He asked that the Fund staff examine the regulations with a view to, (1) determining whether the draft regulations might imply a multiple currency practice, and if so, (2) assisting the Brazilian authorities in formulating these regulations in a manner that would not give rise to a multiple currency practice within the meaning of the Fund Articles of Agreement.

It should be noted that the application of the "contribution quota" on proceeds from exports of green coffee has been considered to be a multiple currency practice. This contribution quota is equal to the difference between the minimum registration price per bag of coffee exported, calculated at the prevailing official rate, and the cruzeiro payment per bag of coffee to the exporter. Both the minimum registration price and the cruzeiro payment are fixed from time to time by the Brazilian Coffee Institute; these vary with the quality of the coffee and the port of shipment. The contribution quota is levied by the banks at the time of the liquidation of the exchange contract and is transferred to the Coffee Defense Fund.

In the case of exports of soluble coffee to the U.S. there is a fixed tax equivalent to 12.8 cents per pound exported. The draft regulations specify that the tax is to be collected by the banks on or before the liquidation of the exchange contract, whether such liquidation takes place prior to the export of the commodity or upon presentation of the shipping documents. The proceeds of the tax are to be transferred to the Banco do Brasil to a special account of the Treasury.

Based on the Legal Department's ruling on a recent case involving an export tax on hides and skins (Attachment 3), I would myself think that there are grounds for considering the tax on exports of soluble coffee not to be a multiple currency practice. In view of the Brazilian request for clarification, and possible advice on changing the implementing regulations and procedures if this should be needed to avoid a multiple currency practice, I would suggest that the matter be taken up immediately with the Legal Department so as to enable us to give an early reply to the Brazilian authorities.

Attachments

cc: Mr. Beza

Translated by C. Ernst
Reviewed by K. Magurn

Rio de Janeiro,

GECAM ANNOUNCEMENT NO.

EXPORT TAX ON SOLUBLE COFFEE

We inform those concerned that, in virtue of the provisions of Decree-Law No. 557 of April 29, 1969 and in accordance with a decision of the National Monetary Council, taken at its meeting of , **exports of soluble coffee to the United States of America, carried out under exchange operations contracted after April 30 of** this year, are subject to payment of the tax referred to in the said legal instrument, to be paid to the Bank of Brazil, in a special account, to the credit of the National Treasury, in the form and conditions established in this Announcement.

2. The tax shall be fixed in the instrument constituting the exchange contract, for the amount in effect at the time the contract is entered into, and must be ~~paid~~ collected by the intervening banking establishment on or before the date on which it acts to settle the exchange operation, whether it be effected prior to the export or by means of delivery of the relevant shipping documents.

3. The payment of the tax shall be made by means of a tax form (specimen attached) which may be obtained from this Department--GECAM/DIVEX--or from the RECON offices at the agencies of the Bank of Brazil in the other coffee trading centers. When the settlement of the contract precedes the export, the notation "to be issued" shall be made in the space on the tax form reserved for the number of the bill of lading.

4. The agency of the Bank of Brazil that receives the tax shall retain the first and second copies of the tax form, and shall send to the local body responsible for the execution of exchange control services the copy intended for this Bank (GECAM/DIVEX in Rio de Janeiro, or a RECON office in the other trading centers).

5. In view of the provisions of Articles 1, 2, and 6 of Decree-Law No. 557, the following system shall be observed for application of the export tax in exchange operations of this type that are contracted:

I. on or before April 30, 1969, if covered by Sales Declarations registered with the Brazilian Coffee Institute on or before April 30, 1969--exempt from the tax;

II. between May 1 and May 12, 1969--NCr$0.51675 per 0.45359 kilograms;

III. between May 13 and July 6, 1969--NCr$0.52325 per 0.45359 kilograms;

IV. from July 7, 1969 until such time as a further variation of the exchange rate occurs--NCr$0.52975 per 0.45359 kilograms.

6. For purposes of execution and control of the payment of the tax due, the formalities and procedure set out below shall be observed for exports of this type:

(a) The Sales Declaration to be registered with the Brazilian Coffee Institute shall contain the clause:
"EXPORT SUBJECT TO THE TAX REFERRED TO IN DECREE-LAW NO. 557 OF APRIL 29, 1969."

(b) The exchange contract shall contain the note:
"EXPORT SUBJECT TO THE TAX REFERRED TO IN DECREE-LAW NO. 557 OF APRIL 29, 1969, IN THE AMOUNT OF NCr$................ PER POUND OF SOLUBLE COFFEE, TO BE PAID TO THE BANK OF BRAZIL ON OR BEFORE THE DATE OF SETTLEMENT OF THIS CONTRACT."

(c) The bill of lading to be submitted to the Central Bank--GECAM/DIVEX in Rio de Janeiro, or the RECON office at the agencies of the Bank of Brazil in other trading centers--shall contain the following statement, signed by the bank intervening in the exchange operation:
"WE ASSUME THE COMMITMENT OF APPLYING THE AMOUNT OF THE MERCHANDISE ACTUALLY SHIPPED TO THE SETTLEMENT OF THE CONTRACT(S) SPECIFIED IN THIS BILL OF LADING ONLY AFTER PAYING THE BANK OF BRAZIL, IN BEHALF OF THE EXPORTER, THE

> AMOUNT OF NCr$................, RELATING TO THE EXPORT TAX CORRESPONDING TO .... POUNDS OF SOLUBLE COFFEE, ON THE BASIS OF NCr$........... PER POUND."
>
> Note: When the bill of lading corresponds to an exchange contract settled previously, the above statement shall be replaced by the following:
>
> "THE EXPORT TAX WAS PAID TO THE BANK OF BRAZIL, ON ...., IN THE TRADING CENTER OF ...., IN BEHALF OF THE EXPORTER, IN THE AMOUNT OF NCr$............., CORRESPONDING TO............. POUNDS OF SOLUBLE COFFEE, ON THE BASIS OF NCr$............PER POUND, AT THE TIME OF SETTLEMENT OF THE RELEVANT EXCHANGE CONTRACT."

7. Exchange operations of this kind may only be contracted under Sales Declarations registered with the Brazilian Coffee Institute and extensions will be permitted only if the said document is also extended by the Institute.

8. Cancellation of the exchange contract as a result of nonshipment of the merchandise extinguishes the obligation to pay the tax.

9. In no event shall it be permitted to modify exchange contracts relating to exports of soluble coffee insofar as changing the country of destination of the merchandise is concerned, nor shall it be permitted to include a clause for transshipment in a North American port when the merchandise is bound for other countries.

10. Any requests for refund of the tax must be addressed to this Unit (GECAM/DICOC) through the office responsible for exchange control in the locality concerned.

11. Underpayment of the tax, or failure to pay it, as well as failure to pay it within the period set, imposes on the banking establishment intervening in the exchange operation the application of the penalties provided for in Art. 44 of Law No. 4595 of December 31, 1964, without prejudice to the fiscal sanctions permitted by the existing tax legislation.

EXCHANGE OPERATIONS DEPARTMENT

Joseph d'Ávila Mendonça
Manager

ETR-53,136
Translated by C. Ernst
Reviewed by K. Magurn

BRAZILIAN COFFEE INSTITUTE

CIRCULAR No. 88/69

In order that it may be fully known, we copy below the text of Decree-Law No. 557 of April 29, 1969, published in the Diário Oficial (Section I--Part I) of the same date, on page 3,625:

DECREE-LAW No. 557 OF APRIL 29, 1969

Providing for a Tax on Exports of Soluble Coffee

The President of the Republic, in exercise of the powers conferred upon him by paragraph 1 of Article 2 of Institutional Act No. 5 of December 13, 1968, and considering the provisions of Article 22, item 11, paragraph 2 of the Constitution, decrees:

Art. 1. There is established, with effect from May 1, 1969, a tax of NCr$0.51675 per 0.45359 kilograms on the export of soluble coffee in any form to the United States of America.

Art. 2. The Central Bank of Brazil shall readjust the tax referred to in this Decree-Law in the light of variations in the exchange rate, the proportion laid down in the preceding article being maintained.

Art. 3. The payment of the tax shall be effected no later than the moment of settlement of the export operation concerned; the payment to the exporter shall be contingent upon proof that the tax was paid in full.

Art. 4. The tax referred to in this Decree-Law shall be paid to the Bank of Brazil, in a special account, to the credit of the National Treasury.

Art. 5. The Central Bank of Brazil shall issue the instructions necessary for exercising control of the payment of the tax.

Art. 6. The tax shall not fall upon exports of soluble coffee registered with the Brazilian Coffee Institute on or before April 30, 1969, with exchange duly contracted for on or before the same date.

Art. 7. All provisions to the contrary being revoked, this Decree-Law shall enter into force on May 1, 1969.

Brasilia, April 29, 1969; 148th of Independence and 81st of the Republic.

A. COSTA E SILVA
Antônio Delfim Netto.
Rio de Janeiro, May 15, 1969
/s/
JAYME BAPTISTA FERREIRA
General Chief, Administration Department
Acting

Attachment 3

January 3, 1967

MEMORANDUM FOR FILES

Subject: Brazil -- Export Tax

I have examined the tax on exports recently introduced by Brazil under Resolution No. 42 of the National Monetary Council with a view to determining whether it constitutes an exchange tax giving rise to a multiple currency practice within the meaning of the provisions of the Fund Agreement. In making this determination I have examined the text of Law No. 5072 of August 12, 1966, which authorized the levying of the tax and have taken into account the information given by the Brazilian officials to the staff mission which conducted the Article XIV consultation and negotiated the proposed new stand-by arrangement.

There are certain aspects of the tax which seem to suggest that it might constitute an exchange tax giving rise to a multiple currency practice. Thus, Article 1 of Law No. 5072 provides that the tax "is of an exclusively monetary and foreign nature." Further, Article 4 of the Law provides that "the tax shall be collected by the banking establishment that effects the exchange transaction." There are, however, various reasons why the tax should be regarded as an export tax and not as a multiple currency practice within the meaning of the provisions of the Fund Agreement.

(a) In accordance with the provisions of Law No. 5072 and of Resolution No. 42 the tax is assessed not on the foreign exchange surrendered by the exporter but on the difference between the f.o.b. price obtained by the exporter and the "base" price established by the Brazilian authorities.

(b) Law No. 5072 specifically provides that "The taxable event giving rise to the obligation to pay the export tax shall be the movement of the product out of the national territory."

(c) Both Law No. 5072 and Resolution No. 42 provide that "If the goods are not actually exported, the Central Bank of the Republic of Brazil shall refund the tax immediately, upon receipt of a properly documented application by the exporter."

(d) The requirement that the tax be collected by the bank at which the exporter surrenders the foreign exchange obtained from the sale of the commodities does not change the fact that the obligation to pay the tax is incurred under the law at the time of the exportation and because of the exportation. The collection of the tax by the bank at the time of the surrender of the exchange simply constitutes the discharge of an already existing tax liability.

(e) It seems clear from the context of Law No. 5072 that the statement in Article 1 that the tax "is of an exclusively monetary and foreign exchange nature" is not intended to imply that the tax is an exchange tax but rather to indicate that, as explained in the second sentence of Article 1, "Its purpose is to offset the effects on our currency of price fluctuations abroad, and to conserve export revenue."

G. Nicoletopoulos
Deputy General Counsel

cc: Mr. Finch
Mr. Beza
Miss Opasnov

Miss M. Opasnov December 22, 1966

G. Nicoletopoulos

Brazil--Export Tax

In order to enable us to determine whether the Brazilian export tax described in your memorandum to Mr. Sturc, dated December 20, 1966, is a multiple currency practice it would be important to know whether the tax is assessed on the sale price of the commodities (i.e., the amount received by the exporter when he sells the commodities) or on the foreign exchange which the exporter is required to surrender or actually surrenders to the monetary authorities. By "assessed" I mean "applied" by the authorities rather than actually "collected" by them. Could we have copies of Law No. 5072 and National Monetary Council Resolution 42?

cc: Mr. Beza

Mr. Restrepo July 17, 1969

Maria Tyler

GATT Documents on Balance of Payments Restrictions in Brazil

The paper presents the situation as at the end of March 1968 and appears to be based on our 1967 Article XIV consultation report dated April 15, 1968.

The description of the methods used in restricting imports as at that date is correct with the following exceptions:

1. The third sentence in the third paragraph on page 4 appears to be a misinterpretation of the "national similars" system.

2. In describing the highest tariff rate in paragraph 5 on page 5, Decree 264 of February 28, 1967 which reduced the highest rate to 100 per cent, is omitted. Both points are dealt with in your memorandum.

Two minor points should be added. The list of legal and administrative measures forming the base for restrictions as at the end of March 1968 is incomplete. The description of the provisions of Instruction 289 of January 1965 is incorrect.

cc: Mr. Beza

Miss Thompson May 20, 1969

Hans W. Gerhard

Transmittal of Consultation Reports to GATT--Brazil and India

I have been informed that the GATT plans to hold consultations with Brazil and India in early July. The GATT secretariat has indicated that they wish to have the consultation reports on Brazil and India by June 1.

Necessary clearances for the transmittal of the consultation reports have not yet been secured from EDs. In view of the timing, however, I should appreciate your arranging to have three copies of Part I and 35 copies of Part II of both reports (SM/69/48 and Supp. 1, and SM/69/11 and Supp. 1 and Corr. 1) sent airprint to Mr. Jones at our Geneva Office as soon as possible. I will arrange with him to transmit the reports immediately after the clearances are obtained. In the 35 copy distribution of Part II of the paper on India, a reference to EBS/68/193 on p. 60 should be deleted.

I will request the transmittal of relevant Board decisions later when the clearances are obtained.

DRAFT
5/15/69

Brazil

Guidance Statement for Fund Representative to the GATT Balance of Payments Consultation

"The Fund invites the attention of the CONTRACTING PARTIES to the Executive Board decision of April 25, 1969 taken at the conclusion of its most recent Article XIV consultation with Brazil and particularly to paragraphs 2 to 5 which read as follows:

> '2. In 1968 there was a strong rise in economic activity and an improvement in the net foreign reserve position of the monetary authorities, but there was no further progress in reducing the rate of inflation. While the fiscal deficit was held to about the amount that had been planned, bank credit rose much faster than had been envisaged in the financial program, including operations financed from a sharp increase in the commercial banks' short-term foreign indebtedness. The trend toward a deceleration of the rate of increase of money wages that has been evident since 1964 was interrupted in the second half of 1968, as workers were compensated for reductions in real wages that had emerged in previous years as an unintended effect of the application of the official wage formula.
>
> '3. The Government's financial program for 1969 aims at a sharp reduction in the rate of price increase--to about 15 per cent--concomitant with a satisfactory rate of growth and sound balance of payments position. To achieve these objectives the program calls for a major cutback in the rate of expansion of bank credit, based in part on important measures adopted to reduce the fiscal deficit but also entailing a much tighter policy on credit to the private sector. In addition, the continued

application of the wage formula is expected to result in a resumption of the declining rate of money wage increases, and the flexible exchange rate policy is to be maintained.

'4. The Fund believes that the fiscal plan which has been adopted for 1969 as a whole is suitable for the achievement of this year's stabilization goal, and it will be essential to adopt whatever additional measures may be needed to ensure that the fiscal deficit does not exceed the targeted amount. Implementation of the credit policy that has been established for 1969 will require an abrupt change from the recent trend, and the Fund notes the critical importance of improving the monetary authorities' control over credit, including the official banks' operations with the private sector. In this connection, the Fund would also advise careful surveillance over commercial bank use of short-term foreign credits with a view to avoiding undesired swings in bank credit or balance of payments difficulties.

'5. The Fund notes with satisfaction the progress Brazil has made in recent years in reducing its reliance on bilateral payments agreements, and it hopes that further steps will be taken in this direction. The Fund welcomes the intention of the authorities to avoid introducing new restrictions or multiple currency practices, and to pursue a flexible exchange rate policy consistent with the maintenance of a satisfactory balance of payments position. It would be desirable to use the flexible exchange rate policy as a basis for new initiatives to liberalize further the trade and payments system. 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/69/48, Part II.'

Mr Gerhard

On April 25, 1969 the Fund approved a stand-by arrangement authorizing Brazil to draw up to the equivalent of $50 million for a period of 12 months beginning April 29, 1969. This stand-by is in support of policies directed toward ~~a high growth rate,~~ a slowdown in the rate of price increases ~~and~~ achievement of a ~~satisfactory~~ sound balance of payments ~~and~~ position, and maintenance of a satisfactory rate of growth.

In 1968, official net foreign reserves rose by $117 million compared with a decline of $112 million in 1967, but the net foreign reserves of the monetary authorities and the commercial banks (taken together) declined, reflecting the drawings made by the commercial banks on short-term credits."

~~At the present time the general level of restrictions of Brazil which are under reference does not go beyond the extent necessary to stop a serious decline in its monetary reserves."~~

INTERNATIONAL MONETARY FUND

TO : Mr. Takamuki

FROM: Ferran

I'm sending back your draft on Brazil, with the understanding that our Department will look again into the paper when it is sent for official clearance.

I would like to insist on the inappropriateness of the last paragraph in page 3 on Brazil, both as a matter of principle and because it is not consistent with paragraph 5 of the Board resolution than you transcribe.

Mr. Ferran May 22, 1969

Iwao Takamuki

Brazil--Guidance Statement at GATT Meeting

Thank you for your valuable comments. I gave a further thought to the points you raised regarding the statement on Brazil, but I still feel that the last paragraph in the statement is appropriate in this case.

1. At the meeting of the GATT consultation it is up to the Fund to determine the justifiability of import (quantitative) restrictions, and the justification can be made, according to the General Agreement Article XVIII:9, only when either of the following conditions is met:

(1) The import restrictions should not exceed those necessary to forestall the threat of, or to stop, a serious decline in its monetary reserves.

(2) The import restrictions should not exceed those necessary to achieve a reasonable rate of increase in its reserves in the case of a contracting party with inadequate monetary reserves.

The paragraph in question simply follows a procedure which has been established over the years. The paragraph does not dare to imply that the import restrictions are desirable (as compared with other economic measures): it simply indicates the Fund's determination that the import restrictions are justifiable in view of the balance of payments position of the country.

2. The operative sentence in the Board decision indicates that "the Fund does not object to the maintenance on a temporary basis of .... restrictions on payments for current international transactions." I think it is appropriate to give a parallel determination with regard to the import restrictions.

3. The Fund has suggested to use "a flexible exchange rate policy consistent with the maintenance of a satisfactory balance of payments position" "as a basis for new initiatives to liberalize further the trade and payments system". The suggestion on the alternative measures is important but it is included in the guidance statement as a quotation from the decision. Further, the suggestion does not seem to be inconsistent with the temporary consent to the import restrictions.

4. Deletion of the paragraph is not advisable, because the quoted Board decision does not refer to the balance of payments justifiability of the import restrictions and also because we have no reason to refrain from expressing our views regarding the import restrictions of the country.

ITakamuki:meb

Mr. Kafka May 6, 1969

Hans W. Gerhard

Transmittal to GATT Secretariat of Papers on
Fund's Article XIV Consultation with Brazil

I should appreciate hearing from you whether you have any objection to the transmittal to the GATT of the papers on the Fund's recent Article XIV consultation with Brazil, viz., SM/69/48 including Supplements 1 and 2. This transmittal would be in accordance with the arrangement set forth in EBD/56/102. Under that arrangement, Part II of the consultation paper and the Board's decision are to be made available to the CONTRACTING PARTIES generally in cases where they are planning to hold a consultation with a common member, and Part I is to be made available only for the confidential use of the GATT secretariat. Brazil is among the countries with which GATT balance of payments consultations are tentatively planned for 1969.

Office Memorandum

TO : Mr. Gerhard

DATE: May 5, 1969

FROM : Jorge Del Canto

SUBJECT : Transmittal to GATT Secretariat of Brazil's Article XIV Consultation Report

We do not anticipate issuing any corrections to the Brazilian consultation report (SM/69/48 and Supplement 1).

cc: Mr. Vera
Mr. Beza

Brazil - Corr. & Docs

RECEIVED
APR 30 1969
EXCHANGE & TRADE RELATIONS DEPT.

SEC-51,921
Translated by C. Ernst
Reviewed by J. Merry
115610

Mr. Hughes ✓

BACENCAM RIO

FROM BANCO CENTRAL DO BRASIL--OFFICE OF THE PRESIDENT

TO INTERFUND WASHINGTON DC

PT 4164 4/29/69

Orig: WHD
cc: MD
DMD
Mr. Kafka
LEG
ETRD

JORGE DEL CANTO

I INFORM YOU BANCENTRAL IN ACCORDANCE DECISION NATIONAL MONETARY COUNCIL MEETING APRIL 24 YESTERDAY ISSUED RESOLUTION NO. 113 PROVIDING DIRECTIVES ON INVESTMENT OF TECHNICAL RESERVES OF INSURANCE COMPANIES AND REVOKING RESOLUTIONS 92 AND 110 ON THE SUBJECT. THE RESOLUTION ISSUED LISTS ALTERNATIVES FOR INVESTING THESE RESOURCES AND ESTABLISHES THAT BETWEEN APRIL 1969 AND MARCH 1970 INSURANCE COMPANIES MUST PURCHASE CENTRAL BANK INDEXED NATIONAL TREASURY BONDS OR NATIONAL TREASURY NOTES IN AN AMOUNT EQUIVALENT TO AT LEAST 50 PER CENT OF THE DIFFERENCE BETWEEN TOTAL AMOUNT OF RESERVES ASCERTAINED IN 1967 AND 1968. COPIES RESOLUTION FOLLOW VIA AIR MAIL. CORDIALLY ARY BURGER, ACTING PRESIDENT BANCENTRAL

Received in Cable Room

April 29, 1969

Mrs Tyler
file: Brazil corresp.

Mr. Eduardo Gomes, Alternate Executive Director for Brazil

April 4, 1969

C.D. Finch, G. Nicoletopoulos, and S.T. Beza

Recent Brazilian Measures Relating to Import Financing

On the basis of information provided by you, the staff understands the practice of the Brazilian authorities with respect to the administration of the recent measures relating to import financing to be the following:

1. Remittances for bona fide interest payments on drafts entered into prior to March 12, 1969, with a term of up to 180 days from date of shipment are permitted freely and without undue delay whether such payments are included as part of the invoiced value of an import or specified separately in the contract.

2. With respect to drafts entered into after March 12, 1969 with a term of up to 180 days, the remittance of interest payments is not permitted if applied for separately. However, importers are free to include any bona fide interest payments on such drafts as part of the invoiced value of an import and as a result there is no effective limitation on the making of current payments abroad.

3. CACEX Announcement 264, subparagraph (d) specifies that applications for import certificates and import licenses issued in the period between May 21, 1968 and March 12, 1969, with a payment term in excess of 180 days and up to 360 days would be examined by CACEX, and, when granted, finalized by means of an addendum. The examination affects only import certificates and import licenses, not exchange contracts already entered into in respect of certificates and licenses issued in this period.

The staff paper on the Article XIV consultation with Brazil will be based on this understanding of the facts. We would, however, appreciate your keeping us informed of any additional information on how these new measures are being applied.

ETR-51,634
Draft translation
by C. Ernst

FROM JOSEPH D'AVILA MENDONCA--CENTRAL BANK OF BRAZIL--TELEX 541 852
TO EDUARDO GOMES--INTERNATIONAL MONETARY FUND--WASHINGTON DC

PT 03601   4/1/69

IN REPLY TO YOUR TELEX MARCH 27, WE INFORM YOU:

(1) REMITTANCES OF INTEREST ON TIME DRAFTS BETWEEN 180 AND 360 DAYS FROM THE DATE OF SHIPMENT OF THE IMPORTED GOODS ARE PERMITTED ONLY AGAINST DEBIT ADVICE OR EQUIVALENT DOCUMENT AND THE RELEVANT AMOUNT SHALL NOT BE INCLUDED IN THE COMMERCIAL INVOICE, EVEN THOUGH, IN CONFORMITY WITH ITEM 3 OF GECAM ANNOUNCEMENT 102 OF MARCH 26, 1969, THE INTEREST AND THE PRINCIPAL ~~XXX~~ MAY BE SETTLED SIMULTANEOUSLY;

(2) TRANSACTIONS CONCLUDED PRIOR TO GECAM ANNOUNCEMENT 99 OF MARCH 12, 1969 ARE SUBJECT TO EXAMINATION BY CACEX IN CONFORMITY WITH ANNOUNCEMENT NO. 264 OF MARCH 12, 1969, ITEM 2 (D) AND CASES ACTED UPON SHALL BE FINALIZED BY MEANS OF ATTACHMENTS, PROVIDED THAT THEY RELATE TO AN IMPORT CERTIFICATE OR IMPORT LICENSE ISSUED BETWEEN MAY ~~1~~ 21, 1968 (DATE OF RESOLUTION 91) AND THE DATE OF THE AFORE-MENTIONED ANNOUNCEMENT;

(3) THE PROVISIONS OF ITEM 2(D) OF CACEX ANNOUNCEMENT 264 DO NOT REFER TO OPERATIONS CONTRACTED FOR WITHIN THE PERIOD MENTIONED THEREIN BUT REFER TO IMPORTS FOR WHICH CERTIFICATES OR LICENSES WERE ISSUED WITHIN THAT PERIOD.

INTERFUND WSH
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INTERFUND WSH

APR - 1 1969

BACENCAM A RIO

DE JOSEPH D'AVILA MENDONCA - BANCO CENTRAL DO BRASIL - TELEX 541 852
PARA EDUARDO GOMES - FUNDO MONETARIO INTERNACIONAL - WASHINGTON DC

PT 03601 1.4.69

EM RESPOSTA SEU TELEX 27 DE MARCO, INFORMAMOS:

1) SAO PERMITIDAS REMESSAS DE JUROS SOBRE SAQUES A PRAZO ENTRE 180 E 360 DIAS DA DATA DE EMBARQUE DA MERCADORIA IMPORTADA UNICAMENTE CONTRA NOTA DE DEBITO OU DOCUMENTO EQUIVALENTE NAO DEVENDO O VALOR RESPECTIVO SER INCLUIDO NA FATURA COMERCIAL, MUITO EMBORA, NA FORMA DO ITEM 3 DO COMUNICADO GECAM 102 DE 26.3.69, A LIQUIDACAO DOS JUROS E DO PRINCIPAL SEJA FEITA SIMULTANEAMENTE.,

2) OS NEGOCIOS CONCLUIDOS ANTERIORMENTE AO COMUNICADO GECAM 99 DE 12.3.69, SERAO PASSIVEIS DE EXAME PELA CACEX NA FORMA DO COMUNICADO NR 264 DE 12.3.69, ITEM 2 ALINEA ''D'', E FORMALIZADOS OS CASOS ATENDIDOS POR MEIO DE ADITIVOS, DESDE QUE SE RELACIONEM COM GUIA OU LICENCA DE IMPORTACAO EMITIDA ENTRE 21.5.68 (DATA DA RESOLUCAO 91) E A DATA DO REFERIDO COMUNICADO.,

3) AS DISPOSICOES DO ITEM 2 ALINEA ''D'' DO COMUNICADO 264 DA CACEX NAO DIZEM RESPEITO A OPERACOES CONTRATADAS NO ESPACO DE TEMPO ALI REFERIDO, E SIM AAS IMPORTACOES CUJAS GUIAS OU LICENCAS TENHAM SIDO EMITIDAS NAQUELE PERIODO.

Mr. Brand March 27, 1969

S.T. Beza

Official Intervention Practices in Exchange Markets - Argentina, Brazil, and Uruguay

The answers to the questions raised in Mr. Habermeier's memorandum of March 19, 1969, are as follows:

1. Argentina

(i) When the present exchange rate of M$N 350 per U.S. dollar (not a par value with the Fund) was established, on March 13, 1967, the Central Bank announced that the rates at which it would intervene in the market would be fixed on a daily basis and would be within 1 per cent of M$N 350 per U.S. dollar. In practice, however, the Central Bank has bought and sold foreign exchange only at the rate of M$N 350 per U.S. dollar over the past two years.

(ii) We do not know why the authorities have chosen to deal at only one rate.

(iii) See answer to question (i).

(iv) See answer to question (i).

(v) While the Central Bank deals in and holds a number of currencies, the U.S. dollar has been and continues to be the main intervention currency.

2. Brazil

(i) Currently, the monetary authorities buy foreign exchange at NCr$3.975 per U.S. dollar and sell foreign exchange at NCr$4.00 per U.S. dollar. The exchange rate is being adjusted frequently--five times in the last seven months--and there is no effective par value with the Fund.

(ii) We do not know why the monetary authorities have chosen the afore-mentioned spread between buying and selling rates, except that the monetary authorities also engage in commercial transactions and therefore would appear to be guided by the practices of the rest of the banking system in setting the spread.

(iii) The monetary authorities operate at the limits indicated above.

(iv) The spread between the buying and selling rates--in terms of cruzeiros per U.S. dollar--has changed with the movements of the exchange rate, but in recent years it has remained in the range of one half of 1 per cent and two thirds of 1 per cent, measured against the buying rate.

(v) While the monetary authorities deal in and hold a number of currencies, the U.S. dollar has been and continues to be the main intervention currency.

3. Uruguay

(i) Currently, the monetary authorities buy foreign exchange at Ur$248 per U.S. dollar and sell foreign exchange at Ur$250 per U.S. dollar. The exchange rate has been adjusted many times in recent years, and the par value agreed with the Fund is not used for any transactions.

(ii) We do not know why the authorities have chosen the afore-mentioned spread between buying and selling rates, except that the monetary authorities also engage in commercial transactions and therefore would appear to be guided by the practices of the rest of the banking system in setting the spread.

(iii) The monetary authorities operate at the limits indicated above.

(iv) The spread between the buying and selling rates--in terms of pesos per U.S. dollar--has changed with the movements of the exchange rate, but over the last two years it has been about 1 per cent or a little less, measured against the buying rate.

(v) While the monetary authorities deal in and hold a number of currencies, the U.S. dollar has been and continues to be the main intervention currency.

TO: Mr. Beza ✓
Mr. Blackwell
Mr. Sansón
Mr. Guenther
Mr. Radford
Mr. Zayas
Mr. Caiola

March 20, 1969

FROM: Paul J. Brand PJB

Would you please look into the questions raised by the attached memorandum from Mr. Habermeier, assemble the information insofar as it is available, and let me have it by March 27.

If you feel a discussion would be useful we can, of course, arrange a meeting.

I take it that in many, if not most, of our countries the "market intervention" points would be the buying and selling rates fixed by the central bank for its dealings with the commercial banks (and in some cases with others). Arrangements such as the variable transfer charge applied in some Caribbean countries are also relevant. In the case of nominally or actually fluctuating rate arrangements, it may be much more difficult to provide specific answers.

Attachment

March 19, 1969

MEMORANDUM

To: Mr. Del Canto ✓
Mr. Gunter
Mr. Savkar
Mr. Touré
Mr. Whittome

From: W.O. Habermeier

Subject: Official Intervention Practices in Exchange Markets

At a recent informal meeting of Executive Directors a request was made by a number of Executive Directors for further information regarding official intervention policies in members' foreign exchange markets. This question may be broken down into the following:

(i) the exchange rate limits (excluding commission charges) that monetary authorities have chosen in which to intervene in their foreign exchange markets;

(ii) the reasons why the monetary authorities have chosen limits which are frequently well within the permitted one per cent either side of parity;

(iii) whether in fact monetary authorities consistently, or otherwise, deal within or at their chosen limits for purpose of intervention in their exchange markets;

(iv) whether they have altered their intervention limits over time and why they might have altered these limits; and

(v) whether they have changed the currency which they regard as their main means of intervention in the foreign exchange market.

In order to be able to prepare a paper on this subject, I should be grateful if it would be possible for you to arrange for the staff in your Department to review, as far as it is possible, and in light of the various aspects of the problems outlined above, the intervention policies and practices of the monetary authorities of each of the countries represented in your Department. We feel that this would be an important first step in gathering detailed country-by-country information on a problem about which comparatively little is generally known.

I should like to ask you to make the information available to Treasurer's within the next two weeks, as we might have to contact central banks directly in case the information presently available in the Fund were to show important gaps.

Mr. Finch March 25, 1969

Maria O. Tyler

Recent Brazilian Measures relating to Import Financing

In view of the status of the consultation paper we need urgent clarification of the new Brazilian arrangements concerning short-term foreign credits for imports. Prima facie it seems that the recently introduced measures may involve restrictions on payments or transactions.

You will recollect that during 1968 and early 1969 the Brazilian authorities have made a series of changes in the regulations relating to the contracting of foreign financing for imports. It may be helpful if I were to try to summarize the measures in chronological order:

1. Early in 1968 the authorities discontinued the requirement that an exchange contract had to be closed prior to the clearance through customs; the effect of this was to free importers to arrange whatever credit terms they could secure from foreign suppliers (Central Bank Resolution 82 of January 3, 1968).

2. On May 21, 1968 this regulation was amended by Central Bank Resolution 91 which provided that, as a general rule, the maximum period for which payments for imports could be delayed was not to exceed 180 days from the date of shipment. In exceptional circumstances and at the discretion of the Central Bank payment for imports could be delayed up to 360 days.

3. On March 12, 1969 new regulations were published (Central Bank Announcement 99) concerning the payment of interest on time drafts for periods of not more than 360 days for imports in the General Category. The Announcement states that, as a general rule, the remittance of interest on drafts payable on account of imports with a term of less than 180 days from the date of shipment will not be authorized. Remittance of interest on time drafts for periods up to 360 days from the date of shipment will be permitted only in respect of the period that exceeds the initial 180 days. However, remittance of interest on drafts maturing in less than 180 days from the date of shipment could be permitted at the discretion of CACEX (the Foreign Trade Department of the Bank of Brazil) in respect of certain imports.

4. Simultaneously, Announcement 264 of the Foreign Trade Department of the Bank of Brazil, provides, inter alia, that applications relating to import certificates and import licenses that had been approved against time drafts of up to 360 days in the period between May 21, 1968 and March 12, 1969 would be subject to re-examination.

It seems therefore that in the period between May 21, 1968 and March 12, 1969 importers were free to arrange short-term credits up to 180 days from date of shipment without prior authorization. The effect of the March 12, 1969 Announcement appears to be to discourage the contracting of such short-term financing by restricting the payment of interest in respect of such loans and credits. Moreover, it is not clear whether the provisions of the Bank of Brazil Announcement 264 may give rise to ex post facto payments restrictions subject to Fund approval.

In an attempt to clarify the position the staff approached Mr. Gomes who explained after talking with Rio, that his authorities assumed that, since interest on time drafts for periods up to 180 days was normally not specified separately in the invoice (but was included as part of the c.i.f. price), the interest payments would not be restricted, in practice. He did not say why in these circumstances, the Announcement had been issued.

I would suggest the position should now be discussed with the Legal Department. It seems that we need assurances that any bona fide interest due on existing and future time drafts for periods of not more than 180 days will be permitted if it is included as part of the cost of the import, and if such interest payments were specified separately in contracts entered into prior to the March 12 announcement their remittance would also be permitted freely. In the period prior to the March 12 announcement this will have no retroactive effect on freedom of remittance. If, however, Mr. Gomes' understanding that it is not the authorities' intention to restrict interest payments is not confirmed, we would need to clarify whether the limitation on interest payments is a restriction on payments or on transactions.

With respect to Announcement 264 of March 12, 1969 by the Foreign Trade Department of the Bank of Brazil we would need confirmation that its provisions would not result in new restrictions on payments for imports and interest contracted under time drafts of up to 360 days between May 21, 1968 and March 12, 1969.

Enclosures

c.c. Mr. Beza
Mr. Hughes
Mr. de Looper

BANK OF BRAZIL

Foreign Trade Department

Announcement No. 264

In view of the provisions of item III of Resolution No. 91 of May 21, 1968 of the Central Bank of Brazil and GECAM Announcement No. 72 of July 23, 1968 of its Exchange Operations Department, the Foreign Trade Department of the Bank of Brazil makes public the following:

Parties interested in availing themselves, in exceptional cases, of a term in excess of 180 (one hundred eighty) days and up to 360 (three hundred sixty) days, reckoned from the date of shipment of the merchandise, for payment of their imports, may file a pertinent application with CACEX, subject to the following:

(a) Such applications will be acted upon only if they relate to raw materials and parts and accessories for own use and capital goods of which there is no similar national production;

(b) Interest, if any, will be counted as from the 181st day from the date of shipment;

(c) Such applications shall be prepared by the interested parties together with each import certificate application ["PGI"] or import license application ["PLI"] to which they relate and shall be submitted to CACEX simultaneously therewith; otherwise they will not be considered;

(d) Applications relating to import certificates or import licenses issued during the period between May 21, 1968 (date of Resolution 91) and today shall also be subject to examination and, when granted, shall be finalized by means of an attachment;

(e) The interested party shall include all the data necessary for consideration of the application:

Term of payment abroad;

Rate of interest for the financing, if applicable;

Name and address of the financing party;

Purpose of import.

Rio de Janeiro (GB) March 12, 1969

/ s/ Benedicto Fonseca Moreira, Director
/ s/ Jefferson Seroa da Motta, Acting Import Manager

CENTRAL BANK OF BRAZIL

Rio de Janeiro, March 12, 1969

GECAM Announcement No. 99

IMPORTS -- Payment of interest on time drafts

We inform those concerned that--in accordance with a decision of the National Monetary Council at its meeting of March 11, 1969--the payment of interest on time drafts at periods of not more than 360 days (three hundred and sixty days) relating to imports regulated by this Bank's Resolutions Nos.82 and 91, of January 3, 1968 and May 21, 1968, shall be subject to the following conditions:

(a) Except as provided in item 2, the remittance of interest on drafts payable at up to 180 (one hundred and eighty) days from the date of shipment shall not be authorized;

(b) On drafts at longer periods--provided that such period does not exceed 360 (three hundred and sixty) days, also counting from the date of shipment--remittance of interest will be permitted only in respect of the amount of time in excess of the initial 180 (one hundred and eighty) days;

(c) The applicable rates of interest may not be higher than those in effect in the money market of the country in whose currency the operation is carried out, on the date of issuance of the import certificate or import license;

(d) collection of the interest referred to may be made by means of a debit advice or an equivalent document, without inclusion in the commercial invoice;

(e) Advance settlement of time drafts subject to payment of interest in conformity with this announcement shall be permitted only if a discount proportionate to such anticipation has been granted.

2. For imports of goods whose marketing conditions are distinguished by special features, at the discretion of the Foreign Trade Department of the Bank of Brazil, the remittance of interest on time drafts maturing in less than 180 (one hundred and eighty) days, may be permitted.

3. Upon applying to the Foreign Trade Department of the Bank of Brazil for issuance of the import certificate or import license, importers must state whether or not they desire to carry out the operation under the time payment procedure. In the event of a period of more than 180 (one hundred and eighty) days, they shall also inform the Foreign Trade Department of the rate of interest agreed upon with the exporters.

4. CACEX shall record such conditions on the import certificate or import license, to enable the importers to acquire, on the basis of that document and upon production, in addition, of a negotiable copy of the bill of lading, the commercial invoice, and the debit advice, the foreign exchange needed to pay the portion that corresponds to interest.

5. Exchange for the remittance of interest shall be contracted for exclusively for immediate settlement, and never prior to the maturity date of the relevant draft.

6. Intermediary banks shall note on exchange contracts of this kind the number of the import certificate or import license, the identification of the means of transportation, the date of shipment, and the number of the relevant bill of lading.

EXCHANGE OPERATIONS DEPARTMENT
Joseph d'Avila Mendonca, Mana

CENTRAL BANK OF BRAZIL

Rio de Janeiro, July 23, 1968

GECAM ANNOUNCEMENT NO. 72

IMPORTS - Item III of Resolution No. 91

[SUMMARY]

This announcement sets out the procedure to be followed in applying for authorization to take advantage of the maximum period of up to 360 days allowed in exceptional cases under the provisions of item III of Resolution No. 91. Applications are to be submitted to CACEX together with the application for the import certificate, import license, or declaration, accompanied by information concerning the import such as terms of payment, description of merchandise, price (showing freight and insurance separately), interest rate charged if any, and the purpose of the import.

Approval of terms of payment up to 360 days shall be expressly stated in the import certificate, license, or declaration and will automatically entitle the importer to conclude a forward exchange contract for a period compatible with the due date of the operation, subject to the provisions of GECAM Announcement No. 42; the limitation set out in item 4 of FICAM Announcement No. 44 is revoked in respect of the operations concerned.

In concluding exchange contracts, banks are responsible for verifying that the operation complies with the periods stipulated in items I and III of Resolution No. 91.

The provisions of Resolution No. 91 do not apply to certificates, licenses, or declarations issued prior to the date on which it took effect.

Exchange Operations Department

/s/
Joseph d'Avila Mendonça
Manager

ETRD-48,735
Translated by C. Ernst
Reviewed by J. Merry

CENTRAL BANK OF BRAZIL

RESOLUTION No. 91

In accordance with a decision of the National Monetary Council at its meeting held today, and in conformity with the provisions of Article 4(V) and (XXXI) and Article 9 of Law No. 4595 of December 31,1964, the Central Bank of Brazil

RESOLVES:

I. To fix at 180 (one hundred and eighty) days, counting from the date of shipment, the maximum period for payment for goods imported under the conditions of this Bank's Resolution No. 82 of January 3, 1968.

II. To make imports for which the period of settlement exceeds 360 (three hundred and sixty) days, counting from the date of shipment of the goods, subject to registration with this Bank.

III. In exceptional cases and at the discretion of the Central Bank, to allow the period mentioned in item I of this Resolution to be extended to 360 (three hundred and sixty) days, in which case this condition shall be expressly stated in the import certificate, import license, or declaration, as the case may be.

Rio de Janeiro, May 21, 1968

CENTRAL BANK OF BRAZIL
/s/
Ernane Galvêas
President

Diário Oficial of May 24, 1968

CENTRAL BANK OF BRAZIL

RESOLUTION No. 82

The Central Bank of Brazil, in accordance with a decision of the National Monetary Council at its meeting held today, and in conformity with the provisions of Article 4(V) and (XXXI) and Article 9 of Law No. 4595 of December 31, 1964,

RESOLVES:

I. Customs clearance of imported goods is exempt from the requirement of proof of closing of an exchange contract referred to in item IV of Central Bank Resolution No. 35 of September 17, 1966.

II. The closing of exchange contracts for payment of imported goods will henceforth be conditional upon prior issuance of an Import Permit, an Import License, or a Declaration, as the case may be.

Rio de Janeiro, January 3, 1968

/s/
Ruy Aguiar da Silva Leme
President

Diário Oficial of January 12, 1968

Translated by C. Ernst
Reviewed by B.M. Popescu

CENTRAL BANK OF THE REPUBLIC OF BRAZIL

RESOLUTION No. 35

The CENTRAL BANK OF THE REPUBLIC OF BRAZIL, in conformity with a decision of the National Monetary Council at its meeting held today, and in accordance with the provisions of Article 4, Section V, and Article 9 of Law No. 4,595 of December 31, 1964,

RESOLVES:

I. Imports of products classified in the General Category are granted dispensation from the prior signing of an exchange contract referred to in item II of Instruction No. 204, of March 13, 1961, of the former Superintendency of Money and Credit; consequently, the Certificate of Exchange Cover (C.C.C.) referred to in the sole paragraph of Article 53 of Decree No. 42,820 of December 16, 1957 is abolished.

II. For purposes of the consular visa and customs clearance, the Foreign Trade Department of the Banco do Brasil S.A. shall issue an Import Permit with the characteristics and data of the Certificate of Exchange Cover.

III. The Import Permit shall have a maximum period of validity of 120 days, for purposes of the shipping of the relevant merchandise in the foreign country concerned.

IV. Independently of the provisions of the preceding section, customs clearance of the imported merchandise remains subject to proof of the closing of the relevant exchange contract with authorized banks.

V. The provisions of this Resolution do not prevent the importer from closing the exchange contract before the Import Permit is issued if it is to his advantage to do so.

VI. As long as the new Import Permit forms have not been printed, the former Certificate of Exchange Cover forms may be used, with such notes as may be necessary.

RIO DE JANEIRO, September 17, 1966

CENTRAL BANK OF THE REPUBLIC OF BRAZIL

/s/

Denio Nogueira
President

Diário Oficial of September 20, 1966

Brazil file

Mr. Finch

February 5, 1969

Maria Opasnov Tyler

Brazil - Certain Issues Relating to the Exchange, Trade and Tax Systems.

During the recent mission to Brazil the following information relating to the above subjects became available.

Imports of Petroleum

A new arrangement governing payments for petroleum imports became effective on January 1, 1969. Its purpose is to eliminate a multiple rate practice which had existed under the previous system. I attach a copy of the description of the new regulations, which was cleared with the Brazilian authorities.

Taxes Levied on Income of Nonresidents

I refer to previous memoranda on this subject (the joint memorandum of ETR and WHD of October 28, 1968, the memorandum of the Legal Department of November 14, my memorandum of December 2, 1968 and the memorandum of the Legal Department of December 6, 1968; copies are attached). I investigated this matter further with the Income Tax Authorities in the Ministry of Finance where I was informed that while the income, including royalties, accruing to nonresidents may not be remitted without compliance with the 25 per cent withholding tax collected either by the Income Tax Authorities or by the commercial banks for the account of the Income Tax Authorities at the time of the remittance, the income is still subject to the same tax if the nonresident chooses to keep the income in Brazil. The information reported on this subject in my memorandum of December 2, 1968, was obtained from the Department for the Control and Registration of Foreign Capital (FIRCE) at the Central Bank and it had not been possible to check its accuracy at that time with the Ministry of Finance.

The supplementary income tax on remittances of profits and dividends, on the other hand, is applied only if the average of actual remittances in any three-year period, from 1963 onwards, is in excess of 12 per cent per year of registered capital and reinvestment (i.e., 36 per cent over a three-year period). If such profits and dividends are kept in Brazil the supplementary tax is not levied.

Enclosure

cc: Mr. Beza, Mr. Hughes, Mr. de Looper

MOTyler/mt

Brazil File

Mr. Finch February 5, 1969

Maria Opasnov Tyler

Brazil - Bilateralism

During the recent consultation and stand-by mission to Brazil I was informed that in 1968 Brazil had again engaged in switch transactions involving the sale of bilateral credit balances for convertible currencies. As in 1967, the transactions consisted of the sale by the Brazilian monetary authorities to European banks of U.S. dollar denominated credit balances accumulated in bilateral accounts in the amount of $24 million against an equivalent amount in convertible currencies. All sales were on November 14 exclusively to Swiss banks. The bank purchasing the bilateral balances was given, without any payment, a claim on coffee imports from Brazil in the form of a guarantee notice issued by the Brazilian Coffee Institute. The guarantee notice entitles the holder to import a stated amount of coffee from Brazil free of charge. The value of the guarantee notices, calculated at the prevailing minimum registration prices for coffee, corresponded to 13.25 per cent of the bilateral balances sold. The amount sold consisted of the following bilateral currencies.

Bilateral Balances	Amount (In millions of U.S. dollars)
Bulgarian	9
Hungarian	5
East German	5
Yugoslavian	5
	24

Brazil's over-all credit balance on bilateral agreements was reduced from $52 million at the end of September 1968 to $27 million at the end of December 1968.

I was informed that prior authorization had to be obtained in each case from the authorities of the government whose bilateral balances were to be sold. A typical resultant transaction would then be for the European bank acquiring the bilateral balance plus coffee guarantee notice to use the bilateral balance for the purchase of commodities in the bilateral country and to sell the goods in western markets at a discount, which the bank would be able to recoup as a result of the gain it realized from the sale of the coffee guarantee notice. The Brazilian official at the Central Bank noted that the special authorization from the bilateral partner was required in order to enable the bilateral partner to ensure that the sale of the bilateral balance by Brazil resulted in exports that would otherwise not have been purchased with convertible currency, thus providing the bilateral partner with an additional export outlet. Obviously, however, there can never be any final certainty of this, although it can take account of traditional customers.

The Brazilian officials emphasized again that it continued to be their policy to move toward a multilateral payments system. Since 1966 Brazil has terminated bilateral payments agreements with four countries, including two Fund members (Portugal and Denmark). Moreover, a decision was reached at the end of 1968 to terminate the agreement with the U.S.S.R. which is expected to be implemented in February. Brazil will then maintain bilateral payments agreements with nine countries, of which four are with Fund members, i.e., Greece, Iceland, Israel and Yugoslavia.

The Brazilian officials noted that the agreement with Greece had not caused difficulties to Brazil as Greece normally settles any excess over the established swing limit of $1 million semi-annually in convertible currencies. They indicated, however, that they were ready to examine the possibility of terminating this agreement. The agreement with Iceland was modified on September 1, 1968 to provide for a greater degree of convertibility. While the swing limit was increased from £ 200,000 to £ 350,000, it was stipulated that debit balances had to be settled in full in convertible pounds sterling semi-annually in June 30 and December 31. The Brazilian officials indicated that the agreement with Israel was maintained for political reasons.

With regard to the agreement with Yugoslavia, they repeated their position that Brazil was ready to terminate this agreement provided Yugoslavia's bilateral arrangements with other coffee exporting countries were also terminated and Brazil was assured of nondiscriminatory treatment for their coffee exports. (My memorandum of October 25, 1968 on this subject is enclosed). Moreover the Brazilian officials stated that, should the Fund attempt to arrange a multinational discussion among the interested parties with a view of terminating the agreements concerned, Brazil should be very ready to participate.

Enclosure.

cc: Mr. Sturc
Mr. Beza
Mr. Hughes
Mr. de Looper.

MOTyler/mt

RIO BL
IN CURRE

Foreign - Exchange
Are Rife Amid Inflati

By PAUL L. MONTGOMERY
Special to The New York Times

RIO DE JANEIRO, July 17—For nearly 40 years, Mr. Roberto has sat near the dusty front window of his exchange shop on the Avenida Rio Branco, watching the nervous buyers and the nervous sellers come and go.

"It's a strange business," he said, hunching over his ledgers while still keeping an eye on the street. "We deal in money, of course, and there is profit in it. But so many things we deal in exist only in the imagination of the people."

Mr. Roberto, who has another name that he likes to keep to himself, is an operator in the Brazilian black market for foreign currency. There are scores of shops like his in the teeming commercial center of the city, many more near the tourist hotels on Copacabana Beach and thousands of other freelance dealers throughout the country.

Dealers in Strange Places

The traveler finds black-market operators in strange places. A dentist, a taxi driver, a florist, even a popcorn vender, may offer a foreigner Brazilian cruzeiros at an illegal rate.

One estimate puts the volume black-market foreign exchange at about $200-million a year, or about 10 per cent of all foreign - exchange transactions.

The last few months in Brazil have been a good time for the black market, which is called the manual or the free market in polite conversation. The last devaluation of the cruzeiro, on Dec. 29, stabilized the market for a time, but the nation's endemically inflationary economy and climbing cost-of-living statistics caused a new break around April.

As in all inflationary economies, the reasons for the black market are complex. The starting point is the official rate, which is set by the Government. In Brazil, all transactions at other than the official rate—3.2 new cruzeiros to the dollar—are illegal.

The Bank of Brazil, the central bank, is committed to sell dollars for cruzeiros at the official rate within certain limits. Businessmen wishing to import materials from abroad can pay cruzeiros into the central bank. Brazilians traveling abroad can buy up to $1,000 in dollars at the official rate once they have shown that they have paid their income taxes.

Many Desire Secrecy

However, there are many people who do not wish to deal in foreign exchange through the central authorities since their financial affairs then become government knowledge. This includes people who want more than $1,000 for a foreign trip and foreign businessmen who wish to avoid a 25 per cent remittance tax on profits if they exchanged cruzeiro profits for dollars at the central bank.

These people create a demand for dollars. The supply is provided by foreigners living in Brazil whose salaries are paid in dollars and who wish to get more cruzeiros for their money, by businessmen who have dollars to invest and wish to get more cruzeiros than they are entitled to under the official rate, and by tourists, who generally will take anything they can get.

There are also many speculators, who buy dollars for cruzeiros at higher than the official rate with the expectation that a devaluation will bring them a profit. This expectation has not been often frustrated, as there has been a devaluation approximately every 10 months since the military coup of March, 1964.

Dollar Speculation Not Wise

Actually, speculation in dollars is not a wise investment in Brazil. Last year the stock exchange average rose more than 70 per cent and the market in letters of exchange rose more than 40 per cent, while the dollar market rose only about 32 per cent.

However, since financial institutions are not remarkably reliable in the country, the tendency appears to be to invest in real things such as dollars.

This week the black-market rate was as high as 3.7 cruzeiros to the dollor. The "tourist rate," which is generally given only to gullible Americans, was 3.35.

Mr. Roberto deals only with customers that he has gotten to know. The other day two Argentine tourists walked into his shop, which operates enly for everything except xchange rate an dhe turned out.

ll, have nothing to do ," he announced, after fered him dollars at

Orig: WHD
cc: MD
DMD
Mr. Kafka
LEG
ETRD

SEC-49,120
Translated by J. Merry
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RECEIVED
JUL 23 1968
EXCHANGE & TRADE RELATIONS

BANCENTRAL RIO--PRESI//INTERFUND WSH--USA//JULY 19, 1968

No. 68/00662

FOR MR. ALEXANDRE KAFKA AND

MR. JORGE DEL CANTO

I inform you that the Central Bank, in accordance with a decision of the National Monetary Council at its meeting of July 15, today handed down Resolution No. 95, worded as follows:

Resolution No. 95

The Central Bank of Brazil, in accordance with a decision of the National Monetary Council at its meeting of July 15, 1968 and considering the provisions of Articles 9 and 4(XXI) of Law No. 4595 of December 31, 1964, and Articles 7, 8, 9, and 16, paragraph 3, of Law No. 4728 of July 14, 1965,

RESOLVES:

1. To establish the maximum limit of 3 per cent per annum, "pro rata temporis," calculated on the face value of the issue, for the placement rate that may be collected or paid on the market for mortgage bonds, exchange paper, or debentures issued, accepted, or co-guaranteed by financial institutions. Payment or collection of this rate may be made only against receipt issued by brokerage or distributing firms, brokers, or autonomous agents duly registered with the Central Bank of Brazil.

II. To establish the maximum limit of 0.25 per cent on the face value of the issue for the distribution rate that may be collected, against receipt as described in Item I, if distribution is not made direct by the issuing, accepting, or co-guaranteeing financial institution.

III. To establish the following maximum limits for the collection of commissions for the services of distribution or placement, on the market, of federal, state, or municipal public debt bonds:

1.5 per cent, on the subscribed values, for bonds maturing in up to one year,

3 per cent, ditto ditto, from one to two years,

4 per cent, ditto ditto, in more than two years.

IV. To change Article 84 of Resolution No. 39, of October 20, 1966 with reference to the brokerage table applied by members of the stock exchange, as follows:

"I--For variable-income stocks and securities, on the basis of the total market value of the operations executed in a single day for a single client:

1--up to NCr$5,000...1.5 per cent, minimum of NCr$5

2--on amount exceeding NCr$5,000 and up to NCr$30,000...1 per cent

3--on amount exceeding NCr$30,000...0.5 per cent

II--For fixed-income stocks and securities, on the basis of the market value:

1--securities maturing in less than three years, between date of operation and date of redemption... 0.5 per cent, minimum of NCr$5

2--securities with three or more years between date of operation and date of redemption...1 per cent, minimum of NCr$5."

III--For federal, state, or municipal public debt bonds, on the basis of the face value, in any amount and maturing on any date: 0.5 per cent, minimum of NCr$5."

Rio de Janeiro, July 19, 1968
BANCO CENTRAL DO BRASIL
Ernane Galveas
President

Copy of the document referred to follows by air mail.

Cordially,

Ernane Galveas, President of the
Banco Central do Brasil

Received in Cable Room:
July 20, 1968

Mrs. Tyler

Mr. D. Finch
Mr. S.T. Beza

November 14, 1968

G. Nicoletopoulos

Brazil--Exchange System

This is in response to your memorandum of October 28, 1968 requesting the Legal Department's views regarding certain features of the Brazilian exchange and taxation systems, namely, (1) the special arrangements for petroleum imports, and (2) certain provisions for taxing the income of persons resident abroad.

With regard to the special arrangements for petroleum imports I should like to confirm the view expressed in a memorandum on Brazil's exchange sytem sent to the Managing Director on August 30, 1968 by Messrs. Finch, Gerstein, and Robichek. According to that view in present circumstances of contemplated frequent rate changes by the Brazilian authorities, the exchange guarantee granted by the Bank of Brazil to Petrobras will give rise to a multiple currency practice subject to Fund approval. When one of the contemplated changes in the exchange rate takes place in accordance with the official statement of the Brazilian authorities a special, preferential, rate will apply to petroleum imports.

In our view, the withholding tax on the income of nonresidents levied under Decree No. 47,373 of December 7, 1959, as amended, does not involve an exchange restriction within the Fund's jurisdiction. With regard to the supplementary tax levied under Decree Law No. 4131 of September 31, 1962, as amended, on profits and dividends effectively remitted to nonresidents, we will need additional information before we could express a view on whether an exchange restriction subject to the Fund's jurisdiction is involved. The specific information we would like to obtain is indicated below:

(a) Method(s) of assessment and enforcement of this tax. For example, would the tax be imposed if the remittance were made to a Brazilian bank account of the nonresident recipient of income, or otherwise credited to the recipient in Brazil? Would the character of the account be relevant for the answer?

(b) Role of the additional collection slip described in § X of Service Order No. DIR/1-67. What use does the Central Bank make of it, and what are the consequences of failure to deliver it to the Central Bank?

ATTACHMENT II

Decree No. 47,373 of December 7, 1959, as amended by Law No. 3898 of May 19, 1961, approving the Regulations governing income tax, contains the following provisions regarding persons resident abroad.

"<u>Persons resident abroad.</u> The income of persons resident or domiciled abroad is subject to tax withheld at the source, at the following rate:

a) At 25 per cent: on income received by individuals or companies resident or domiciled abroad including the income derived from exploitation of motion pictures, and by residents of Brazil who are absent for more than 12 months;

profits
dividends
interest
+ royalties
(capital
gains ?)

b) Income received by the foregoing persons as royalties, such as income derived from exploitation of a trademark or patent or of manufacturing processes or formulas.

The above provisions apply also to residents abroad who remain in Brazil for less than twelve months. Excepted from these provisions are: a) Commissions paid by exporters of national products to their agents abroad, for services rendered in that capacity; b) Commissions paid by shipping companies to their agents abroad; c) profits shown by the affiliates of companies domiciled abroad which are used in Brazil for expansion of their industrial plant; d) profits received by persons domiciled in Brazil but who are outside the country in the service of the Nation or for study.

The taxable income from the exploitation of foreign motion picture films is computed at 30 per cent of the amounts paid, credited, employed, remitted, or turned over to producers, distributors, or intermediaries abroad."

ATTACHMENT III

Excerpt from Decree Law 4131 of September 3, 1962, as amended by Law No. 4390 of August 29, 1964 governing foreign investment and financial remittances abroad.

"<u>Article 43.</u> The sum of profits and dividends effectively remitted to persons and companies resident or domiciled abroad, is subject to supplementary income tax when the (annual) average remittance, over three years beginning with the financial year 1963, exceeds 12 per cent on the capital and reinvestments registered in accordance with Articles 3 and 4.

<u>Paragraph 1.</u> The supplementary tax will be levied as follows:

For remittances of 12 to 15 per cent of profits on capital and reinvestments	40 per cent
For remittances of 15 to 25 per cent	50 per cent
For remittances above 25 per cent	60 per cent

<u>Paragraph 2.</u> This supplementary tax will be deducted and collected at source, on the occasion of each remittance that exceeds the three-year average referred to above.

<u>Article 44.</u> The tax will be increased by 20 per cent when companies are engaged in activities of less interest to the national economy because of the place of operation and other factors. Such activities will be defined in a decree of the Executive, after consultation with the National Economic Council and the Council of the SUMOC.

<u>Article 45.</u> Revenue from the showing of cinematographic films, except the revenue of exhibitors who are not importers, will be subject to deduction of tax at the rate of 40 per cent; but the taxpayer may opt for the deposit in the Banco do Brasil in a special account of 40 per cent

of the tax due, which may be applied with the authorization of the Cinema Industry Executive Group-GEICINE (set up under Decree No. 50278 of 17th February 1961), in film production in Brazil, under the terms of Decree No. 5106 of 1st August 1961.

Article 46. Profits derived from the sale of fixed assets, including the cession of rights, when the owner is an individual or a company resident or with head office abroad, are subject to tax at the rates provided for in Article 43.

Attachment IV

INCOME TAX DEPARTMENT

SERVICE ORDER No. DIR/1-67

— INCOME SUPERTAX, OWING AT THE SOURCE, ON REMITTANCES ABROAD OF PROFITS OR DIVIDENDS.

Whereas Article 43 and Law No. 4131, of September 3, 1962, amended by Law No. 4390, of August 29, 1964, determines that the amount of the net profits or dividends effectively remitted to physical and juridical persons, resident or having a head office abroad, shall be subject to an income supertax whenever the average of such remittances over three years, from the year 1963 on, exceeds 12% (twelve per cent) of the registered capital and reinvestments, in the terms of Articles 3 and 4 of Law 4131, amended by Law No. 4131, amended by Law No. 4390;

Whereas Law No. 4131, Article 7, defines reinvestment as being the sums that might have been legally remitted abroad, but were not, having been plowed back into the business that earned them or into another sector of the national economy, and Decree No. 55,762, of February 17, 1965, Article 10, makes it clear that reinvestments shall be registered simultaneously in Brazilian currency and in the currency of the country to which the returns might have been remitted, and that conversion shall be operated at the average rate of exchange ascertained over the period from the date the profits were posted on the balance sheet in the case of a juridical person to the date the reinvestment was effectively made or, rather, converted into capital;

The Director of the Income Tax Department, making use of the powers conferred upon him, and after having consulted the competent sectors of the Central Bank of Brazil.

Determines that all Regional Sectional Delegates and Chief inspectors of Income Tax Inspectorates observe the following instructions and see that they are carried out:

I — Net profits or dividends effectively remitted to physical and juridical persons, resident or domiciled abroad, are subject to an income supertax whenever the average remittances every three years, from the year 1963 on, exceed 12% (twelve per cent) of the capital and capitalized profits, registered at the Central Bank of Brazil.

II — In the calculation of the supertax, profits shall be considered to include all sums remitted abroad, corresponding to expenses of any kind not deductible for purposes of determining the taxable profits or a juridical person with head offices in this country.

III — Calculation of supertax shall cover all remittances of profits or dividends made during the three-year period, even though these receipts correspond to previous years.

IV — The capital and capitalized profits shall be computed proportionally to the time they remained in the business, during the three years, with due observance of their registration at the Central Bank of Brazil, the effective average of the three-year period being determined from the books of the firm and the aforesaid registration.

V — Pending registration at the Central Bank of Brazil, the capital and capitalized profits shall be computed for purposes of calculating the three-year average, so long as they figure on acknowledgments of responsibility and are determined in accordance with the previous item being subject to subsequent readjustment of the components, if called for, after registration has been completed.

VI — The first three-year period to be considered in the calculation of the supertax covers the years 1963, 1964 and 1965 and the second the years 1964, 1965 and 1966. Subsequent three-year periods will follow the same order.

VII — The remittances of the last two years of a three-year period will be considered in the first two years of the next at the average value for the preceding three-year period up to the limit of 12% (twelve per cent) of the capital and capitalized profits.

VIII — The supertax shall be withheld at the source from the first remittance ocurring after the expiry of the three-year period and shall be collected within the term fixed for the collection of the normal tax corresponding to that remittance.

IX — The supertax collection slips shall be accompanied by an explanatory schedule of the capital, including the capitalized profits and the remittances during the three-year period (model attached).

X — At the time of payment of the tax referred to in the previous item, in addition to the collection slip normally furnished to the company, another will be handed it for delivery together with a certified copy of the attached schedule to the Central Bank of Brazil when application is made for remittances abroad of profits or dividends.

XI — Without detracting from the control specifically entrusted by law to the Central Bank of Brazil as regards the remittance abroad of profits or dividends, it is also the duty of Income Tax Department authorities to exercise such supervision and control as may be necessary.

XII — Service Order No. DIR/23-64 is hereby revoked — ORLANDO TRAVANCAS, Director.

Mr. Nicoletopoulos October 28, 1968

C. David Finch and Sterie T. Beza

Brazil: Issues to be clarified prior to forthcoming mission

Attached is a memorandum describing certain features of the Brazilian exchange and taxation systems, namely

(1) special arrangements for petroleum imports, and

(2) certain provisions for taxing income of persons resident abroad.

We would appreciate an opinion from the Legal Department whether the practices described and documented in the attached memorandum give rise to multiple currency practices. If it should not be possible to reach a decision on the above issues on the basis of the information contained in the attached memorandum, we would like precise instructions as to the additional information required so that it may be obtained during the forthcoming mission to Brazil on November 10.

Attachment

Mr. Finch
Mr. Beza

October 28, 1968

Maria Opasnov Tyler

Brazil: Issues to be clarified with Legal Department prior to forthcoming mission

Prior to the proposed review mission to Brazil in mid-November, it would be helpful to clarify with the Legal Department the following practices in Brazil's exchange and taxation systems with a view to facilitating a determination as to whether they constitute multiple currency practices subject to Fund approval.

I. Petroleum imports

Under a special arrangement[1] for petroleum imports, the state-owned petroleum importing company "Petrobras" closes an "open exchange contract" with the Bank of Brazil for a period of 120 days for estimated requirements of petroleum imports for that period. Individual exchange contracts for actual shipments of petroleum up to the value of the open contract during any such period are then closed at the exchange rate prevailing on the day when the open contract was signed. Payment for such petroleum imports is made 110 days from the date of shipment, with the Bank of Brasil charging Petrobras 2 per cent per month on the value of the contract outstanding during the 110 days. This is the estimated premium charged at present by private commercial banks for future contracts and is in addition to the interest rate levied by foreign suppliers of oil who normally extend credit for 110 days. It is understood that the premium applied in the financing of petroleum contracts will be adjusted in accordance with the prevailing market premium for forward contracts for other imports.

For imports other than petroleum the following payments procedures apply: Exchange contracts may be closed for settlement at sight when intended to settle drafts accompanied by shipping documents, with the requirement that such exchange contracts must be settled within two days. Exchange contracts may be closed forward only when it is intended to open a letter of credit or to pay for goods already shipped; the credit has to be opened within five working days from the date of the exchange contract. Commercial banks normally require a guarantee deposit for their own protection for forward exchange contracts; the deposit varies from bank to bank and from customer to customer and may amount to as much as 100 per cent for forward contracts connected with letters of credit. The effective cost to the customer of these guarantee deposits may be estimated at about 2.7-2.8 per cent per month, or equivalent to the reported going rate of interest. For any uncovered balance, banks charge a premium; the going market rate for financing uncovered forward contracts is at present around 2 per cent per month. The maximum period for which payments for imports may be delayed normally does not exceed 180 days from the date of their shipment.

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[1] The system described here is the one introduced following the adoption of the new exchange system in August 1968. For a description of the previous arrangement for petroleum imports, see Attachment I.

Thus, the main differences between the payments system currently applying to petroleum imports and other imports are as follows.

1. The exchange rate for petroleum imports is fixed forward for a period of 120 days. The exchange rate at which the individual contract for actual petroleum imports are concluded during that period is the one prevailing on the date when the open contract was signed and will differ from the rate applying to exchange contracts concluded at the same time in respect of other import transactions whenever there is an adjustment in the exchange rate. Because under the present exchange system the exchange rate is to be adjusted frequently, special exchange rate treatment for petroleum imports will result in a systematic deviation of the rate applicable to these imports from that applicable to all other imports.

2. The exchange contracts for actual petroleum imports have a specified forward form.

(a) There is no guarantee deposit requirement.

(b) There is a fixed premium for financing the forward contract. This premium is, in principle, to be adjusted periodically to reflect the premium prevailing in the market for forward contracts.

(c) The duration of the individual exchange contract is fixed at 110 days.

The above features distinguishing the payments system for petroleum imports from that for other imports appear to be the ones relevant to a decision on the possible existence of a multiple currency practice. However, the Legal Department may wish to examine whether there are any additional features of the payments system described above that may be relevant to reach a decision on this matter.

II. Certain provisions for taxing income of persons resident or domiciled abroad

During discussions with the Brazilian delegation to the Annual Meeting, Mr. Pereira-Lira, a Director of the Central Bank, mentioned the payment of a remittance tax on transfers abroad of interest payments. In reply to a question, Mr. Pereira-Lira noted that the tax was an income tax which was also levied on interest payments on funds borrowed in Brazil. He explained, however, that the remittance of the interest payment abroad could not be effected unless the tax had been paid and that the payment of it took place at the time of the remittance and could not be delayed until the filing of the respective income tax return at the end of the taxable year. However, he was not completely clear about all the details of the provisions.

The Brazilian income tax law (Decree No. 47,373 of December 7, 1959, as amended by Law No. 3898 of May 19, 1961) contains a withholding tax provision in respect of nonresidents. A copy of the text of the provision is attached (Attachment II). Under the law, this tax is withheld at source and does not appear to differ from theusual provisions for withholding taxes. On the face of things, there is no connection between the income tax and the exchange system as such. However, since Mr. Pereira-Lira has implied a connection, we shall need to ascertain during the forthcoming mission the precise operation of the withholding tax provisions in order to determine whether they constitute an exchange tax.

Separately, Decree Law 4131 of September 3, 1962, as amended by Law No. 4390 of August 29, 1964 governing foreign investment in Brazil, contains certain provisions for taxation of income remitted to nonresidents. Among the main features is one that provides for the levying of a supplementary income tax, ranging up to 72 per cent, on the sum of profits and dividends effectively remitted to persons and companies resident abroad when the average remittance over three years, from 1963 onwards, is in excess of 12 per cent of registered capital and reinvestments. A copy of the text of the relevant provisions of this decree law is contained in Attachment III. A copy of Service Order No. DIR/1-67 regarding the operation of this tax is also attached (Attachment IV). Paragraphs three and four of this order make it clear that the administration of the tax is carried out by the tax authorities and not by the central bank. Article VIII specifies that the tax is withheld at source, while in Article X a clear distinction is made between the levying of the tax and the exchange transaction, both in terms of the administering authority and the timing of the two operations. The above would seem to confirm our interpretation in previous consultation papers where we described the system without raising the issue that a possible multiple currency practice existed. If, however, it should not be possible for the Legal Department to confirm this view on the basis of the information presented above and in attachments III and IV, it would be helpful if it could indicate precisely what further information is needed to reach a decision on this matter.

Attachments

ATTACHMENT I

Previous payments system applicable to petroleum imports

Under the previous system, Petrobras closed an "open exchange contract" with the Bank of Brazil at the beginning of each calendar quarter for estimated requirements of petroleum imports for that period. Individual exchange contracts for actual imports made during the life of the contract were closed at the exchange rate prevailing on the date the open contract was signed. Payment against such exchange contracts was made 30 per cent cash on the date of shipment and the balance of 70 per cent 110 days from the date of shipment. The balance outstanding during the 110 day period was subject to a monthly charge of 1 per cent.

Geraldo Vouga

ATTACHMENT II

Decree No. 47,373 of December 7, 1959, as amended by Law No. 3898 of May 19, 1961, approving the Regulations governing income tax, contains the following provisions regarding persons resident abroad.

"Persons resident abroad. The income of persons resident or domiciled abroad is subject to tax withheld at the source, at the following rate:

a) At 25 per cent: on income received by individuals or companies resident or domiciled abroad including the income derived from exploitation of motion pictures, and by residents of Brazil who are absent for more than 12 months;

b) Income received by the foregoing persons as royalties, such as income derived from exploitation of a trademark or patent or of manufacturing processes or formulas.

The above provisions apply also to residents abroad who remain in Brazil for less than twelve months. Excepted from these provisions are: a) Commissions paid by exporters of national products to their agents abroad, for services rendered in that capacity; b) Commissions paid by shipping companies to their agents abroad; c) Profits shown by the affiliates of companies domiciled abroad which are used in Brazil for expansion of their industrial plant; d) Profits received by persons domiciled in Brazil but who are outside the country in the service of the Nation or for study.

The taxable income from the exploitation of foreign motion picture films is computed at 30 per cent of the amounts paid, credited, employed, remitted, or turned over to producers, distributors, or intermediaries abroad."

profits
also
incl.
royalties

ATTACHMENT III

Excerpt from Decree Law 4131 of September 3, 1962 as amended by Law No. 4390 of August 29, 1964 governing foreign investment and financial remittances abroad.

"Article 43. The sum of profits and dividends effectively remitted to persons and companies resident or domiciled abroad, is subject to supplementary income tax when the (annual) average remittance, over three years beginning with the financial year 1963, exceeds 12 per cent on the capital and reinvestments registered in accordance with Articles 3 and 4.

Paragraph 1. The supplementary tax will be levied as follows:

For remittances of 12 to 15 per cent of profits on capital and reinvestments	40 per cent
For remittances of 15 to 25 per cent	50 per cent
For remittances above 25 per cent	60 per cent

Paragraph 2. This supplementary tax will be deducted and collected at source, on the occasion of each remittance that exceeds the three-year average referred to above.

Article 44. The tax will be increased by 20 per cent when companies are engaged in activities of less interest to the national economy because of the place of operation and other factors. Such activities will be defined in a decree of the Executive, after consultation with the National Economic Council and the Council of the SUMOC.

Article 45. Revenue from the showing of cinematographic films, except the revenue of exhibitors who are not importers, will be subject to deduction of tax at the rate of 40 per cent; but the taxpayer may opt for the deposit in the Banco do Brasil in a special account of 40 per cent of the tax due, which may be applied with the authorization of the Cinema Industry Executive Group-GEICINE (set up under Decree No. 50278 of 17th February 1961), in film production in Brazil, under the terms of Decree No. 5106 of 1st August, 1961.

Article 46. Profits derived from the sale of fixed assets, including the cession of rights, when the owner is an individual or a company resident or with head office abroad, are subject to tax at the rates provided for in Article 43."

Office Memorandum

Exchange and Trade Relations Department
No. 153 Date: 9/12/68

TO : The Managing Director

DATE: August 30, 1968

FROM : C.D. Finch, A.S. Gerstein, and E.W. Robichek

SUBJECT : Brazil - Exchange System

In the report on their recent visit to Brazil, Messrs. Restrepo and Daremblum noted that the President of the Central Bank referred to the use of three-month exchange rate guarantees for wheat and petroleum imports to prevent frequent adjustments in the exchange rate, as are now planned, from having a continuous impact on the prices of these products. Apparently, the idea is to maintain an exchange rate for imports of these products that would usually entail a more appreciated cruzeiro than for other imports. It is our view that such procedures constitute multiple currency practices subject to the approval of the Fund. Under the previous arrangement the exchange rate for petroleum imports was fixed for specified periods and a multiple currency practice arose for a limited time after each adjustment in the exchange rate. Under a system of frequent rate changes (perhaps as often as once a week, if the earlier plans of the Minister of Finance are put into effect), special exchange rate treatment for wheat and petroleum would result in a systematic deviation of these rates from that applicable to other foreign transactions.

During the Minister of Finance's visit to the Fund next week we should take the opportunity to obtain as precise a picture as possible of the new exchange rate system, and in this connection it would be useful to enquire about the proposed treatment for petroleum and wheat. If his response should indicate that the arrangements contemplated would result in multiple currency practices, the Minister should be told (1) that such practices are subject to Fund approval and (2) that it would be difficult to justify approval, inasmuch as they would entail continuous subsidization by the Central Bank of the consumption of these products while not effectively helping to reduce the rate of increase of prices of such products. The Minister may contend that it is not possible to adjust the prices of bread and gasoline more than once every two to three months, and therefore exchange rate guarantees are needed. To meet this problem a more satisfactory solution would be to set the prices of these products for any given period to correspond to the average expected cost of importing the requisite raw materials over that period. It would therefore appear appropriate to try to persuade the Minister to avoid resorting to exchange rate arrangements that give rise to multiple currency practices.

cc: The Deputy Managing Director
Mr. Del Canto
Mr. Vera
Mr. Nicoletopoulos
Mr. Beza

Mr. W. F. Hughes October 25, 1968

Maria O. Tyler

Bilateral Payments Agreement--Brazil-Yugoslavia

The following background information on the Brazil-Yugoslavia bilateral payments agreement is submitted with a view to preparing plans for possible action by the Fund toward elimination of the agreement.

On the occasion of the Brazilian Finance Minister's visit to the Fund at the beginning of September, the Brazilian officials indicated that they envisaged difficulties in persuading their authorities to abandon the arrangement with Yugoslavia unless two specific conditions were met. First Yugoslavia's bilateral arrangements with other coffee exporting countries would also have to be terminated. Second, Brazil would require strong assurances that Yugoslavia would not enter into new bilateral arrangements with other coffee exporting countries.

Yugoslavia maintains such agreements with India and Guinea; there is also a bilateral arrangement between a Yugoslav Foreign Trade Organization, "Intertrade" and the National Federation of Coffee Growers, which the Yugoslavs claim is not a bilateral agreement, though the Colombians regard it as such.

Imports of coffee into Yugoslavia are admitted under quotas which are established in either physical quantities (RK) or dinars (DK). Separate quotas are issued for coffee imports from countries with which settlements are made in convertible currencies and from the bilateral partners. In order to be meaningful, the elimination of bilateral payments agreements with the coffee growing countries would, therefore, have to be followed by a shift of coffee imports to the LB system applicable to liberalized imports.

During discussions at the time of the IMF Annual Meeting, Mr. Mermolja (National Bank of Yugoslavia) noted that the agreement with India was important politically though plans were being prepared for altering the basis of settlement. He further said that there seemed no particular reason for the retention of the agreement with Guinea. Mr. Mermolja stated, however, that the agreement with Brazil was of importance to the Yugoslav economy and it was not easy to see how it could be abolished. By far the most important part of Yugoslavia's coffee imports comes from Brazil, the latter's share in the Yugoslav market having increased from 41 per cent in 1963 to 84 per cent in the first half of 1967. Listed in decreasing order of importance other suppliers during the first half of 1967 were Colombia, India, and Guinea. Under the Brazil-Yugoslav agreement, Yugoslavia has been a persistent debtor. Yugoslavia's debt balance reached $25 million by the end of September 1967. During the latter part of 1967 Brazil sold $14.5 million from the accumulated bilateral balance through switch transactions to European banks at an effective discount of around 14 per cent (via coffee guarantee notices). At the end of 1967 Yugoslavia's outstanding debit balance in the account was $10 million.

In view of the fact that the unwillingness of Yugoslavia to terminate the agreement is directly linked to Yugoslavia's shortage of foreign exchange reserves, action by the Fund toward its elimination may prove particularly difficult. This is a hard core agreement, mainly, it would appear, because of difficulties on the Yugoslav side. As for Brazil, the authorities have stated their willingness to move towards terminating the agreement provided they are assured of nondiscriminatory treatment for their coffee exports. Obviously the Colombia-Yugoslavia arrangement is the most critical in this respect, but the agreements with India and Guinea are also relevant. If those three agreements could be terminated, accompanied by a shift to a liberalized system of coffee imports, it would seem that Brazil's export position in Yugoslavia should not be damaged, since Brazilian coffee suits the Yugoslav demand for price taste and quality. Moreover, Brazil would be paid in convertible exchange.

On the Yugoslav side, the probable consequences of termination do not seem favorable. The Yugoslav attitude at present is that without the agreement Yugoslavia would have to pay for coffee with convertible currency and, owing to the shortage of reserves that this would imply a corresponding reduction in other imports currently bought from the convertible area, even though these would be likely to be of higher priority. It is implicit in this argument, of course, that the sale of bilateral balances by Brazil results in Yugoslav exports to the purchasers of these balances that would not otherwise have occurred. If, however, the balances are in fact used in payment for Yugoslav exports that would otherwise have been purchased with convertible currency, then Yugoslavia does not benefit, and the Yugoslav argument against termination becomes somewhat weaker. The staff has no information on the conditions, if any, that Yugoslavia imposes on these sales of balances by Brazil. It should be helpful, therefore, if the next missions to the two countries could obtain information on this matter. If it appears that the balances are being used by "normal" buyers of Yugoslav exports, then the staff would be in a stronger position to argue that Yugoslavia is merely foregoing convertible currency receipts. The staff should also explore means by which the arrangement with Colombia can be terminated, since whether or not it is a payments agreement in the language of the Fund, it certainly is a major impediment to a termination of the agreement with Brazil. In any event, the staff should continue to urge Yugoslavia to terminate the agreements with Guinea and India. A joint confrontation between Yugoslavia, India, Guinea, and Colombia in September 1968 might bring some results.

The main difficulty facing Yugoslavia in the external sector is its inability to increase sufficiently its receipts from the convertible area, and it is this which makes it reluctant to terminate the Brazilian agreement, which has provided Yugoslavia with a low-interest loan over a long period. If Yugoslavia can improve its over-all balance of payments, then the problem of termination will be eased. However, a solution to the balance of payments problem cannot be expected in the short-term. In the circumstances, the Brazilian-Yugoslav agreement must be classed as hard core.

With regard to the short run target, however, Yugoslavia should be encouraged to raise the standard of performance of its exports to Brazil so that the swing margin under the agreement can be given some degree of reality and might then be adequately policed. This is a matter for the Yugoslav authorities rather than those of Brazil, and should be emphasized to the Yugoslavs in the course of the next staff mission in March/April, 1969. In this connection, it should be noted that there are no impediments in the Brazilian exchange and trade system to imports from Yugoslavia. On the contrary, in the past imports from bilateral payment agreement countries, including Yugoslavia, enjoyed preferential treatment through the exchange system, and more recently the Central Bank of Brazil has encouraged imports from bilateral countries, including Yugoslavia, by engaging in the financing of such imports.

Minutes of Meeting Held with the Brazilian Delegation
Sheraton Park Hotel - Thursday, October 3, 1968 at 3:00 pm

Present: Brazilian Delegation

Mr. Ernane Galveas, President, Central Bank
Mr. Paulo Pereira Lira, Director, Central Bank
Mr. Affonso Celso Pastore, Advisor, Ministry of Finance
Mr. Pedro Cipollari, Advisor, Ministry of Finance

IMF Staff

Jorge Del Canto
C. David Finch
Sterie T. Beza
Maria O. Tyler
Jorge Restrepo

Executive Directors

Mr. Alexandre Kafka, Executive Director
Mr. Eduardo da Silveira Gomes, Jr., Alternate Executive Director

Mr. Del Canto opened the meeting by asking the Brazilian representatives for details on the working of the new exchange rate system which was put into effect at the end of August, following a devaluation of the cruzeiro equivalent to 13.4 per cent. Mr. Pereira Lira began by expressing the authorities' satisfaction with the operation of the new system and especially with the support of the general public, including the main newspapers. Mr. Pereira Lira stated that the new exchange system could best be described as one of small, more frequent, unannounced, and irregularly timed changes in the rate. These were the characteristics of the second adjustment of the rate, which was equivalent to about 1.3 per cent and came about four weeks after the initial move was made. The magnitude of the changes, Mr. Pereira Lira continued, will depend mainly on the movement of prices and foreign reserves, and will also take into account the performance of the export sector. However, these criteria would not be applied in any fixed pattern. He added that the authorities are now making projections of cash flows in the foreign sector to determine the seasonality of reserve movements, thereby providing them with a firmer basis for making judgements on the necessary adjustments of the exchange rate.

Mr. Pereira Lira proceeded to describe the complementary exchange measures which were adopted at the time the new system was introduced last August. He expressed satisfaction with the way the newly authorized interbank exchange market was working. Although limited, this market is viewed by the authorities as a first step in the establishment of a wider exchange market in Brazil, under which the banks would play an active role rather than merely being the agents of the Central Bank. Mr. Pereira Lira explained that the authorization given to banks to collect premiums on forward exchange contracts was designed to legalize a common practice, but the principal change is that premiums will have to be specified separately in such contracts. The new requirement that banks stamp the passport of a traveler when he obtains foreign exchange also represented the formalization of a practice that had been quite common.

Referring to the recent talks with the Minister of Finance, Mr. Beza said that there were some policy questions related to the new system that had been raised at that time but which the Minister said could be taken up more fully during the Annual Meeting. In particular, he asked the Brazilian representatives for a clarification of the policies the Government intends to pursue with respect to petroleum imports, the exchange rate for coffee exports, and the operations of the manual and futures markets. To these questions, Mr. Pereira Lira gave the following answers: first, with respect to imports of petroleum, under the system existing prior to August, 1968, Petrobrás would close an open exchange contract for 90 days and individual contracts for actual imports made during the life of the contract would be paid at the rate prevailing on the date the open contract was signed. Payment for petroleum imports was made 30 per cent cash on the date of the corresponding shipment and the balance of 70 per cent was paid 110 days from the date of shipment. The outstanding balance during the 110 days was subject to a monthly charge of 1 per cent. Under the new system, worked out in connection with the new exchange rate policy, the rate for petroleum imports will still be fixed at the time the open contract for estimated petroleum requirements is signed by Petrobrás, but the time period of the contract is to be extended to 120 days. Individual exchange contracts for actual imports of petroleum during any such period will continue to be entered into at the exchange rate prevailing at the beginning of the period. Moreover, no cash payment will be required at the time of shipment and the obligation for the full value of imports will fall due 110 days from the date of shipment. Petrobrás will be charged 2 per cent a month on the amount of each contract from the date of shipment until final payment is made (this charge is approximately equivalent to the forward premium currently charged by banks and is in addition to the interest rate levied by foreign suppliers of oil who normally extend credit for 110 days).

The staff representatives expressed their concern with respect to the possible losses that the Central Bank could incur as a consequence of the petroleum policy outlined and also with respect to the differential treatment for petroleum as against other imports. Mr. Pereira Lira replied that pricing policy for petroleum products would be designed to avoid losses and that the financial charge on petroleum contracts would be adjusted so as to approximate the premium in the forward market. The staff representatives pointed out, however, that the fixing of the exchange rate for petroleum imports for the period of the open contract (as was described above) gave rise to the possibility of a multiple currency practice. Mr. Pereira Lira noted that petroleum prices will be increased by about 18 per cent on November 1, 1968, and thereafter adjustments will be made three times a year. In this connection, the staff representatives observed that the adoption of a pricing policy for petroleum products that took account of future movements in the exchange rate (for periods of three to four months) would obviate the need for a special exchange rate treatment for petroleum imports.

There was also some discussion of possible wheat import arrangements, but the Brazilian delegation indicated it was not sure of the details involved, and it was agreed to take up this matter more fully during the forthcoming review mission.

On coffee policy, Mr. Pereira Lira explained that the authorities do not intend to adjust the coffee rate on the occasion of each adjustment of the exchange rate under the new system. Basically, coffee policy will continue to be set once a year, although there may be provisions for adjustments in the coffee rate during the course of the coffee year, as has been the practice in the recent past. He noted that the cruzeiro return to coffee exporters was increased slightly at the time of the devaluation in August, but it was not changed when the exchange rate was adjusted in September. He added that it is planned to increase the cruzeiro return to exporters in January 1969, in accordance with the coffee program that was announced in April 1968.

Answering questions from the staff representatives on the operations of the manual market, Mr. Pereira Lira explained that it was the policy of the authorities not to provide exchange cover for exchange houses, which are expected to achieve balance in their operations without support from the authorities or the commercial banks. He added that the exchange houses are required to operate at the exchange rates set by the authorities and that any departure from these rates is illegal. Replying to a question from the staff on limits on foreign exchange for travel, he stated that any bona fide traveler may request foreign exchange in excess of the $1,000 authorized per person per trip, and he also noted that the practice of requiring a certificate confirming income tax compliance for this purpose has been discontinued.

With respect to the new arrangements in the futures market, Mr. Pereira Lira indicated that forward operations continue to be authorized only for imports and exports of goods and services; forward exchange contracts may not be entered into for transfers related to financial transactions such as those made under Instruction 289 and Resolution 63. Premiums on futures contracts, he added, will not be fixed by the monetary authorities but will, of course, be affected by interest rate policy, inasmuch as importers have the alternative of closing a futures contract or securing a loan and buying exchange spot.

Regarding movements of short-term capital, Mr. Pereira Lira drew attention to the problems that had been experienced this year. Foreign resources were brought into the country on a massive scale after the devaluation in January, but later the inflow petered out and subsequently was reversed as speculation against the cruzeiro mounted in the middle of the year. He noted that the previous exchange rate system of large step movements in the rate--every eight to twelve months--coupled with the prohibition of forward exchange cover for these transactions was bound to give rise to large swings in such capital flows, inasmuch as the relative cost of foreign and local borrowing fluctuated sharply during the period between exchange rate changes. The potential user of foreign credits has to compare the total cost of foreign funds (say, 8 per cent for interest plus the equivalent of 3 per cent to cover the remittance tax plus the expected change in the exchange rate) against an interest cost of 36 per cent a year for local funds. Under the new exchange rate system the expected change in the exchange rate at any given point in time will be more predictable, and therefore the relative costs of borrowing internally or externally will be more stable and fluctuations in the movements of short-term capital much more moderate. Mr. Pereira Lira observed that the new system could result in a reduction in the inflow of short-term capital related to prefinancing of exports, and consequently the authorities are considering the possibility of allowing forward cover for this kind of operation, thereby alleviating pressures on credit from domestic sources. With respect to the aforementioned remittance tax, the staff representatives requested further information to determine if it is an exchange tax, but it was decided that further discussions on this issue will take place at the time of the next mission to Brazil.

Finally, it was agreed to field a review mission to Brazil next month, with an advance party traveling to Rio de Janeiro on November 10. The purpose of this mission would be to review performance under the current stand-by arrangement and to negotiate a financial program for the four-month period of the stand-by that extends into 1969. The Brazilian Executive Director expressed his doubts as to the possibility of preparing a financial plan for 1969 by November, but he indicated that it might be possible to describe the targets in the form of a range. In response the staff representatives noted that it would appear likely that by November the financial plans for the early months of 1969 would be reasonably firm, even though the program for the full year might still be incomplete, and therefore they did not see why it would be necessary to adopt a new approach in describing the quantitative bases of the program.

Responding to a question from Mr. Kafka on whether the mission would be expected to prepare a report for the Executive Board on the results of the review, the staff representatives replied that this would be decided after the mission has returned to Washington, but they anticipated that such a report would be necessary in view of the need to present the quantitative program for the first four months of 1969.

STBeza/JRestrepo:nsr

Mr. Hughes September 23, 1968

Maria O. Tyler

<u>Agreement between Central Bank of Iceland and Banco Central do Brasil</u>

The text of the above agreement was referred to me by Mr. Scott for my comments.

The agreement, effective on September 1, 1968, replaces the bilateral payments agreement signed between the two parties on May 8, 1956. The present agreement provides that the two institutions grant each other reciprocal lines of credit of £350,000 each, which is to be utilized in payment for imports and exports of goods, of expenses connected with trade as well as of other expenses previously approved by both parties. The credit is initially for a six-month period and is automatically renewable for equal subsequent periods in the event one of the two parties has not denounced the agreement 30 days before the expiration of one such six month time period. At the end of each six month period, i.e., on June 30 and December 31 of each year any debit balance (including principal and interest) is to be liquidated in free convertible pounds sterling. If the limit of the reciprocal credit is exceeded the debtor bank, at the creditor's request, shall pay the excess within five working days of receipt of the respective advice.

There is no mention in the text of the agreement of the establishment of clearing accounts nor of the obligatory channeling of payments through such an account, i.e. there is no currency prescription. The bilateral payments element appears thus to have been removed in the new agreement and replaced by a reciprocal line of credit between the monetary authorities in the two countries. There is a presumption, therefore, that the settlement of payments and transfers between Brazil and Iceland is made in the same way as that applicable to other countries and hence that the agreement as such does not entail any currency discrimination involving currency prescription and limitation of the convertibility and transferability of balances acquired by the partner countries. In order to ascertain, however, that the new agreement no longer constitutes for either party a bilateral payments agreement in the language of the Fund, assurances would need to be obtained from both parties to the Agreement on the following points that

(1) there are no clearing accounts established under the agreement; and

(2) there is no obligatory channeling of payments through such accounts involving a prescription of currency requirement.

I would suggest, however, that we might refer the case to the Legal Department to confirm our understanding. If you agree, I shall prepare an appropriate memo.

Enclosure: Copy of text of agreement.

cc. Mr. de Looper
Mr. Scott

Office Memorandum

TO : The Managing Director

DATE: August 30, 1968

FROM : C.D. Finch, A.S. Gerstein, and E.W. Robichek

SUBJECT : Brazil - Exchange System

In the report on their recent visit to Brazil, Messrs. Restrepo and Daremblum noted that the President of the Central Bank referred to the use of three-month exchange rate guarantees for wheat and petroleum imports to prevent frequent adjustments in the exchange rate, as are now planned, from having a continuous impact on the prices of these products. Apparently, the idea is to maintain an exchange rate for imports of these products that would usually entail a more appreciated cruzeiro than for other imports. It is our view that such procedures constitute multiple currency practices subject to the approval of the Fund. Under the previous arrangement the exchange rate for petroleum imports was fixed for specified periods and a multiple currency practice arose for a limited time after each adjustment in the exchange rate. Under a system of frequent rate changes (perhaps as often as once a week, if the earlier plans of the Minister of Finance are put into effect), special exchange rate treatment for wheat and petroleum would result in a systematic deviation of these rates from that applicable to other foreign transactions.

During the Minister of Finance's visit to the Fund next week we should take the opportunity to obtain as precise a picture as possible of the new exchange rate system, and in this connection it would be useful to enquire about the proposed treatment for petroleum and wheat. If his response should indicate that the arrangements contemplated would result in multiple currency practices, the Minister should be told (1) that such practices are subject to Fund approval and (2) that it would be difficult to justify approval, inasmuch as they would entail continuous subsidization by the Central Bank of the consumption of these products while not effectively helping to reduce the rate of increase of prices of such products. The Minister may contend that it is not possible to adjust the prices of bread and gasoline more than once every two to three months, and therefore exchange rate guarantees are needed. To meet this problem a more satisfactory solution would be to set the prices of these products for any given period to correspond to the average expected cost of importing the requisite raw materials over that period. It would therefore appear appropriate to try to persuade the Minister to avoid resorting to exchange rate arrangements that give rise to multiple currency practices.

cc: The Deputy Managing Director
Mr. Del Canto
Mr. Vera
Mr. Nicoletopoulos
Mr. Beza

DRAFT

TO: Mr. Kafka

DATE: August 15, 1968

FROM: C. David Finch
G. Nicoletopoulos

SUBJECT: Your request for an outline of issues which would arise in connection with a possible move by Brazil to Article VIII.

On the basis of the findings of the latest Fund mission for the discussions in connection with the 1967 Article XIV consultation to Brazil (SM/68/77) the following are the main elements in Brazil's exchange system that would either have to be eliminated or would require Fund approval if Brazil were to move to Article VIII status.

1. Multiple currency practices resulting from the application of taxes on exports of coffee, cocoa and specified cocoa products.

The arrangement of quarterly annual foreign exchange contracts for imports of petroleum and specified petroleum products under which a multiple currency practice may arise.

2. Current payments. Restrictions on current payments and transfers arising from,

(a) the special arrangements for petroleum imports that provide for the tying of payments for such imports to the fulfillment of specified commitments by the foreign supplier;

(b) certain provisions of the Profits Remittance Law, viz. the limitation on remittances of profits to 8 per cent per annum of registered capital invested in the production of goods and services for luxury consumption, and the prohibition of payments for the use of patents and trademarks under specified circumstances;

(c) the maintenance by Brazil of bilateral payments agreements with four Fund member countries, namely Greece, Iceland, Israel, and Yugoslavia.

In addition, a detailed up-to-date review of Brazil's exchange and trade system would have to be made to ascertain whether any other practices exist that may affect a possible move to Article VIII. In particular, the following matters would require further examination:

(a) It would be necessary to ascertain whether the authorities take reasonable action to ensure that all spot exchange transactions (other than those mentioned above) comply with the provisions of Article IV, Section 3 (i) of the Articles of Agreement, i.e., that the maximum and minimum rates for such exchange transactions are within one per cent of the official quotations, and, assuming they are, the actual mechanisms used to achieve this result. In this connection, it will be necessary to have more information than is now the case on the operations of the manual market and also on the working of the provisions of Resolution 94 of July 16, 1968.

(b) It would also be necessary to make sure that other provisions relating to outgoing payments and their administration do not result in restrictions on or undue delays in the making of payments and transfers for current international transactions. In this connection the Fund needs to be assured, among other, that

(i) the Brazilian authorities, in applying their capital controls, do not restrict payments which would be identified as current within the meaning of Article XIX (i) of the Articles of Agreement;

(ii) normal commercial practices are permitted with respect to advance payments for imports;

(iii) the provisions and administration of the LAFTA compensation agreements do not give rise to restrictions on current payments and transfers.

Mr. Kafka August 27, 1968

E. Walter Robichek
C. David Finch

<u>Brazilian Exchange Regulations</u>

We refer to the cable of August 26, 1968 from the President of the Central Bank of Brazil communicating the text of Resolution 98. The resolution introduces the requirement that banks record in passports or other travel documents the date and amounts of foreign exchange sold to travelers for the purpose of ensuring compliance with the limit of $1,000 established in Central Bank Resolution 84. We would like to be informed whether the Central Bank will continue to authorize sales of exchange to travelers in excess of $1,000 for bona fide travel expenses.

SBeza/MOTyler/vh

SEC-49,478
Translated by C.Ernst
Reviewed by B.M.Popescu
106602

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BANCENTRAL RIO--PRESI/INTERFUND WASHINGTON 8/26/68 N68/917

FOR ALEXANDRE KAFKA

FOR JORGE DEL CANTO

Orig: WHD
cc: Mr. Kafka
MD
DMD
LEG
ETR

I INFORM YOU CENTRAL BANK ACCORDANCE DECISION NATIONAL MONETARY COUNCIL MEETING AUGUST 24 ISSUED RESOLUTION NO. 98 WORDED AS FOLLOWS:

"WHEN SELLING FOREIGN EXCHANGE TO MEET PERSONAL EXPENSES OF TRAVELERS, BANKS MUST NOTE IN THE PASSPORTS OR DOCUMENTS SERVING IN LIEU THEREOF THE AMOUNT AND THE DATE OF THE OPERATION, FOR PURPOSES OF OBSERVING THE LIMIT OF U.S. DOLLARS /1,000? AMOUNT GARBLED/ (THOUSAND DOLLARS) OR THE EQUIVALENT IN OTHER CURRENCIES ESTABLISHED IN ITEM III OF CENTRAL BANK RESOLUTION NO. 84 OF JANUARY 3, 1968".

COPIES SAID RESOLUTION FOLLOW VIA AIR MAIL.

CORDIALLY

ERNANE GALVEAS
PRESIDENT BANCENTRAL

RECEIVED
AUG 27 1968
EXCHANGE & TRADE RELATIONS DEPARTMENT

Received in Cable Room
August 26, 1968

Mr. Nicoletopoulos　　　　　　　　　　　　　　　　August 15, 1968

C. David Finch

<u>Brazil and Article VIII</u>

Ref: Mr. Kafka's request for an outline of issues
which would arise in connection with a
possible move by Brazil to Article VIII

Attached is a draft reply to Mr. Kafka on the above matter for your clearance.

You will note that we have included among the main issues the provision of quarterly annual foreign exchange contracts for petroleum imports. We would appreciate, in particular, your view on this point. The arrangement for payment of petroleum and specified petroleum products provides for the closing of an "open foreign exchange contract" at the beginning of each calendar quarter for estimated requirements of such imports during that quarter. Individual contracts are then closed for actual imports shipped during the respective quarter up to the cumulative value of the open contract at the exchange rate prevailing on the day of the closing of the open contract in accordance with the following financing arrangements provided by the Bank of Brazil: 30 per cent of the value of a shipment has to be paid eight working days following the week in which the shipment has taken place, and the remaining 70 per cent 110 days after the date of shipment; for imports of liquid gas the remaining 70 per cent is to be paid 140 days after the date of shipment. The Bank of Brazil charges an interest rate of 1 per cent a month on the balance outstanding during the 110 days or 140 days, respectively. In the past, this practice has been described in our consultation reports as an arrangement that may give rise to multiple rates, i.e., in the case when the exchange rate is adjusted.

In addition to the points raised in the attached draft we wish to draw your attention to the provision contained in the "Profits Remittance Law" for the levying of a supplementary income tax on remittances of profits and dividends from foreign investments if, on a three-year average basis, such remittances exceed 12 per cent of the registered capital and reinvestments.

Attached is a copy of the section on the Exchange and Trade System of the last consultations report on Brazil (SM/68/77). The relevant pages on the points raised above are pp. 71 and 80. Mr. Kafka expressed a wish to receive our note by the end of the week.

Attachments

Mr. Kafka August 20, 1963

C. David Finch
G. Nicoletopoulos
F. Vera

Your request for an outline of issues which would arise in connection with a possible move by Brazil to Article VIII.

On the basis of the information available to us the following are the main practices in Brazil's exchange system whose elimination would need to be considered if Brazil were to decide to move to Article VIII.

1. Multiple currency practices resulting from the application of taxes on exports of coffee, cocoa and specified cocoa products, and the administration of the provision contained in the Profits Remittance Law for the levying, under certain circumstances, of a supplementary income tax on the sum of profits and dividends from foreign investments effectively remitted abroad.

2. Current payments. Restrictions on current payments and transfers arising from

   (a) ~~the special arrangements for petroleum imports that provide for the tying of payments and transfers for such imports to the fulfillment of specified commitments by the foreign supplier;~~

   (b) certain provisions of the Profits Remittance Law, viz. the limitation on remittances of profits to 8 per cent per annum of registered capital invested in the production of goods and services for luxury consumption, and the prohibition of payments for the use of patents and trademarks under specified circumstances;

   (c)

   (d) the maintenance by Brazil of bilateral payments agreements with four Fund member countries, namely Greece, Iceland, Israel, and Yugoslavia.

In addition, a detailed up-to-date review of Brazil's exchange and trade system would have to be made to ascertain whether any other practices exist that may affect a possible move to Article VIII. In particular, the following matters would require further examination:

   (a) It would be necessary to know whether the authorities ensure that all spot exchange transactions (other than those mentioned above) take place at unitary rates; in this connection, more information would be required on:

(i) the operation of the manual market and also on the working of the provisions of Resolution 94 of July 16, 1968;

(ii) ~~the arrangement of quarterly annual foreign exchange contracts for imports of petroleum and specified petroleum products to determine whether it may give rise to a multiple currency practice; and~~

(iii) ~~the administration of the provision contained in the Profits Remittance Law for the levying, under certain circumstances, of a supplementary income tax on the sum of profits and dividends from foreign investments effectively remitted abroad.~~

(b) It would be necessary to have more information regarding the requirement that in the case of certain imports the letter of credit opened for their payment must contain a clause requiring that the transport of the goods be effected on a ship of the Brazilian flag or of the flag of the exporting country.

(c) It would also have to be made sure that other provisions relating to outgoing payments and their administration do not result in restrictions on or undue delays in the making of payments and transfers for current international transactions. Thus, the Fund would need to be assured that

(i) the Brazilian authorities, in applying their capital controls, do not restrict payments which would be identified as current within the meaning of Article XIX (i) of the Articles of Agreement; and

(ii) the provisions and administration of the LAFTA compensation agreements do not give rise to restrictions on current payments and transfers.

GNicoletopoulos/CBFinch/MOTyler/vh

File
Brazil (admin)

June 3, 1968

Dear Mrs. Potter:

As promised, I have read the draft paper on Brazil and also gave it to a colleague who is in charge of the Division in our Western Hemisphere Department, which works on that country. We realize the draft is very much an early version and will be revised and amended but, even allowing for that and for the fact that additional information is needed, we do not find it at all good or adequate. As our comments are informal and are designed to be helpful, I hope you will not mind this blunt reaction. I have a large number of detailed comments but as many will no doubt be taken care of when the draft is edited, I think it would be more useful if I were to give you our broad reactions. The detailed comments relate to such points as (a) the precise measurement of inflation (see p.1); (b) the use of the future tense in the first paragraph on p.11; (c) the relevance of the footnote on p.10; (d) the need for consistency in terms (see top of p.13 re square miles and ha.); (e) the need for precise source references when using phrases such as "according to an estimate" (p.13), and so on.

The major weaknesses or shortcomings my colleague, who has worked intensively on Brazil, finds in the draft are: "(1) The sections of the report on import replacement and industrialization are both too general and analytically weak. If these sections are to be retained, a much more exhaustive investigation of the period under consideration would be required. (2) The draft treats the various development plans formulated in Brazil much more seriously than any of the Brazilian officials I have met; in Brazil, new plans are written and old plans are discarded faster than performance under such plans can be assessed. Finally, the report does not contain the latest development in this field, which is the formulation of a public sector investment program for the three-year period 1968-70. To sum up, I question the utility of a section on development planning in the GATT report. (3) I did not find the product-by-product report projections for 1971 to be convincing, since they are based on what seems to be wild guesses as to prospective volume and prices. A more fruitful approach would be to identify the areas in which Brazil's potential for export expansion is high, and then to examine the external impediments (if any) that may interfere with such growth. Indeed, I was under the impression that the approach I have just suggested is what the new-style consultation is supposed to be about."

My own feeling is that the report attempts to cover too much ground and suffers from inadequate treatment of some aspects and from lack of strong bases for certain judgments.

I do hope that you will find these comments helpful. I am awaiting clearance from Brazil to send you the latest Fund report on Brazil and hope to receive this in a day or two.

With kind regards,

Sincerely yours,

R. J. Familton

Mrs. M. Potter
General Agreement on Tariffs and Trade
Villa le Bocage
Palais des Nations
Geneva 10, Switzerland

Office Memorandum

TO : Mr. Familton

DATE: June 1, 1968

FROM : S. T. Beza

SUBJECT : GATT Consultation with Brazil

I am returning herewith the draft report prepared by the GATT secretariat for the forthcoming consultation with Brazil under Article XVIII:B.

As I told you over the telephone, I found the report to be incredibly poor, and I do not believe that it serves the purpose of helping the GATT to conduct its new-style consultations with certain members.

While the report is inadequate throughout, there are three major weaknesses or shortcomings I would draw to your attention. "(1) The sections of the report on import replacement and industrialization are both too general and analytically weak. If these sections are to be retained, a much more exhaustive investigation of the period under consideration would be required. (2) The draft report treats the various development plans formulated in Brazil much more seriously than any of the Brazilian officials I have met; in Brazil, new plans are written and old plans are discarded faster than performance under such plans can be assessed. Finally, the report does not contain the latest development in this field, which is the formulation of a public sector investment program for the three-year period 1968-70. To sum up, I question the utility of a section on development planning in the GATT report. (3) I did not find the product-by-product report projections for 1971 to be convincing, since they are based on what seem to be wild guesses as to prospective volume and prices. A more fruitful approach would be to identify the areas in which Brazil's potential for export expansion is high, and then to examine the external impediments (if any) that may interfere with such growth. Indeed, I was under the impression that the approach I have just suggested is what the new-style consultation is supposed to be about." (A)

RJF comments and notes X

Comments by Mrs Potter GATT → pp1-30 to be boiled down + some Tables to an annex

we are trying to do a balanced but selective job on industries + a general cleanup

1 April 1968

plan to issue it about 1 June perhaps with a supplement if Brazil Central Bank comes through

BRAZIL - CONSULTATION UNDER ARTICLE XVIII:B

1. The consultation with Brazil in 1968 will take place in accordance with the expanded arrangements for consultations with developing countries agreed upon by the CONTRACTING PARTIES at their twenty-fourth session (L/2943). These consultations will fall within the scope of the existing procedures, but particular emphasis will be given to those elements in the procedures relating to the export sector of the country being consulted.

2. The normal country documentation in connexion with Article XVIII:B consultations, including that provided by the International Monetary Fund, will be circulated in due course. In addition, because of the new emphasis in the consultations with developing countries, a further document on Brazil is being prepared by the GATT secretariat. A preliminary draft of this document is attached.

3. Certain information which is not available to the GATT secretariat still requires to be provided if the document is to serve its purpose of focussing attention *inter alia* on those products of present and potential export interest to Brazil. The commodity notes in Section V which refer to these products need to be expanded and it is hoped that Brazil and its main trading partners will help to provide the necessary additional information. Among the points on which information is still needed for incorporation in Section V are particularly the following:

(a) Commodity notes on additional export products, especially manufactures;

(b) an indication of plans for future production, and availabilities for exports in the case of relevant commodities in Section V;

(c) prospects for increased exports especially to LAFTA;

(d) main obstacles in importing countries impeding increased exports to those markets from Brazil (specify obstacles under relevant commodities in Section V).

4. As the new emphasis is on ways and means of increasing the consulting country's export earnings, and on the steps which that country and its trading partners might take so as to facilitate such an increase, the information provided should preferably have this orientation.

x about July 8, 1968

5. To be of use on present plans concerning timing of the consultations, additional information on Brazil's exports should be in the secretariat's hands by the end of April.

BACKGROUND MATERIAL FOR ARTICLE XVIII:B CONSULTATION WITH BRAZIL

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BACKGROUND MATERIAL FOR ARTICLE XVIII:B

Consultation with Brazil

INTRODUCTION

The Brazilian economy experienced a remarkably rapid expansion of domestic production during the post-war period. While industrialization in previous periods had been spasmodic, development in the post-war period has been characterized by a determined effort to alter drastically the structure of the Brazilian economy, based on the realization that the country could not expect to achieve a high rate of growth by depending mainly upon the exports of primary commodities. The nineteen fifties were marked by rapidly increasing import substitution, stagnating exports, and towards the end of the period, by the special stimuli created by the construction of Brazilia. Inflation during the period fluctuated between 14 and 26 per cent per annum. The balance of payments showed a deficit in the current account practically every year from 1951 onwards - small surpluses were achieved in 1953 and 1956. During the 1950-52 period, the deficits were caused mainly by the doubling of imports and, in order to reduce the rate of growth of imports, the Government gave special incentives to entrepreneurs so as to increase the production of commodities important for domestic demand. The cruzeiro was devalued and this led to a rise in prices of imports relative to prices of domestically produced goods, thus stimulating the rapid growth of industrial output.

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The year 1961 marked the end of this period of rapid industrialization, which was characterized at the same time by neglect of the non-industrial sectors. Brazil reached in this year one of its highest real growth rates of gross domestic product: 7.7 per cent. However, the high rate of inflation and the sectoral imbalances which had developed were such that drastic reforms had become necessary. The real growth rate of gross domestic product declined to 3.7 per cent in 1962 and 2.1 per cent in 1963 while, at the same time, the rate of x inflation climbed to 50 per cent in 1962 and 80 per cent in 1963. When a new government came into power in early 1964, a set of economic reforms for the restoration of price stability and the abolition of the distortions in the economy was introduced. The country's infra-structure, particularly electric power, railroads and telecommunications, had suffered heavily from inadequate pricing policies.[1] As a result of the new policies, these enterprises could generate at least part of the urgently needed finance for improvements and expansion. The Federal Government moved from negative current account savings x and a cash deficit equivalent to more than [in excess of] 4 per cent of gross national product in the early 1960's to a substantial current account surplus and a cash deficit of less than 1.5 per cent of gross national product. These and other measures - stand-by x ? particularly the debt rescheduling agreement with major creditor countries in 1964 - helped restore Brazil's international credit standing. Furthermore, substantial improvements resulted from the rise in coffee prices, the relaxation of export controls on other agricultural products and the correction of the overvaluation of the currency which helped exports of manufactures to expand and resulted in sizeable overall export increases, and favourable current account balances from 1964 to 1966.

In March 1967 the Government stated its intention of continuing the same general stabilization policies. The economy went through a recession in industrial production at the beginning of the year and the Government's main concern consisted in stimulating output by tax reductions, increasing the coffee support price, and easing credit to the private sector. The economy responded favourably to these policies and in the second half of 1967 the Government took steps to tighten up Federal public expenditures in order to achieve a surplus of aggregate revenue over aggregate expenditures. This goal could not be achieved and budget over-expenditure, particularly for road, rail and

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[1] Because of the rigid Government law concerning public utility rates, a price could only be charged so as to assure a profit of no more than 10 per cent of the historical value of the investment. In an inflationary environment, this obviously caused real profits to be very low, if not non-existent, and investment was thus neglected. ?

communication projects, amounted to 1.2 milliard new cruzeiros. However, the projected 5 per cent rate of growth of gross national product for 1967 was reached and the rate of inflation was reduced to 24.5 per cent per annum, which is the lowest rate since 1960. But, partly as a result of the more liberal import policy, imports rose in 1967 far more than expected and a deficit in visible trade of about $100 million, the worst deficit since 1963, occurred. This led to an overall payments deficit in 1967. In order to help correct this situation, the new cruzeiro, which stood after the February 1967 devaluation at a parity of 2.70 to the United States dollar, was devalu~~at~~ed again by 15 per cent on 28 December 1967 to 3.20 to the United States dollar.

I. IMPORT REPLACEMENT DEVELOPMENTS IN THE 1950'S

The Brazilian economy experienced a high rate of real growth during the post-war period ending in 1961. Real gross national product grew at an average annual rate of 5 per cent. A large part of this growth is to be attributed to industrialization policies; while the real product between 1947 and 1961 rose by 128 per cent, the real agricultural product went up by only 87 per cent, whereas the real industrial product increased by 262 per cent. The industrial sector was, therefore, the key element in this development. Although Brazil's gross national product was expanding rapidly during the period under consideration, world exports of Brazil's main export products showed a sluggish rate of growth - the highest rate of growth of 3.8 per cent was attained by sugar, the lowest of 2.2 per cent by coffee - while prices of these products constantly declined after 1953, with the result that the share of exports declined from 14 to 7.9 per cent of gross national product; under the impact of import substitution development that of imports declined in the same period from 15.3 to 8.5 per cent.[1] Investments necessarily had a high import content and the investment proportion was therefore correlated with the balance-of-payments deficits. During the latter part of the period, the investment coefficient was maintained by a substantial inflow of private foreign capital.

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[1] Are these growth rates of world or Brazilian exports? We need both. Balance of paragraph should be expanded.

It appears that the beginning of Brazil's industrialization drive can be regarded as the consequence of measures for dealing with balance-of-payments difficulties and that these measures gradually became conscious instruments for the active promotion of industrialization. It is therefore necessary to look very briefly into the exchange policies used during the early post-war period.

1. The system of import licensing

The exchange policies consisted initially of a thorough system of import licensing by which the demand for import goods was kept in check so that the balance of payments could be more or less equilibrated. But it seems that these policies actually had a hindering effect on industrialization since the quotas of foreign exchange received by importers were based on the importer's volume of transactions before the introduction of the licensing system; the particular import needs of new developing industries were thus not taken into account. Under-utilization of new industrial capacity resulted.

2. Multiple exchange rate system 1953-57

The multiple exchange rate system adopted after 1953 introduced more flexibility to the system. The earnings of certain exports which the Government wanted to stimulate were partially or totally allowed to be sold into the free market and imports were classified according to categories, depending upon the degree of their essentiality, with each category receiving a different exchange rate. The effects of the previously over-valued exchange rate on trade and development were thus softened, and progress was made in the direction of currency devaluation in the light of the continuing domestic inflation. However, this system tended to give protection to the development of industries without regard to their relative importance.[1]

The character of the exchange system changed in the mid-1950's. From then onwards, it was no longer regarded merely as an instrument for dealing with balance-of-payments difficulties, but it became a concrete means for the active

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[1] Include more on Latin American experience with multiple rate systems? IMF material available?

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promotion of the industrialization of the country. This was reflected among others by such new measures as the Tariff Law, SUMOC Instruction 113, and the revival of the Law of Similars. The Tariff Law of 1957 was introduced to protect sufficiently newly-stimulated industries complementary to SUMOC Instruction 113 of 1955 which enabled foreign investors to import capital equipment with which they could assume cruzeiro capital participation in the enterprises in which the equipment was to be used. The tariffs, as a protection for the growing domestic industry, were raised substantially. Furthermore, goods which were already supplied by domestic industry could only be imported via the "special category" of commodities under which the price of foreign exchange would rise as high as twice or three times as much as the value in other categories. Favoured industries, on the other hand, were allowed to import necessary equipment and raw materials at the "gambio de gusto", the strongly subsidized rate.

These measures were supplemented by the Law of Similars. This Law, dating back to the "Register of Similar Products" in 1911, permitted Brazilian producers desiring protection to apply for the registration of the goods they were producing or intended to produce. This procedure became, during the 1950's, the basis for broad tariff protection and for classification of products in a multiple foreign exchange rate system. The Law is still used for the application of various kinds of protection for goods produced domestically which are similar in nature to those imported. The Law of Similars acted therefore as a powerful incentive for trading firms and particularly foreign ones, to switch their operations from importing to assembly, or from assembly to full production. It also stimulated domestic capital into setting up supplying firms and it therefore appears to have encouraged a substantial amount of vertical integration either within firms or within the country. As an overall result of this development, as mentioned earlier, imports declined from 15.3 to 8.5 per cent of gross national product between 1947 and 1962. The commodity structure of imports revealed furthermore that an important decline in the share of processed goods took place. A large share of the increased proportion of raw materials consisted of goods not available in sufficient quantities (such as petroleum) and of great importance to new industries.

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only causal factor?

The industries which were most stimulated by the import substitution policies were those with high backward and forward linkages and high-income elasticities. This was most strongly the case in the automobile industry.[1] Other industries in this category are the chemical industry, especially petroleum products, the machinery industry, the electrical industry, iron, steel and other basic metal production, and paper and paper product industries. The food and textile industries, have in general, lower income and population elasticities. Their changes in the share of value added and in import substitution were therefore low. But the overall picture emerging from these developments is that, as a result of the simultaneous growth of industries which are to a great extent each others customers, a remarkably balanced industrial growth resulted. Industry thus became in a relatively short time the principal contributor to the gross domestic product.

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II. INDUSTRIALIZATION AND THE RISING IMBALANCE IN THE BRAZILIAN ECONOMY

The remarkable development that has taken place in Brazil's industrial sector during the 1950's was not shared by other sectors of the economy. Imbalances were already inherent in the economy at the beginning of the period under consideration. However, the rapid growth of industrial production had the tendency to intensify the situation. The areas mostly affected by the unequal growth were infra-structure facilities, the requirements for trained manpower and the lack of training facilities, imbalances between agricultural production and the requirements of the rapidly growing population and imbalances between various regions. In brief, these problems are as follows:

1. Infra-structure facilities

The electric power facilities are one of the most important infra-structure prerequisites for industrialization. Brazil has suffered from acute power shortages which were not without effect on the growth of the manufacturing industry. While manufacturing production rose by 200 per cent between 1949

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[1] In the United States, for example, the automobile industry became by 1938 the largest consumer of output of the following industries, absorbing the stated percentages of production: gasoline 90 per cent, rubber 80 per cent, plate-glass 69 per cent, alloy steel 54 per cent, malleable iron 53 per cent, strip steel 51 per cent, sheets 41 per cent, bars 34 per cent, mohair 40 per cent, lead 35 per cent, nickel 29 per cent.

and 1961, electric energy output increased by 138 per cent only. As a result many industrial firms were forced to build their own generators in order to protect themselves against shortages, a fact that added to the cost of production. Most of the investments in power facilities in the 1950's were performed by public authorities since controlled rates, which lagged behind the rate of inflation, made it impossible for private facilities to expand energy output. This situation is to be corrected partly by measures to nationalize electric energy production in the 1960's and partly by a substantially increased construction programme.

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Another important imbalance that has to be overcome is the growing congestion, concentration and inefficiency of the transportation system which, among others, contributed to the growing lag of agricultural production and exports.

Roads have become the key instrument of transportation, their share of total freight traffic rose from 33 per cent in 1950 to nearly 70 per cent in 1965. However, of the 341,000 miles of roads only 12,000 were paved in 1965. The railroad system includes over 18,000 miles of track which needs improvement and standardization of the gauge. The 19,700 miles of the country's riverways and the sea and river ports need improvements in order to reverse the declining share of total commodity shipments handled by railroads and ships. Of the total ton/kilometres handled in 1950, 67 per cent went by railroad and ships, in 1955 this percentage decreased to 47 per cent and in 1963 to 34 per cent. Since trucking absorbed the difference this has heavily burdened the highway system.

x too simplified

The Federal Government has recognized the importance of a well-functioning transportation system for the future growth of the country and set up a National Transport Council in 1964, headed by the Minister of Transport, to plan the priority investments and to co-ordinate the various Federal and State transport policies. At the same time a National Transportation Plan was worked out setting the goals to be achieved during the next twenty-five years. This plan calls on the Federal Government to concentrate on intra-capital trunk lines, access roads for the development of the interior and tie-in roads between State capitals, while the States are to continue with their individual plans. Brazilia is to be the focal point in this plan and all new roads, railroads and air routes will radiate from it.

A serious bottleneck situation developed also from inadequate investments in the period of rapid industrial growth in the telecommunication system. As a result, severe deficiencies developed in most urban centres, the connexions between cities became inadequate constituting a serious impediment to efficient operations in both the private sector and the Government. As in the electric power sector, this unsatisfactory situation is due to past Government policies of not approving adequate tariff increases in periods of rapidly rising costs which led to a severe shortage of funds. A National Telecommunications Council was set up as an agency to regulate, plan, and supervise the future operations of the system.

2. Education

Another serious bottleneck situation which is endangering the further ? development of the country lies in education which is lagging severely behind the general pace of development. It was estimated that in 1962 the illiteracy rate between the ages of ten and nineteen was 51 per cent for the country as a whole. According to a breakdown in urban and rural populations, there exist great differences between the two groups: in urban areas 14 per cent of the men over the age of twenty were illiterate and 15 per cent of the women; in rural areas, however, this rate was 40 per cent for men and 61 per cent for women. Education had a very low priority in the Federal budget during the 1950's while the population increased rapidly, expenditure for education and research decreased from 9.5 per cent of total Federal expenditure in 1950 to 6.1 per cent in 1960. About 11-12 per cent of State and local Governments' expenditures went for the same item during that decade. The expenditure on education at all levels of Government amounted therefore to about 10 per cent of the total public spending. It is quite apparent that such a situation will lead to severe shortages of trained manpower and higher costs for industry, if it spends resources on teaching or low labour efficiency if it does not. Overall the result may be a reduction of a potential growth rate.

x Consistency?

3. Agriculture

Brazil's total area comprises 3.3 million square miles of which only 30 per cent or about 260 million ha. is agricultural land. Of the total farm land only 10 per cent is used for crops, 50 per cent is grazing land and 40 per cent consists of idle and unproductive land. At first agriculture did not act as a bottleneck to industrial development during the 1950's. While the rate of industrial production surged substantially ahead of the rate of increase of agricultural production, the latter was still, until the end of the 1950's, ahead of the total rate of population growth, which was slightly over 3 per cent. However, the rapid rate of industrialization led to an urban population explosion, an increase of 5.4 per cent per annum, which resulted in two types of bottleneck problems: the first consisted of the problem of transporting and distributing the increased food output to the large urban countries and the second resulted from the changed income elasticity of demand for foodstuffs in urban centres as compared to that of the countryside.

As an example of the first type of problem, the dearth of storage facilities for agricultural products in many urban areas, according to an which? estimate, resulted in losses of output of as much as 20 per cent. But the high prices of foodstuffs were also the result of inefficiency in agricultural production. There was little investment in agriculture to increase productivity[1] which, as a result, had been stagnant, except for small increases in cotton, potatoes, coffee and sugar. The rise in overall production was due to the expansion of land under cultivation.

In the second case the rate of increase of demand for protein-rich foods in urban areas is higher than the rate of increase in demand for traditional foods. Since the rate of increase in production of livestock (2 per cent per annum in 1957-61) was smaller than the rate of increase of the urban population

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? [1] For instance, the area cultivated per tractor in the early 1960's was 400 ha. in Brazil against 8 ha. in Britain, 17 ha. in West Germany, 38 ha. in the United States and 80 ha. in Canada. The low priority of agricultural investment is also reflected by the fact that during the years 1952-62 only 4 per cent of the development banks' local currency loans went to the agricultural sector.

(5.4 per cent per annum), the result was a shortage of these foods, particularly in the late 1950's and the early 1960's, which caused prices of these foods to rise more rapidly than prices of other foodstuffs, thus adding to the inflationary pressures. Continuously rising food prices increased the real cost of industry due to the growing success of labour unions in demanding higher real wages for industrial workers. Bottlenecks in food production appeared thus to have contributed to a slowdown of industrial expansion and to pressure toward expansion along more capital-intensive lines which may intensify Brazil's difficulty in providing work for the rising urban population. Between 1950 and 1960 industrial employment increased at an annual rate of 2.8 per cent while the urban population rose by 5.4 per cent. Substantial investment in agriculture is therefore one of the prerequisites for continued economic growth of the country.

This bottleneck theory is not persuasive

4. Regional imbalances

The problems of Brazil's regional imbalances are so complex and diversified in a country of continental proportions that they can only briefly be touched upon in this context. Most of Brazil's industrial development, even before the Second World War, took place in the central southern part of the country while other parts, particularly the north-east, lagged behind. The industrialization movement of the 1950's and the early 1960's accentuated this trend. For example, industry and trade had become concentrated in the south-east, new firms tended to settle in that rapidly growing area to take advantage of available external economies, such as skilled labour, a wide variety of available auxiliary goods and services, infra-structural advantages etc. But while it is possible for economic growth to be transmitted to more static regions, in Brazil's case the growth area in the south-east seems to have drained goods, capital, and labour to itself from the more static eastern and north-eastern parts of the country. In 1949, for example, the north-east contained 24 per cent of Brazil's population which earned only 11 per cent of the national income, while the south with 33 per cent of the population earned 48 per cent of the national income. By 1960 the population of the north-east still amounted to 24 per cent of the population due to migration and earned still 11 per cent of the national income, while the share of the total population in the south had risen to 35 per cent and its share in the national income to 51 per cent. While the percentage changes are slight, they emphasize that the inequality between Brazil's two major regions has in fact increased.

Such tendencies can only be reversed by public action, such as fiscal policy and/or direct official measures (such as tax credits) to encourage firms to settle in the more backward areas, as it is currently performed under the SUDENE development programme for the north-east.

In conclusion one may state that Brazil's industrialization drive was carried out in such a way that it neglected some areas of investment and fostered development of some industries which are high cost and may never be able to compete with imports on to exports. The result was that disequilibria which existed before made themselves felt more severely and new imbalances appeared. The most important neglected sectors were the infra-structure facilities, particularly the transportation system, education and agriculture. Regional imbalances appear to have been intensified during the period of rapid industrialization, a trend which must be reversed if the industrialization policies are to be continued. It also became clear in the early 1960's that import substitution cannot be carried beyond a certain point and that choices must be made as to which industries have best prospects of becoming fully competitive. The growing industrial sectors will need larger imports of raw material and capital goods, for which the necessary foreign exchange has to be earned with increased exports. Considering the unpromising outlook for Brazil's traditional exports, a change in Brazil's export structure becomes therefore a vital matter if industrialization is to develop.

III. DEVELOPMENT PLANNING IN THE POST-WAR PERIOD

1. The period 1950-1963

The first post-war plan, which was to run from 1950-1954, was the SALTE plan; it consisted of a five-year public expenditure programme in health, food, transportation and energy. Due mainly to financing difficulties, the plan was discontinued after one year.

Another attempt at planning was the work of the Joint Brazil-United States Economic Commission during the 1951-53 period. This carried out some of the most complete surveys of the Brazilian economy so far and set up programmes for a number of infra-structure projects. Foreseeing the consequences of imbalances in a period of rapid industrialization, the Commission's projects aimed at modernization of railroad lines, harbours, coastal shipping, road building, the expansion of electric energy producing capacity, the importation of agricultural equipment, the construction of silos and industrial plant. It furthermore recommended the expansion of technical training, diversification of exports and measures to overcome regional imbalances, particularly in the north-east. The Joint Commission's projects practically covered these items, which at the end of the decade and during the early 1960's developed into serious bottlenecks and thereby contributed to the decline in the rate of industrial growth. The plan of the Joint Commission was never formally adopted, but it had some beneficial effects, for instance, the establishment of the National Bank for Economic Development (BNDE). This Bank subsequently financed in co-operation with international lending institutions many of the projects recommended by the Joint Commission.

Under the Kubitchek Administration (1956-61) a National Development Council was created which formulated a Program of Targets (Programa de Metas) for a five-year period. Targets were set by the Government and the private sector in the following areas: energy, transportation, food supply, basic industries, and education. The Program of Targets was, therefore, not a general development plan since it did not cover all areas of public investment or basic industries, and it did not reconcile the resource needs for infra-structure investments and for the productive sectors. The infra-structure investments aimed mainly at the elimination of structural bottlenecks; in some cases detailed targets were set while in others the targets were formulated in broad general terms. The financing was to have come from Government budgets (40 per cent Federal, 10 per cent State), 35 per cent from private and mixed enterprises and 15 per cent from public entities, a total of 236.7 billion cruzeiros plus US$2.3 million in foreign exchange. Many of the targets and some of the infra-structure projects planned were to a substantial extent fulfilled. However, the price paid for the achievements was rapidly rising inflation.

In 1962, a Three-Year Development Plan for the period 1963-65 was formulated. It consisted of a series of projections based on growth rates of the immediately preceding years and of a stabilization plan to cope with the run-away inflation. The plan was severely criticized and discontinued several months after its presentation.

While most of the planning during the 1950-63 period may not be considered as general development planning since it was limited to certain sectors of the economy, it resulted in concrete and significant public investment programmes which acted to some extent as complements to the strong stimulants which the private sector received from protective measures. However, these complementarities were not strong enough to avoid the impasses resulting from the industrialization burst of the 1950's and they were, therefore, unable to avoid the decline in the rate of economic growth during the first half of the 1960's.

2. Economic planning after 1964

In 1964, the planning authorities began to prepare a Ten-Year Plan for the period 1967-1976 and, parallel with this work, in 1966 a Five-Year Investment Program for 1967-1971.

(a) The draft Ten-Year Plan

The overall purpose of this Plan is to reduce the rôle of the public sector in the economy. Government current revenue rose from 18.8 per cent of gross domestic product in 1955 to 30.6 per cent in 1966 and, with aggregate expenditures also increasing at a very rapid rate, the fiscal deficit of the Government ranged from the equivalent of 3 to 6 per cent of gross domestic product. This deficit is considered to be the most important cause of inflation. A reduction of Government consumption as a proportion of gross domestic product is therefore envisaged. It is planned to increase the rate of investment, estimated at 15 per cent of gross domestic product in 1967, to 19.4 per cent in 1970; from there on until 1976 it is to be stabilized at this level. The share of infra-structure investment in total investment is to be reduced.

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The plan relies in part on master plans prepared for sectors such as transportation, power and steel production and in part on incomplete plans for other sectors with a much shorter time-span. But, as an overall result of these planning efforts, much economic information has been collected by the planners for the first time and major problems of the various sectors identified.

(b) The Five-Year Investment Plan 1967-1971

The Five-Year Investment Plan deals mainly with public investments, particularly in the Federal sector, which comprised about 60 per cent of total public investment in 1964-1966. The Plan is preliminary in some cases: for instance, investment needs by some agencies of the Government differ from the estimates made by the planning experts; in others, it only gives the proposed expenditures in a lump sum for the whole period without an annual breakdown. The plan is essentially a public investment programme.

(i) Expenditure

The Plan projects aggregate public capital expenditure at all levels of Government to rise by 4 per cent per year during the five-year period. Of the major sectors, transportation is to receive the main share of aggregate public investment during the planning period. The different regions are to be integrated by a better transport network, highways, railroads, ports and coastal shipping. Total expenditure on transport during the five years is to amount to Cr.11,377 billion gross of maintenance; the lion's share is to go to highway construction. The neglected telecommunications system is to receive funds amounting to Cr.500 billion. In the energy field aggregate investment (public and private) for electric power production is planned to be much larger than in the past and will amount to Cr.7,000 billion during the five-year period. For petroleum production expenditures are also to be increased over the past; they will rise from Cr.415 billion in 1965-66 to Cr.520 billion per annum or to Cr.2,600 billion for 1967-71. Brazil would then be able to provide more than one half of its projected crude oil requirements from domestic production, compared to less than one third in previous years.

The investment requirements for Government-owned industry (Federal sector) is estimated at Cr.1,800 billion for the total period. The expansion of publicly-owned steel mills is a major factor in this programme. The total steel ingot capacity is to be increased from 4.9 million tons in 1967 to 7.3 million tons in 1970. Of this increase, 2 million tons would be in Government-owned mills.

An amount of Cr.1,200 billion has been allocated for the development of agriculture. The largest item in this programme - Cr.300 billion - is assigned to the activities of the Agrarian Reform Institute, followed by expenditures of Cr.250 billion for the construction of dams, irrigation and drainage facilities mainly in the north-east. The remainder of the allocated amount is to be used for research activities, extension services, technical surveys, seed production, warehouse construction, etc.

Equally important in this investment plan are the expenditures for the improvement of education, which is to absorb Cr.1,300 billion based on the estimated future enrolment in primary schools, secondary and higher education.

An amount of Cr.1,900 billion is allocated to the improvement of water supply. In the past, the rate of expansion of the water supply system has not kept pace with population growth, particularly in the rapidly growing urban centres. As a result, in cities with over 100,000 inhabitants, segments of the new population and areas lack services and a large majority of the cities with less than 100,000 inhabitants need water supply and sewerage improvements.

The situation is similar in the housing sector, where the aggregate need for urban and rural housing construction during the 1967-71 period has been estimated at 3.7 million dwelling units, three fourths of which are required in order to keep pace with population growth and one fourth for the replacement of obsolete units. The public sector is to provide 30 per cent of the requirements, amounting to 200,000 to 250,000 dwelling units annually at a total cost of Cr.3,100 billion.

(ii) Financing the Investment Plan

The analysis of the resources available during the 1967-71 period to finance the aforementioned investments is only possible within the framework of broad trends and on the basis of a number of assumptions as to the future course of the Brazilian economy. These assumptions must include the expected future rate of price increase, the growth of the economy, industrial growth, which affect the amounts of revenue to be collected, as well as the Government's position on the proportion of current and capital public expenditures of total product (33 per cent in 1966). This information and, therefore, the domestic savings to be realized by the public sector and the amounts of foreign savings necessary have not yet been made available by the Brazilian Government.

IV. EXPORT TRADE

1. General developments, 1955-1966

The export earnings of Brazil followed a declining trend during the second half of the 1950's. They reached a low of $1,269,000 million in 1960, after $1,423,000 million in 1955. This decline was due to reduced earnings from agricultural exports, which fell by 17 per cent between 1955 and 1960. Coffee, the largest item within this group, generated more than half the total export earnings. The factor most responsible for diminishing export earnings was the constant decline of coffee prices, which fell by one third between 1955 and 1960 to $42 per bag. The export volume of coffee fluctuated within a relatively narrow range.

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In the case of other major agricultural products, such as cotton, sugar, cocoa, sisal, the decline in export earnings was caused by severe price drops combined with stagnating or declining export volumes - with the exception of sugar, where the export volume nearly doubled and of sisal which experienced a substantial price rise and a steady increase in volume.

Other exports, such as minerals and manufactures, experienced substantial increases. Earnings from mineral exports rose by 17 per cent per annum, due mainly to the doubling of the volume of iron ore exports (15 per cent per annum), with the unit value declining, and a five-fold rise in manganese ore exports. Earnings from manufacture exports stagnated until 1959 and then doubled in 1960; however, their share in total exports remained small: 8 per cent in the case of minerals and 2 per cent in the case of manufactures in 1960.

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Total export earnings began to rise again after 1960, and they reached $1,741,000 million in 1966, an increase of over 5 per cent per annum. Coffee exports, which in volume and value remained relatively stable, continued to provide the major share of foreign exchange earnings. As a percentage of the total, however, they declined from 56 per cent in 1960 to 44 per cent in 1966. The export earnings of other agricultural products, particularly maize, cotton, rice, cocoa, sisal and sugar, rose rapidly by 10 per cent annually, due in general to rising export volumes and stable or increasing unit values. In 1966 the value of other agricultural exports reached nearly the value of coffee exports.

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Export earnings accruing from minerals continued to rise. However, compared to the second half of the 1950's, the rate of growth declined to 9 per cent annually. The volume of iron ore exports continued to rise at about the same annual rate as during the late 1950's: 16 per cent. However, unit values declined by roughly one quarter. Manganese ore exports, on the other hand, which experienced a steep increase in volume in the previous period, stagnated at the 1960 level as unit values declined by 20 per cent. The slower rate of growth of export earnings of minerals was, therefore, mainly due to falling prices.

Manufactured exports, which began to rise in 1960, experienced during the 1960's a remarkable increase of 36 per cent annually. But their share in total export earnings is still quite small: a rate of 5 per cent ~~in 1966~~.

Overall, the main characteristics of the period beginning end 1960 was a reversal in the trend of export earnings accompanied by changes in the composition of exports. The share of coffee in total exports declined from 56 per cent in 1960 to 44 per cent in 1966. The foreign sales of other agricultural

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Table

BRAZIL - SUMMARY OF EXPORTS OF AGRICULTURAL PRODUCTS

(million US dollars)

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966 (prelim.)/1
AGRICULTURAL EXPORTS	1,363	1,407	1,272	1,119	1,150	1,130	1,231	1,070	1,259	1,248	1,334	1,499
Group I												
Traditional products	1,164	1,239	1,062	919	937	959	1,003	887	1,050	1,017	956	1,089
Coffee	844	1,030	846	688	733	713	710	643	748	760	707	772
Others (cotton, sugar, cocoa, sisal and tobacco)	320	209	216	231	204	246	293	244	302	257	249	317
Group II												
Expansionary products	53	54	65	70	96	50	99	83	106	102	212	241
Rice and maize	5	10		6	1		13	5	30	4	52	69
Livestock products	25	29	36	39	73	31	37	31	26	60	90	91
Oils and fats	23	15	29	25	22	19	49	47	50	38	70	81
Group III												
Forest products	108	83	114	100	78	88	90	70	70	84	95	105
Lumber, pine	58	37	64	52	38	43	48	39	37	50	54	56
Others (carnauba wax, Brazil nuts, ervamate, and other lumber	50	46	50	48	40	45	42	31	33	34	41	49
Group IV												
Miscellaneous products	38	31	31	30	39	33	39	30	33	45	71	64
Fruit, pepper, canned fish, and essential oils	27	23	22	19	18	20	21	20	22	23	33	20
Others (at least 20 items)	11	8	9	11	21	13	18	10	11	22	38	44

Note: Figures have been rounded and adjusted to add to total.

/1 See Table for revised total only.

Source: Table

Table

COMPOSITION OF BRAZILIAN EXPORTS, 1960-1966

(major product groups, million US dollars)

	Coffee	%	Other agr. products	%	Minerals	%	Manufactures	%	Fuels	%	Others	%	Total	%
1955	844	59	519	36	42	3	12	3	-	-	6	1	1,423	100
1960	713	56	417	33	92	7	21	2	13	1	13	1	1,269	100
1961	710	51	521	37	102	7	35	2	23	2	12	1	1,403	100
1962	643	53	427	35	105	9	30	2	7	1	2	0	1,214	100
1963	748	53	511	36	101	7	34	2	9	1	3	0	1,406	100
1964	760	53	488	34	107	7	67	5	3	0	5	0	1,430	100
1965	707	44	627	39	144	9	106	7	-	-	11	1	1,595	100
1966	774	44	726	42	143	8	100	8	-	-	5	0	1,741	100
1967														

Source: Issues of Annuario Estatistico do Brasil, IBGE: Conselho National de Estatistico, except 1966, which is CACEX.

Table

BRAZIL - EXPORTS, 1955 TO 1966

Volume - '000 metric tons, unless otherwise specified
Value - million US dollars
Unit value - dollars per metric ton, unless otherwise specified

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966 (prelim)
GRAND TOTAL, value	1,423	1,482	1,392	1,243	1,282	1,269	1,403	1,214	1,406	1,430	1,595	1,740/13
Agricultural products, value	1,363	1,407	1,272	1,119	1,150	1,130	1,231	1,070	1,259	1,248	1,334	1,499
Group I												
Coffee, beans												
Volume, thousand bags	13,696	16,805	14,319	12,883	17,436	16,819	16,971	16,376	19,513	14,946	13,582	17,030
Value	844	1,030	846	688	733	713	710	643	748	760	707	772
Unit value, dollars per bag	61.6	61.3	59.0	53.4	42.0	42.4	41.9	39.2	38.3	50.8	52.0	45.3
Cotton, raw												
Volume	176	143	66	40	78	95	206	216	222	217	196	236
Value	131	86	44	25	36	46	110	112	114	108	96	111
Unit value	746	601	670	619	456	480	532	519	515	499	488	470
Cotton, linters, etc.												
Value	5	5	3	3	1	3	3	3	4	4	5	10
Sugar, raw												
Volume	418	15	347	640	483	700	783	440	461	252	710	998
Value	33	1	36	48	33	53	66	39	63	33	54	80
Unit value	80	84	104	74	69	75	84	89	136	131	76	81
Sugar, refined												
Value	13	/1	10	10	9	5	/1	/1	10	-	3	-
Cocoa, beans												
Volume	122	126	110	103	80	125	104	55	69	75	92	113
Value	91	67	70	89	59	69	46	24	35	35	28	51
Unit value	745	533	634	868	743	553	442	440	508	464	301	449
Cocoa, butter												
Volume	6	12	15	15	18	23	15	17	14	10	17	21
Value	9	11	20	26	25	25	15	17	17	11	13	21
Unit value	1,430	884	1,317	1,703	1,414	1,071	984	987	1,122	1,085	785	988
Other cocoa products												
Value	7	4	3	3	7	4	2	1	1	1	/1	/1
Sisal												
Volume	80	107	100	97	113	108	129	137	130	136	150	139
Value	11	15	13	12	18	22	25	25	36	38	25	22
Unit value	141	140	128	127	162	207	192	181	280	278	164	158
Tobacco, raw												
Volume	27	30	28	30	28	31	48	41	44	60	55	45
Value	18	20	17	15	15	19	27	24	24	28	26	22
Unit value	668	664	608	507	546	599	555	576	548	472	477	499

BRAZIL - EXPORTS, 1955 TO 1966 (cont'd)

Volume - '000 metric tons, unless otherwise specified
Value - million US dollars
Unit value - dollars per metric ton, unless otherwise specified

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966 (prelim)
Group II												
Rice, milled												
Volume	2	102	/2	52	10	/2	151	44	-	12	237	320
Value	/1	10	/1	6	1	/1	13	5	-	1	24	37
Unit value	119	95	107	108	108	70	87	108	-	71	100	114
Maize												
Volume	80	-	-	-	-	-	4	-	699	62	560	621
Value	5	-	-	-	-	-	/1	-	30	3	28	32
Unit value	57	-	-	-	-	-	45	-	42	47	50	51
Livestock products												
Beef												
Chilled												
Volume	-	-	-	-	-	/2	/2	1	2	/2	1	n.a.
Value	-	-	-	-	-	/1	/1	/1	1	/1	1	/8
Unit value	-	-	-	-	-	500	418	376	381	567	822	
Frozen												
Volume	1	8	25	31	22	6	14	11	10	18	30	n.a.
Value	/1	3	9	11	9	3	7	5	4	11	20	11
Unit value	453	400	350	369	414	526	503	438	430	611	675	
Canned												
Volume	3	3	3	9	28	8	13	9	6	7	17	n.a.
Value	2	2	2	6	20	7	12	7	5	5	12	9
Unit value	827	597	536	629	732	813	902	766	662	770	727	
Meat extract												
Volume	/2	/2	/2	/2	1	/2	/2	/2	/2	/2	1	n.a.
Value	/1	0.5	/1	2	6	2	2	2	1	4	7	3
Unit value, dollars per lb.	1.41	1.44	2.34	3.41	3.45	2.32	2.22	2.21	2.45	5.26	4.61	
Other meats and products												
Value	2	1	3	5	8	2	2	4	2	3	8	12
Hides and skins, raw												
Value	9	10	9	10	16	13	11	9	8	10	19	24
Hides and skins, prepared												
Value	1	1	1	1	3	1	1	2	1	1	5	7
Wool, all kinds												
Value	9	10	10	2	9	1	/1	/1	3	24/3	15/3	25/3
Other livestock products												
Value	2	1	2	2	2	2	2	2	2	2	3	/9

BRAZIL - EXPORTS, 1955 TO 1966 (cont'd)

Volume - '000 metric tons, unless otherwise specified
Value - million US dollars
Unit value - dollars per metric ton, unless otherwise specified

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966 (prelim)
Oils and fats /4												
Castor, beans												
Volume	61	24	32	25	10							
Value	6	3	5	3	1							
Unit value	93	118	152	102	86							
Castor oil												
Volume	25	20	48	55	48	42	91	61	77	111	140	96
Value	5	5	17	14	10	10	24	15	18	24	27	23
Unit value	200	253	364	260	198	231	262	243	231	220	191	234
Groundnuts												
Volume	18	1	/2	2	1	-	5	22	15	/2	18	14
Value	3	/1	/1	/1	/1	-	1	4	2	/1	4	3
Unit value	161	181	300	130	146	-	185	184	166	190	228	251
Groundnut oil												
Volume								/2	8	-	-	
Value								/1	2	-	-	/10
Unit value								240	211	-	-	
Groundnut cake /11												
Volume											128	154
Value					2	3	6	5	7	2	9	12
Unit value											71	76
Soyabeans												
Volume	51	41	17	34	42	-	73	97	33	-	75	121
Value	6	4	2	4	5	-	7	8	3	-	7	13
Unit value	113	100	106	109	116	-	94	86	94	-	98	108
Soyabean meal												
Volume									n.a.	n.a.	75	121
Value									4	3	7	14
Unit value											98	108
Linseed												
Volume	-	-	13	3	-	-	4	7	25	-	6	
Value	-	-	2	/1	-	-	1	1	3	-	1	/9
Unit value			162	120	-	-	147	124	114	-	116	
Babussu nut												
Volume	8	/2	4	1	-	-	-	9	-	-	-	-
Value	1	/1	1	/1	-	-	-	1	-	-	-	-
Unit value	168		264	273	-	-	-	146	-	-	-	-
Babussu oil												
Volume			/2	2	4	-	-	3	1	-	12	
Value			/1	/1	1	-	-	1	/1	-	4	/10
Unit value					281	-	-	229	190	-	297	

BRAZIL - EXPORTS, 1955 TO 1966 (cont'd)

Volume - '000 metric tons, unless otherwise specified
Value - million US dollars
Unit value - dollars per metric ton, unless otherwise specified

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966 (prelim)
Babussu cake												
Volume						3	11	9	16	32	32	
Value						/1	/1	1	1	1	2	/12
Unit value								63	60	44	55	
Oiticica oil												
Volume	9	9	7	7	3	9	12	19	6	12	10	10
Value	2	3	2	2	1	2	3	5	3	4	4	4
Unit value	254	285	305	233	254	249	248	274	474	356	371	359
Other oilseeds												
Value	/1	/1	/1	/1	/1	/1	/1	0.8	/1	/1	/1	/9
Other vegetable oils												
Value					/1	-	1	/1	2	/1	0.5	3
Other oilcake and meal												
Value	/1	/1	/1	1	2	4	5	5	5	4	6	9
Group III												
Forest products												
Lumber, pine												
Volume	673	388	817	672	482	559	661	502	492	653	701	729
Value	58	34	64	52	38	43	48	39	37	50	54	56
Unit value	87	87	79	77	79	76	72	77	76	76	77	77
Lumber, excl. pine												
Volume	113	89	106	66	68	74	72	71	77	86	102	n.a.
Value	6	4	5	4	3	4	4	4	5	6	11	17
Unit value	52	42	50	56	51	53	50	54	61	70	103	
Carnauba wax												
Volume	12	12	12	11	10	11	10	9	11	11	12	14
Value	17	17	19	18	16	18	14	10	10	10	11	10
Unit value	1,405	1,441	1,569	1,610	1,567	1,617	1,414	1,107	923	931	901	718
Brazil nuts, edible /7												
Volume	6	42	25	29	16	26	36	23	25	24	20	30
Value	6	8	10	12	8	14	16	10	9	10	12	15
Unit value	1,045	187	398	413	506	549	434	431	355	434	580	499
Brazil nuts, inedible												
Volume	19	16	5	-								
Value	7	6	2	-								
Unit value	359	362	341									
Erva - maté												
Volume	52	58	55	57	55	56	61	47	48	48	42	35
Value	14	15	14	15	13	9	9	7	9	8	7	7
Unit value	261	260	257	265	230	160	155	159	180	162	165	198

BRAZIL - EXPORTS, 1955 TO 1966 (cont'd)

Volume - '000 metric tons, unless otherwise specified
Value - million US dollars
Unit value - dollars per metric ton, unless otherwise specified

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966 (prelim)
Group IV												
Fruit, fresh												
Bananas												
Volume, thousand bunches	10,499	9,312	10,920	13,572	10,654	12,097	12,297	10,817	10,295	11,277	10,187	10,250
Value	10	12	13	11	4	5	4	3	3	6	6	6
Unit value, dollars per bunch	0.97	1.32	1.22	0.80	0.41	0.38	0.31	0.30	0.28	0.52	0.62	0.62
Oranges												
Volume, thousand boxes	1,314	1,225	1,310	2,084	3,184	3,212	3,219	2,984	4,104	2,770	4,544	2,286
Value	6	4	4	5	7	6	6	5	6	4	7	4
Unit value, dollars per box	4.37	2.92	2.87	2.28	2.14	1.90	1.87	1.57	1.50	1.34	1.63	1.38
Other fruits												
Value	5	3	2	1	1	2	2	2	4	4	6	/9
Pepper												
Volume		/2	1	1	3	2	3	3	2	4	7	6
Value		/1	/1	/1	2	3	3	2	2	3	6	5
Unit value, cents per lb.		13.6	19.7	25.9	34.4	59.1	44.9	36.4	34.4	34.1	37.0	38.5
Canned fish /5												
Value	-	/1	/1	1	1	2	3	4	4	3	5	5
Essential oils												
Value	6	4	3	2	3	2	3	4	3	3	3	/9
Other vegetable products /6												
Value	11	10	10	11	21	14	15	11	11	22	38	44
Minerals, value	42	52	93	76	81	92	102	105	101	107	144	137
Iron ore												
Volume	2,565	2,745	3,537	2,823	3,958	5,160	6,237	7,528	8,207	9,730	12,731	12,588
Value	30	35	48	39	43	53	60	68	70	81	103	98
Unit value	11.7	12.8	13.6	13.9	11.0	10.3	9.6	9.1	8.6	8.3	8.1	7.8
Manganese ore												
Volume	177	260	798	664	914	866	869	760	841	833	1,068	959
Value	5	8	38	30	30	30	32	27	25	21	29	27
Unit value	30.4	31.8	47.0	45.4	33.2	34.4	36.7	36.2	29.3	24.7	27.4	28.0
Others, value	6	8	7	7	7	10	10	9	6	5	12	12

BRAZIL - EXPORTS, 1955 TO 1966 (cont'd)

Volume - '000 metric tons, unless otherwise specified
Value - million US dollars
Unit value - dollars per metric ton, unless otherwise specified

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966 (prelim)
Manufactures, value	12	15	13	10	11	21	35	30	34	67	106	100
Chemicals	4	4	4	5	5	10	16	11	12	14	10	19
Pharmaceuticals	/1	/1	/1	/1	/1	1	1	1	1	1	2	3
Motor vehicles and parts	3	1	-	/1	/1	/1	5	5	1	2	3	7
Other machinery and equipment	/1	1	1	1	1	2	6	7	10	16	26	31
Metallurgical products	2	7	5	/1	/1	3	3	1	3	17	45	20
Textile manufactures	1	/1	1	2	1	4	2	2	4	7	11	7
Others	2	2	2	2	4	1	2	3	3	10	9	13
Others, value	6	8	11	11	11	13	12	2	3	5	11	4

Note: Due to rounding individual figures may not add to the totals; the unit value has been calculated from unrounded figures.

n.a. - not available

/1 Less than $500,000.
/2 Less than 500 metric tons.
/3 About thirteen items, each 1-2 million dollars.
/4 Includes oilcake and meal.
/5 Mainly lobster and some shrimp in 1964, 1965 and 1966.
/6 Includes at least twenty items; from 1964, miscellaneous beverages, prepared wood, pastes, fibres, and cereal products increased substantially.
/7 From 1959, it is not specified whether edible or inedible.
/8 Included in other meats, if any.
/9 Included in other vegetable products, which for 1966 includes "all other agricultural products", if any.
/10 Included in other vegetable oils, if any.
/11 Includes meal.
/12 Included in other oilcake and meal, if any.
/13 See Table for revised figures for totals only.

Source: Various issues of Anuario Estatistico do Brasil, IBGE, Conselho Nacional de Estatistica, except 1966 which is CACEX. IBRD Economic Growth of Brazil, Problems and Prospects, Vol. III 23 October 1967.

2. Exports of agricultural products

Agricultural exports accounted for the predominant share of Brazil's export earnings which, as a percentage of the total, declined from 96 per cent in 1955 to 86 per cent in 1966. These exports are sub-divided into four groups: Group I comprises traditional products, such as coffee, cotton, sugar, cocoa, sisal and tobacco; Group II includes the more recently exported dynamic ? products, such as rice, maize, livestock products, oils and fats; Group III deals with forest products, carnauba wax, erva-maté; and Group IV with miscellaneous products, fish, fruit, pepper, essential oils and others.

(a) Group I: traditional export products

Brazil's traditional export products are coffee, cotton, sugar, cocoa, sisal and tobacco. Of these commodities, coffee plays the most important rôle in Brazil's economy and exports.

The export earnings in Group I amounted to $1,164 million in 1955 or 85 per cent of total agricultural exports. This percentage was maintained during the 1955/60 period. In the course of the country's efforts to stimulate ?the export of other agricultural exports, the share of traditional products declined to 73 per cent in 1966, or to $1,089 million in absolute terms. Exports of traditional products in general followed a declining trend from 1955 to 1960. Within this group the sales of the "others" decreased more rapidly than that of coffee. During the period 1961-66, the Group I exports rose again slightly by 1.7 per cent annually, a rate of growth shared equally by coffee and by the "others" (Table). For coffee see Chapter V.

The traditional agricultural products other than coffee include cotton, sugar, cocoa, sisal and tobacco. Total exports of these products amounted to $320 million in 1955; they declined to $204 million in 1959 and rose again to reach $246 million in 1960. Within this group, the importance of cotton declined substantially due to falling prices and decreasing export volume; there was an increase in sugar exports at an annual rate of 10 per cent from 418,000 tons to 700,000 tons while prices fluctuated; cocoa exports decreased in value by nearly one third to $69 million with prices declining by roughly one third; and sisal doubled its exports to $22 million under favourable price developments.

During the 1961/66 period, earnings from these exports increased, although fluctuating by 5 per cent annually. Cotton exports consisting of medium and long staple cotton and tree cotton rose in volume by nearly two and a half times to 236,000 tons over the 1960 volume, as prices declined slightly. Earnings from cotton exports rose from $46 million in 1960 to $110 million in 1966; thereafter they stagnated. Sugar exports reached nearly 1 million tons (783,000 tons in 1961) as prices stagnated. Cocoa and sisal exports remained relatively stable in volume and value. Sugar exports therefore provided the dynamic element in the export earnings of these products although this was mainly as a result of the Cuban situation, which led to an increase in the quota granted to Brazil by the United States.

x

Odd wording

(b) Group II: dynamic exports

X

These products consist of rice, maize, livestock products, oils and fats. Exports of these products remained fairly stable during the six-year period 1955-60; $53 million in 1955 and $50 million in 1960, with increases in 1958 and 1959 due to the sudden upsurge in exports of livestock production. During the 1961-66 period exports of these products remained at a level of $100 million during the first four years. Between 1964 and 1965, however, foreign sales doubled and in 1966 they rose by an additional 14 per cent due mainly to substantial price rises for chilled and frozen beef and increases in the volume of these exports. In 1966 exports of Group II products amounted to $241 million. As a percentage of total agricultural exports they rose from 4 per cent in 1960 to 16 per cent in 1966.

(c) Group III: forest products

These products include pine lumber and other types of lumber, carnauba wax, Brazil nuts, erva-maté. The group as a whole accounted for 8 per cent of total agricultural exports in 1955 ($108 million) and 7 per cent in 1966 ($105 million). More than 50 per cent of the value of the group was derived from pine lumber and the fact that little growth in exports occurred is attributed to the over-cutting of forests.

(d) Group IV: miscellaneous products

This group of products consists of fruit, pepper, canned fish, essential oils and others (at least twenty items). During the 1955-60 period exports remained fairly stable around $34 million. In the 1961-66 period, exports rose by 10 per cent annually to $64 million. The growth is attributable to the substantial rise of the "others", mainly cereal products, including tapioca, miscellaneous beverages and fibres.

3. Exports of minerals

Brazil's mineral exports are, for all practical purposes, limited to iron ore and manganese ore, of which iron ore is the major export item. Exports in terms of value of all minerals amounted to only 3 per cent of total exports in 1955; by 1960, this percentage had risen to 7 per cent, corresponding to an annual growth rate of 17 per cent. During the 1961-66 period this rate of growth slowed down to 6 per cent annually and the 1966 export earnings of $137 million corresponded to 8 per cent of Brazil's total export earnings.

(a) Iron ore

Iron ore exports rose in terms of value from $30 million in 1955 to $53 million in 1960 or by 12 per cent annually. Since prices remained fairly stable this increase was achieved by a substantial rise in the volume of iron ore exports. Total foreign sales rose by 15 per cent annually to over 5 million tons in 1960. Exports continued to rise at the 15 per cent annual rate during the 1961-66 period to 12.5 million tons. However, since prices declined constantly during the whole period, export earnings grew only at a rate of 10 per cent per year and amounted to $98 million in 1966.

(b) Manganese ore

The value of manganese ore exports amounted in 1955 to an insignificant $5 million. It rose, however, very rapidly to $30 million in 1960, mainly as a result of the fast increase - 37 per cent per year - in export volume (866,000 tons in 1960). Prices rose only moderately during that period.

During the 1961-66 period, on the other hand, manganese ore prices declined from $36.7 per ton in 1961 to $28 in 1966, and since exports in terms of volume showed only an increase of 2 per cent annually, export earnings declined by $5 million to $27 million in 1966.

4. Export of manufactures

Exports of manufactures during most of the period under consideration were the smallest item in Brazil's export picture. Total foreign sales remained fairly stable, around $12 million, during the second half of the 1950's, but they began to rise very rapidly during the 1960's to reach $100 million in 1966, corresponding to an annual rate of growth of 36 per cent. The items most responsible for this rapid increase were chemicals, machines and equipment and, above all, metallurgical products. The important upswing during the 1964-66 period was partly the result of the change in the exchange rate, partly, and particularly in 1965, of the industrial recession in Brazil which forced manufacturers to expand in foreign markets.

5. Direction of exports

The United States has traditionally been the major importer of Brazilian exports. However, its share has declined constantly from 43 per cent of total exports in 1958 and 46 per cent in 1959 to 33 per cent in 1966, with exports in absolute terms remaining fairly stable around $540 million.

Brazil's second most important and rapidly expanding market is the European Economic Community. EEC purchases of Brazilian goods rose by 9 per cent annually between 1958 and 1966 to $431 million, and in 1966 the EEC absorbed 25 per cent of Brazil's exports, compared with only 18 per cent in 1958. Within the EEC the leading place is taken by the Federal Republic of Germany which imports mainly coffee, textile fibres, iron ore, oilseeds, nuts and kernels, lumber, cork and vegetable products. The Federal Republic of Germany's imports of Brazilian goods have risen by 6 per cent annually to $134 million in 1966. Italy imports roughly the same commodities from Brazil. Purchases have risen very rapidly by 16 per cent per annum between 1958 and 1966 to reach $109 million.

Table

BRAZIL - EXPORTS OF MINERALS AND MANUFACTURES, 1955-1966

(million US dollars, '000 metric tons, unit value: dollars per metric ton)

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966
Grand total, exports	1,423	1,482	1,392	1,243	1,282	1,269	1,403	1,214	1,406	1,430	1,595	1,740
Minerals, value	42	52	93	76	81	92	102	105	101	107	144	137
Iron ore												
Volume	2,565	2,745	3,537	2,823	3,958	5,160	6,237	7,528	8,207	9,730	12,731	12,588
Value	30	35	48	39	43	53	60	68	70	81	103	98
Unit value	11.7	12.8	13.6	13.9	11.0	10.3	9.6	9.1	8.6	8.3	8.1	7.8
Manganese ore												
Volume	177	260	798	664	914	866	869	760	841	833	1,068	959
Value	5	8	38	30	30	30	32	27	25	21	29	27
Unit value	30.4	31.8	47.0	45.4	33.2	34.4	36.7	36.2	29.3	24.7	27.4	28.0
Others	6	8	7	7	7	10	10	9	6	5	12	12
Manufactures, value	12	15	13	10	11	21	35	30	34	67	106	100
Chemicals	4	4	4	5	5	10	16	11	12	14	10	9
Pharmaceuticals	/1	/1	/1	/1	/1	1	1	1	1	1	2	3
Motor vehicles and parts	3	1	-	/1	/1	/1	5	5	1	2	3	7
Other machinery and equipment	/1	1	1	1	1	2	6	7	10	16	26	31
Metallurgical products	2	7	5	/1	/1	3	3	1	3	17	45	20
Others	2	2	2	2	4	1	2	3	3	10	9	13
Textile manufactures	1	/1	1	2	1	4	2	2	4	7	11	7

/1 Less than 500,000 metric tons.

Source: Table .

The Netherlands increased its imports from Brazil by 8 per cent annually during the same period to reach $89 million in 1966, while France's purchases of Brazilian goods rose by 5 per cent annually from 1958 onwards and amounted to $60 million in 1966.

The United Kingdom also plays an important rôle in Brazil's export trade. Its purchases of lumber, textile fibres, fruit and vegetable products, sugar and iron ore increased by 4 per cent annually between 1958 and 1966 to $4 million. Brazil's exports to other European Free Trade Association countries have remained fairly stable within fluctuations. Sales to the group as a whole rose by 2 per cent annually to $209 million.

Eastern Europe's imports from Brazil stood at an insignificant $41 million, or 3 per cent of Brazil's exports in 1958. They rose very rapidly by 15 per cent per annum to $124 million in 1966.

Brazil's exports to other Latin American Free Trade Association countries rose by 3 per cent annually between 1958 and 1966 to $182 million. However, very little information as to the composition of this trade is so far available. It appears, however, that a large and increasing share of Brazil's exports to other LAFTA countries consisted in recent years of manufactures. Of exports of machines and transport equipment in 1966, for example, 81 per cent was shipped to LAFTA countries, mainly to Argentina, Chile, Venezuela and Mexico.

6. The growth picture of Brazil's export commodities

Table presents thirty-one export commodities which comprised 90 per cent of Brazil's total exports in 1966. The table gives an index (1962 = 100) of the growth of exports in terms of volume and value between 1962 and 1966. It shows that during this period exports of nineteen commodities (61 per cent of the number of commodities) rose more rapidly in terms of value than total exports, that foreign sales of twelve commodities grew slower than total exports and that, within the latter group, exports of seven commodities declined.

The six largest export commodities with sales of more than 50 million each in 1966 were, in order of importance, coffee, cotton, sugar, cocoa, pine lumber and iron ore. Within this group the two largest, coffee and cotton, which

Table

DIRECTION AND PERCENTAGE DISTRIBUTION OF EXPORTS

(million dollars)

	1958	%	1959	%	1960	%	1961	%	1962	%	1963	%	1964	%	1965	%	1966	%	1967	%
United States	534	43	592	46	564	44	563	40	485	40	531	38	474	33	520	33	581	33		
EEC	218	18	253	20	249	20	313	22	290	24	394	28	372	26	412	26	431	25		
EFTA	173	14	179	14	178	14	181	13	168	14	179	13	183	13	193	12	209	12		
LAFTA /1	142	11	74	6	85	7	95	7	76	6	76	5	133	9	197	12	182	10		
East Europe /2	41	3	58	5	79	6	77	6	76	6	101	7	101	7	102	6	124	7		
Others	135	11	126	9	114	9	174	12	119	10	125	9	167	12	171	11	214	12		
Total	1,243	100	1,282	100	1,269	100	1,403	100	1,214	100	1,406	100	1,430	100	1,595	100	1,741	100		

/1 Venezuela joined in October 1967, Bolivia in 1966.

/2 Eastern Europe plus Yugoslavia.

Source: United Nations *Yearbook of International Trade Statistics* 1962;
United Nations *Commodity Trade Statistics* 1965;
Banco do Brazil *Annual Report*, 1963.

together amount to one half of Brazil's total exports, grew more slowly than total exports. The index of cotton exports even declined somewhat to ninety-nine (1962 = 100) while the coffee index rose to 120. For the other four commodities growth has been substantial: their sales in terms of value more than doubled in the case of sugar and cocoa beans and increased by nearly one half in the case of pine lumber and iron ore.

Another group of ten commodities amounting to 14 per cent of Brazil's total exports, accounted in 1966 for exports ranging from 20 million to 50 million each.

Within this group exports of six of the commodities grew more rapidly than Brazil's total exports, or by more than 43 per cent: rice, maize, frozen beef, hides and skins, castor oil and metallurgical products. Of the remaining four products the foreign exchange earnings of cocoa butter increased by 24 per cent, that of manganese ore stagnated at the 1962 level while export earnings from tobacco and sisal declined by 8 per cent and 12 per cent respectively. For the group as a whole the performance was most outstanding in the case of rice, maize, frozen beef and metallurgical products, foreign sales of which grew by more than 300 per cent between 1962 and 1966.

Two thirds ($1,130 million) of Brazil's total foreign exchange receipts in 1966 were thus earned by the sixteen commodities mentioned above. Within the remaining group of commodities in Table there are a number of products the export growth of which has been outstanding but whose share in total exports is still quite small. These products include lumber other than pine and manufactures. Foreign sales in terms of value of lumber other than pine have increased by 175 per cent between 1962 and 1965, while exports of manufactures as a whole, which were at a low level in 1962, have risen by 233 per cent until 1966. Within the group of manufactures the products which merit particular attention if their spectacular rate of growth continues in the future are chemicals, pharmaceuticals, machinery and equipment, metallurgical products and textiles.

Table

BRAZILIAN EXPORTS IN 1962 AND 1966

	1962			1966			
	Volume '000 metric tons /1	Value $ million	Index Volume/Value	'000 metric tons /1	Value $ million	Index Volume	Value
Group I							
Coffee beans, bags	16,376	643	100	17,030	772	104	120
Cotton, raw	216	112	100	236	111	109	99
Sugar, raw	440	39	100	998	80	227	205
Cocoa, beans	55	24	100	113	51	205	213
Cocoa, butter	17	17	100	21	21	124	124
Sisal	137	25	100	139	22	101	88
Tobacco, raw	41	24	100	45	22	110	92
Group II							
Rice, milled	44	5	100	320	37	727	740
Maize	-	-		621	32		
Beef, frozen	11	5	100	30(1965)	20(65)	273	400
Beef, canned	9	7	100	17	12	189	171
Hides, skins, raw	-	9	100	-	24	-	266
Castor oil	61	15	100	96	23	157	153
Groundnuts	22	4	100	14	3	64	75
Soyabeans	97	8	100	121	13	125	164
Oiticica oil	19	5	100	10	4	52	80
Group III							
Lumber, pine	502	39	100	729	56	145	144
Lumber, other	71	4	100	102(65)	11(65)	144	275
Carnauba wax	9	14	100	14	10	156	71
Brazil nuts	23	10	100	30	15	130	150
Group IV							
Bananas ('000 bunches)	10,817	3	100	10,250	6	95	200
Oranges ('000 boxes)	2,984	5	100	2,286	4	77	80
Canned fish	-	4	100	-	5	-	125
Iron ore	7,528	68	100	12,588	98	167	144
Manganese ore	760	27	100	959	27	126	100
Manufactures	-	30	100	-	100	-	333
Chemicals	-	11	100	-	19	-	173
Pharmaceuticals	-	1	100	-	3	-	300
Motor vehicles, parts	-	5	100	-	7	-	140
Other machinery and equipment	-	7	100	-	31	-	443
Metal products	-	1	100	-	20	-	2,000
Textile manufactures	-	2	100	-	7	-	350
Total exports	-	1,214	100	-	1,740		143

/1 Unless otherwise specified.

Source: For 1962: Annuario do Brazil, IBGE, Conselho National de Estatistica, 1966 - CACEX: IBRD, Economic Growth of Brazil: Problems and Prospects. Vol. III, 23 October 1967.

Source?

7. Export projections, 1967 to 1971

The export projections made by the World Bank show an annual rate of increase of total exports of 6 per cent between 1967 and 1971. Total foreign sales would then reach $2,180 million in 1971 as compared with $1,691 million in 1967. Agricultural exports are estimated to rise at roughly the same rate as total exports, i.e. 6 per cent per year, to $1,800 million in 1971. However, in the traditional agricultural exports group the increase is expected to be roughly one half of the overall rate of growth as a result of the slow rise in earnings from cotton, sugar, cocoa, sisal and tobacco, due to competition from synthetic substitutes and to an over-supply in world markets likely to lead to price declines. Earnings from coffee are expected to rise by 3 per cent per year. Export earnings in 1971 will amount to $1,212 million.

The group of expansionary agricultural products is expected to rise by 10 per cent per year to $400 million in 1971. This increase will mainly be ? due to favourable market conditions for maize, rice and edible oilseeds in Western Europe. Livestock products are expected to show a very modest rise, ? an increase in meat and wool exports being offset by falling demand for leather and skins as a result of competition from synthetic leather products.

A stagnation in the value of exports of forest products (Group III) is anticipated due to the lack of supply of pine lumber following overcutting. The situation is the same in the case of the products of Group IV (fruit, pepper, canned fish) where little change is expected from the 1966 level.

The projection for mineral exports foresees an increase of 8 per cent per year to $208 million in 1971. Iron ore exports should rise by over 9.5 per cent annually to $162 million and manganese ore exports by 7 per cent per year to $36 million. Exports of manufactures are expected to grow at a rate of 10 per cent per year to reach $160 million in 1971, which would represent a decrease in the growth rate of recent years. It is estimated that the major growth products will be wallboard, plywood, iron and steel, special machinery, vehicles and vehicle parts.

Table

BRAZIL - EXPORT PROJECTIONS, 1967-1971

(million US dollars)

Year	Agricultural products	%	Minerals	%	Manufactures	%	Fuels	%	Others	%	Total
1967[1]	1,387	82	150	8	148	9	-		6	0	1,691
1968	1,630	84	175	9	121	6	-		9	0	1,935
1969	1,675	83	199	8	134	7	-		7	0	2,015
1970	1,730	83	208	10	148	7	-		9	0	2,095
1971	1,800	83	208	10	162	7	-		10	0	2,180

[1] Projection by CACEX, based on performance of first half of 1967.

Source: Estimates of IBRD Mission, Economic Growth of Brazil, Problems and Prospects, Vol. III, Table

Table

BRAZIL - SUMMARY OF EXPORT PROJECTION OF AGRICULTURAL PRODUCTS, 1967-1971

(million US dollars)

	1967[1]	1968	1969	1970	1971
AGRICULTURAL EXPORTS	1,525	1,630	1,675	1,730	1,800
Group I					
Traditional products	1,077	1,142	1,159	1,179	1,212
Coffee	764	833	856	876	899
Others (cotton, sugar, cocoa, sisal and tobacco)	313	309	303	303	313
Group II					
Expansionary products	270	307	334	364	400
Rice and maize	62	82	97	115	137
Livestock products	108	107	104	106	109
Oils and fats	100	118	133	143	154
Group III					
Forest products	100	100	100	100	100
Lumber, pine	57	57	57	57	57
Others (carnauba wax, Brazil nuts, erva-mate, and other lumber)	43	43	43	43	43
Group IV					
Miscellaneous products	78	81	82	87	88
Fruit, pepper, canned fish, and essential oils	32	33	34	35	36
Others (at least 20 items)	46	48	48	52	52

[1] See Table for CACEX projection.

Note: Due to rounding, figures have been adjusted to add to totals.

Source: IBRD Mission estimates.

V. COMMODITY NOTES

Coffee

1. Introduction

Coffee production plays a dominant rôle in the economy of Brazil. From the point of view of altitude, climate and soils large areas of the country are particularly suited for the growing of coffee and the rapid growth of five of the most important and most developed States of Brazil, and therefore the livelihood of a large part of the Brazilian population depends on coffee. The past earnings from coffee have been the main source of capital for the important industrial complex created in south-eastern Brazil.

Traditionally, coffee has played a most important rôle in Brazil's foreign trade. There was no year until 1964 in which coffee did not provide more than one half of Brazil's total export earnings. The Government has, therefore, always naturally been concerned with coffee production, exports, and the world market situation for coffee.

2. Production

Substantial growth took place in the area planted with coffee trees in the post-war period from 1945 to 1962. During this time this area nearly doubled from 2.4 million ha. to 4.5 million ha. Thereafter it declined gradually to a figure of 2.9 million ha. in 1967, thanks to successful efforts to eradicate coffee trees and to diversify agricultural production. The eradication and diversification programme is described [dealt with] below.

unclear

Total output of coffee experienced substantial yearly fluctuations; these were intensified by the change in geographic distribution of coffee growing which moved westward from the State of Sao Paulo to the State of Parana which is periodically affected by frost. Of the four major coffee growing States of Brazil, the State of Parana became after 1959 the most important coffee producer followed by Sao Paulo, Minas Gerais and Espirito Santo.

Table

EXPORTABLE PRODUCTION IN MAJOR COFFEE PRODUCING STATES

	1949/50 1953/54 average	1954/55 1958/59 average	1959/60 1961/62 average	1964/65	1965/66	1966/67	1967/68 estimate/1
				(million bags)			
Sao Paulo	7	8.6	10	6.8	11.7	5.3	7.7
Parana	3.5	4.6	15.9	7.1	21.0	9.6	11.1
Minas Gerais	2.9	3.3	3.3	1.8	2.8	2.4	2.4
Espirito Santo	1.6	2.1	2.2	1.7	1.4	1.6	0.5

/1 Trade source: George Gordon Patton Co., 21 June 1967.

Source: Brazilian Coffee Institute (IBC), IBRD, Current Economic Position and Prospects of Brazil, Vol. III, 14 June 1966, page 7 and Vol. II, 23 October 1967.

Coffee production grew more rapidly than did the area under plantation. If one takes the 1955/56-1957/58 averages and the 1959/60-1961/62 averages, the first went up by 95 per cent, while the second rose by only 27 per cent, indicating the higher yields being achieved per ha. and per tree during that period. The increase in yield is particularly apparent during the years of the eradication programme. The total coffee production area was reduced by 1.5 million ha. between 1962 and 1967 to 2.9 million ha. In spite of this, a peak production of 37.6 million bags of coffee was achieved in the 1965/66 harvest, the second highest of the post-war period. This seems to indicate that mostly low-yielding old coffee trees - a tree lasts for fifty years - were eliminated, while at the same time planting of new high-yielding varieties, increased weeding, better methods of cultivation and greater use of fertilizer, increased the yield of the plantations. The result was that, while there was a reduction in the coffee producing area of 35 per cent, coffee production fell by only 28 per cent in comparison with the crop years 1959/60-1961/62 and 1965/66-1967/68.

Table

PRODUCTION AREA AND REGISTERED PRODUCTION OF COFFEE

	Area/1 in '000 ha.	Registered production/3 '000 bags of 60 kg.
1945	2,382	14,000
1955/56	3,266	22,100
1956/57	3,412	12,500
1957/58	3,672	21,600
1958/59	4,079	26,800
1959/60	4,297	43,800
1960/61	4,420	29,800
1961/62	4,384	35,900
1962/63	4,463	28,700
1963/64	4,286	23,200
1964/65	3,622	18,100
1965/66	3,622	37,600
1966/67	2,900/2	19,400
1967/68	2,900	22,200/4

Sources: /1. IBRD, Current Economic Position and Prospects of Brazil, Vol.III, 14 June 1966.

/2. FAO, telephone information.

/3. IBRD, Current Economic Position and Prospects of Brazil, Vol.II, 1967.

/4. Estimate by George Gordon Patton Co.

3. Exports of coffee

Brazil has traditionally been the largest supplier of coffee to the world market. Her share was as high as 70 per cent during the first decade of this century; during the early 1950's it was still 50 per cent, but by the early 1960's it had shrunk to 38 per cent and in 1964-1966 to 33 per cent. It is believed that this trend was the result of Brazil's high price policy which stimulated coffee production in other areas of the world, particularly in Africa.

This, in turn, made it difficult for Brazil to maintain world prices at a high level by restricting her own exports. The way out of this dilemma could only be international action to regulate coffee supplies to the world market and therefore coffee prices. Brazil was one of the founders of the International Coffee Agreement which, in 1962, brought exporters and importers of coffee together in order to reach agreement on export quotas for the various sources of supply of coffee.

(a) Quality considerations for export

The value of Brazil's coffee exports does not depend on volume alone; an important consideration is also the quality of the coffee. The Brazilian coffee and coffee from other Latin American countries are of the "arabica" species, which is also called "mild" coffee as compared to the "robusta" coffee from Africa. In the immediate past, the unit value of the Brazilian "mild" has been lower than that of the other "milds" of Latin America, but it was higher than the "robustas" from Africa. While the "mild" coffee berries are said to be identical in intrinsic qualities wherever they may be grown, differences in flavour, due to the method of harvesting and processing of the berries and to the various bacteria moulds and soils with which the berries come into contact, apparently account for the price differences between Brazilian coffee and coffee from other Latin American countries.

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(b) Export performance, 1955 to 1966

The volume of exports of coffee rose by 4 per cent annually between 1955 and 1966. However, the price received per bag declined by nearly one third from $61.60 in 1955 to $42.40 in 1960, and total export earnings from coffee, while fluctuating, declined from $844 million in 1955 to $713 million in 1960. Exports of coffee continued to increase somewhat during the period 1961-1966; the average annual foreign sales amounted to 16.4 million bags as compared to 15.3 million bags during the 1955-60 period, with a low of 13.5 million bags - due to frost damages to the 1964 harvest - and a high of 17 million bags in 1966. Prices continued to decline to $38.30 per bag up to 1963; thereafter

Table

EXPORTS OF COFFEE, 1955 TO 1966

	Volume '000 bags	Unit value $ per bag	Value US$ million
1955	13,696	61.6	844
1956	16,805	61.3	1,030
1957	14,319	59.0	846
1958	12,883	53.4	688
1959	17,436	42.0	733
1960	16,819	42.4	713
1961	16,971	41.9	710
1962	16,376	39.2	643
1963	19,513	38.3	748
1964	14,946	50.8	760
1965	13,582	52.3	707
1966	17,030	45.3	772

Source: Issues of Annuario Estatistico do Brasil, IBGE, Conselho Nacional de Estatistica; 1966 is CACEX estimate, Economic Growth of Brazil, Problems and Prospects, Vol. III, 23 October 1967.

they rose again to $52 in 1965 and $45.30 in 1966. As a result, total export earnings rose by 1.5 per cent per annum during this period to $772 million in 1966. As a percentage of total revenue from all exports, there was a decrease in coffee's share from 59 per cent in 1955 to 44 per cent in 1966.

4. Government policy and the International Coffee Agreement

Due to the dominating rôle of the coffee sector in the Brazilian economy, the Government tried for years to regulate output and exports in order to maximize the country's foreign exchange earnings. This policy was based on the assumption that world demand for coffee is highly inelastic; that Brazil, which produces nearly half of the world's coffee, might act as a residual supplier and that it was therefore in a position to influence prices in any given period; that the International Coffee Agreement (ICA) would help to limit the replacement of Brazilian coffee exports by exports from other producing countries. Brazil tried to convince the other coffee producing countries through the ICA that world prices for coffee could only be maintained if supply could be kept under control through export quotas. It also attempted to make it clear that if some exporters tried to increase their share in the world market whenever permitted supplies exceeded demand, Brazil would adjust her prices in order to stay in line.

In its domestic policy the Government tries to reconcile two different objectives: (1) the limitation of production of coffee to the amounts needed for export and for internal consumption, plus an adequate reserve for bad crop years and (2) the granting of satisfactory incomes to the coffee sector. It uses various measures in order to insulate internal prices from export prices, such as tight controls for exports by requiring that each shipment is to be formally authorized, the fixing of the amount of foreign exchange which exporters have to surrender for each bag of coffee exported and the fixing of the rate of exchange for coffee exports. The effect of these measures is that the Government, in the first place, by setting the amount of the foreign exchange to be handed over to it, is setting a floor price. It thus limits the attractiveness of Brazilian coffee in foreign markets. In the second place, the fixing of the exchange rate for coffee exporters limits the attractiveness of exports against sales to the Government itself. ?

Through the disparity thus created, the Government can retain a large share of the export receipts which is used to buy surplus coffee from the growers. While the funds withheld in this way have a contract~~iona~~ivery effect on the economy, the buying of the surplus from farmers has an expansionary effect and whether or not the whole transaction is inflationary depends on a number of factors, such as the size of the crop, the prices paid for it, the value of the foreign exchange an exporter has to surrender per bag of coffee exported, the amount of cruzeiros he receives in return and the prices charged for internal consumption.

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5. The surplus problem and measures to curb overproduction

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While it would be normal for Brazil to maintain coffee stocks of about one year's production as a safety measure for bad crop years, the stocks actually accumulated during the 1960's were far larger. They rose from 35 million bags in the 1959/60 crop year to 66 million bags in the 1965/66 year, (80 per cent of the world stocks) and declined slightly to 61 million bags in 1966/67.

Table

THE GROWTH OF STOCKS

(in million bags)

	1960/61	1961/62	1962/63	1963/64	1964/65	1965/66	1966/67
Beg. stocks/1	34.9	42.9	55.1	60.3	57.6	54.4	66.0
Reg. production/2	29.8	35.9	28.7	23.2	18.1	37.6	19.4
Int. consumption/3	5.8	6.2	6.7	7.5	8.1	8.5	9.0
Exports/3	17.0	16.4	19.5	14.9	13.5	17.0	17.0
Surplus/deficit	+7.0	+13.3	+2.5	+0.8	-3.5	+12.1	-5.2
End stocks/1	42.9	55.1	60.3	57.6	54.4	66.0	60.8

/1. From 1960/61 to 1965/66, stocks are based on crop year figures, i.e. end stocks are 30 June of last half of crop year; for 1966/67 preliminary figures.

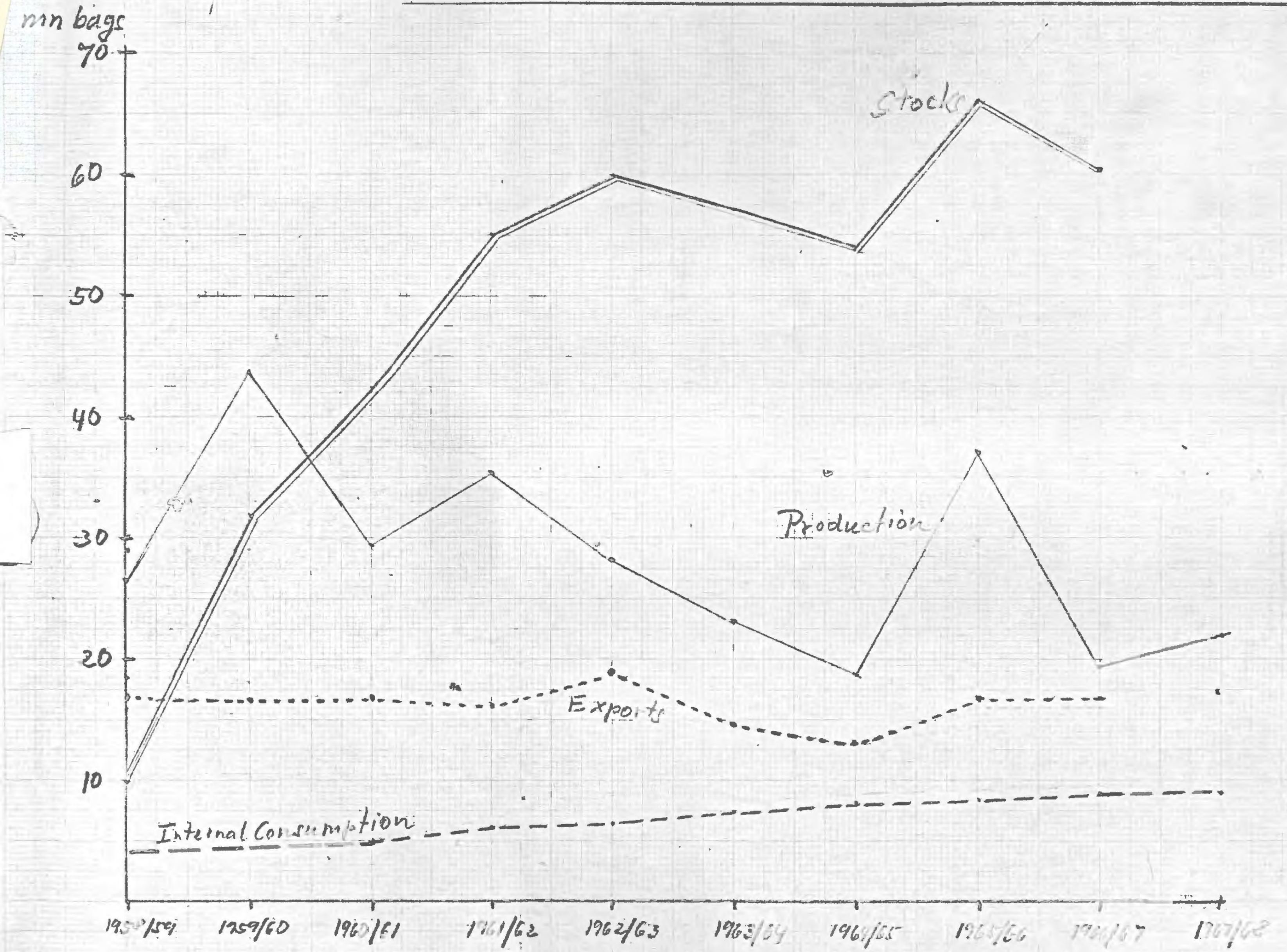
/2. Crop year (July/June) figures.

/3. Calendar year figures of last half of crop year designation.

Source: Brazilian Coffee Institute (IBC); IBRD, Current Economic Position and Prospects of Brazil, Vol. II, page 64, 23 October 1967.

In order to prevent any further rise in stocks, the annual production would have to decline to an average of 25 million bags. However, to reduce accumulated stocks, production would have to come down even further, probably to about 23 million bags annually. This target could be raised again if and when exports and internal consumption increased.

BRAZIL'S COFFEE PROBLEM



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To achieve this goal, there is only one long-term answer - the diversification by coffee growers into other crops. This could be achieved by various methods such as lower support prices for coffee, individual quotas, measures to reduce replanting, geographical limitations on production, inducements for the eradication of coffee trees and/or inducements towards other kinds of production (diversification). The method adopted and followed by the Government has been that of granting inducements for the eradication of coffee trees and for the production of other crops (diversification) and, to some extent, the setting of lower support prices.

The eradication and crop diversification programme

A special group - the Executive Group for the Rationalization of Coffee Growing (GERCA) was set up with the original goal of eliminating 2 milliard coffee trees within a period of two years. GERCA's main method consisted of granting payment for each tree eradicated. Its achievement from 1962 to 1964 is revealed by the following:

Table

NUMBER OF TREES ERADICATED UNDER
GERCA PROGRAMME, 1962-64

(millions of trees)

	1962	1963	1964	Total
Sao Paulo	93	117	30	241
Minas Gerais	60	115	20	194
Parana	14	72	35	122
Espirito Santo	23	43	7	73
Others	16	34	5	56
Total	207	381	98	686

Source: GERCA "Relatorio", 1964; IBRD, Current Economic Position and Prospects of Brazil, Vol. III, 14 June 1966, p.18.

The goal of the GERCA Programme was far from achieved and of the 2.4 million ha. planned for clearance only 772,000 ha. were cleared. A reason given for this shortfall was the lack of financial incentive. The rate of compensation paid - Cr.15 per tree - remained the same throughout this period of inflation. A large amount of eradication, estimated at 995 million trees net (1,295 million cut down and 300 million replanted), took place outside the GERCA programme. Since most of these trees were old and low-yielding, the total coffee production was not reduced commensurately with the number of trees. It ? seems that one of the loopholes in this programme was that payments made for the cutting down of old coffee trees has merely been channelled back into improving the productivity of the rest of the coffee plantation. It has, for instance, been pointed out that, in the Sao Paulo region, the number of coffee trees in 1966 was only half as great as seven years earlier, whereas coffee production remained as high as before.

Some of the shortcomings of the programme were corrected later on; for instance, compensation paid per tree varied between Cr.260 and Cr.500, depending upon the area and the percentage of trees eradicated per plantation (payment per tree increased if a higher percentage of the trees of the plantation was cut down). Moreover, the total amounts were not paid out to the farmers immediately. A farmer received Cr.70 per tree on signature of an eradication contract, Cr.50 on proof that eradication had taken place, 50 per cent of the balance on proof that there had been ploughing, seeding and germination on the eradicated land, and the balance sixty days after this payment in the form of credit for two years. If the farmer maintained the crop diversification for two years, no repayment was required at the end of the two years.

Crops allowed in the coffee diversification areas are as follows:

Maize
Rice
Wheat
Beans
Avocados
Walnuts
Peppermint oil
Tung oil

Manioc
Castor beans
Sunflower
Soyabeans
Groundnuts
Cotton
Tobacco
Citrus fruits
(except in Parana and Minas Gerais)
Animal feeds
Wood
Erva-maté
Pineapple
Silk
Vegetables, general
Potatoes
Onivus

Somewhat different arrangements were made for the use of cleared land for the livestock industry for milk production. This industry is permitted in nine States only[1] and limitations are imposed as to the percentage of the inducement payments to be spent for livestock, equipment and forage crops.

An additional stimulus was given to the programme by announcing the increase in support prices for alternative crops in advance of planting. These increases, except in the case of beans, were moderate in the light of inflation. For instance, the 1966/67 support price per 60 kgs. bag for long-grain rice was Cr.10,500 (Cr.8,289 in 1965/66), for maize Cr.5,580-6,300 (Cr.4,815), for beans Cr.18,000 (Cr.9,800). Additional Government measures are subsidies on purchases of fertilizers, special terms for the purchase of agricultural machinery and IBC interest-free loans after July 1967 in areas covered by diversification contracts on non-permanent crops for two years and on permanent crops and forestry development until the first economic crop has been harvested.

The first phase of the eradication programme was finished after mid-1967. The coffee planting area was reduced by 1.5 million ha. from 4.4 million ha. in 1961 to 2.9 million ha. in 1966/67. The land cleared from coffee trees has been replanted in the following way:

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[1] Acre, Bahia, Ceara, Espirito Santo, Minas Gerais, Paraiba, Pernambuco, Rio de Janeiro, Santa Catarina.

Table

NEW USE OF LAND CLEARED FROM COFFEE TREES

Land use	Area in ha.	%
Pasture	650,000	44
Maize	275,000	19
Rice	120,000	8
Cotton	85,000	6
Beans	60,000	4
Sugar cane	50,000	3.5
Cassava	35,000	2.5
Peanuts	35,000	2.5
Castor beans	20,000	1
Forestry	10,000	0.5
Other	160,000	9
Total	1,500,000	100

Source: FAO.

With these results the first phase of the coffee tree eradication and crop diversification programme was concluded. The second phase of the programme will consist of developments in the field of processing facilities for agricultural produce and a better transportation system in order to improve the marketing process for the new crops in the coffee producing areas.

? Theoretically Brazil's coffee production should have been reduced by 16 million bags of coffee per year, if one assumes (a) that one ha. bears an average 870 coffee trees, (b) that, therefore, 1.3 milliard coffee trees were eradicated and (c) roughly 400 million coffee trees produce 5 million bags of coffee per year. However, since in many cases old and low-yielding trees were cut down while high-yielding trees were left to produce, a very rough estimate of the reduction in annual output might be put at about 10 million bags.

Repetitive

6. The problem of the coffee support price

It seems that successive governments were hesitant to take the most important step in reducing coffee production, which is the lowering of the guaranteed minimum price for coffee in order to make marginal coffee plantations downright unprofitable. One step in this direction was carried out in July 1966 when the IBC announced that the 1966 minimum price was to be the same as in the previous year. Allowing for inflation, this meant a price reduction of more than a third in real terms. Production was also discouraged by raising the quality standards for coffee beans to qualify for the guaranteed price. Thus, the IBC also ceased for 1966/67 to offer price guarantees for coffee inferior to type 6 in areas where the best coffee is grown.

These encouraging measures were offset again by IBC Resolution 409 which, beginning 12 June 1967, arranged for a substantial increase in the coffee support price. The support price for medium-type coffee, mainly for export, was raised to Cr.50,600 per bag compared with Cr.39,500 in January 1967 and Cr.36,500 in July 1966. This is an increase of 8 per cent and 28 per cent respectively. It was, furthermore, announced that an increase of 11.5 per cent at both price levels was to take place in January 1968.

x By whom?

If the achievements reached so far towards the solving of the coffee problem are to be secured, three possible alternatives are stated to be open to the Government:

(a) the coffee support price must be set at a level which does lead to an expansion of production. This means that the Government must establish a breakdown price for coffee versus other crops;

(b) the Government must impose a strict control over the planting of new coffee trees and over the replanting of areas where old coffee trees have been eradicated;

(c) the Government must set up a system whereby IBC pays a lower price than the average support price for the amount of coffee produced in excess of that needed for exports, plus internal consumption, plus stock replenishment.

COTTON

Cotton is Brazil's major industrial raw-material crop. Production increased rapidly by an average of 10 per cent annually, between 1958 and 1966, to 822,000 metric tons, while the acreage rose on the average by only 4.4 per cent per annum, thus reflecting the substantial increase in yield achieved. The total acreage amounted to 3.7 million hectares in 1965.

The principal cotton-growing States of Brazil are Sao Paulo, Parana and Minas Gerais which produce more than half the annual cotton crop. Of importance are, furthermore, the North-Eastern States of Maranhao and Pernambuco which account for one third of the crop. The cotton grown in these States is perennial or tree cotton.

po?

Brazil once belonged to the four major cotton-exporting countries of the world with the United States, India and Egypt which together supplied roughly 80 per cent of the world's exports in 1938/39. By 1964/65, this share was about halved since cotton is now exported by more than fifty countries.

Brazil's exports of raw cotton have risen at a fast pace, from 40,000 metric tons in 1958 to 236,000 metric tons in 1966 thus averaging a 25 per cent growth rate per annum. This increase was most rapid between 1958 and 1961. Since prices experienced a constant decline after 1961 from $532 per metric ton to $470 in 1966, export earnings remained stable at around $111 million between 1961 and 1966.

The world cotton situation is dominated by United States policy, which at present is guided by the Food and Agriculture Act of 1965 with respect to the crop years 1966/67 to 1969/70; this led to a reduction of support prices in the United States and to the granting of incentives for the diversion of cotton acreage to soil conservation use. The effects of these measures during the 1966/67 season was to reduce the cotton acreage in the United States by 30 per cent; stocks decreased by 26 per cent as a result of higher exports (for the 1966/67 cotton crop year the price was set at 21 cents per pound compared with 29 cents in 1966) and defense demand. This section needs to consider staple length of Brazil's production as longer than medium staple prices are strong and rising.

BRAZIL - PRODUCTION AND EXPORTS OF RAW COTTON (SITC 263)

Year	Production[1] '000 m.t.	Volume '000 m.t.	Exports[2] unit value US$/m.t.	Value million US$	Area[3] '000 ha.
1958	382	40	619	25	2,771
1959	466	78	456	36	2,707
1960	536	95	480	46	2,745
1961	609	206	532	110	2,930
1962	634	216	519	112	3,224
1963	652	222	515	114	3,458
1964	590	217	499	108	3,554
1965	662	196	488	96	3,749
1966	822	236	470	111	

Sources:

[1] UN Statistical Bulletin for Latin America, Vol. IV, No. 1.

[2] Issues of Annuario Estatistico do Brasil, IBGE, Conselho National de Estatistica; 1966-CACEX preliminary figure.

[3] FAO Production Yearbooks 1960, 1961, 1963, 1965.

?

With higher United States exports and continuing competition from man-made fibres, Brazil's future foreign exchange earnings from cotton will depend, not on her ability to expand production, but on the limited international demand for cotton. If the United States raises her share in world exports of cotton to 30-35 per cent in 1968/69 and if Brazil is able to maintain her share in the remaining cotton market, her exports in the 1969/70 season may amount to approximately 219,000 metric tons compared to 236,000 metric tons in 1966. Since unit prices are also expected to decline from $470 per metric ton in 1966 to $430 in 1970, Brazil's exchange receipts from cotton exports for the period up to 1970 may amount to approximately $100 million per year.

why?

Cut prices of record

In 1966, 51 per cent of Brazil's exports of raw cotton was shipped to Western Europe. The EEC purchased 41 per cent of total Brazilian cotton exports ($45 million), and within the EEC 18 per cent ($20 million) were imported by the Federal Republic of Germany, 9 per cent ($10 million) by the Netherlands, 6 per cent ($6 million) by France and 5 per cent ($5.7 million) by the Benelux countries. Other important markets for Brazil's cotton were Eastern Europe, which bought 17 per cent ($19 million) of total Brazilian cotton exports, and Singapore, which imported 13 per cent ($14 million).

SUGAR CANE

The acreage used in Brazil for the production of sugar cane rose steadily by nearly one third between 1958 and 1965 to 1.5 million hectares. The conditions for the cultivation of this crop are favourable throughout the country, except for the extreme South. The major production areas are Rio de Janeiro, Minas Gerais, Sao Paulo, Parana, Pernambuco, Alagoas and Paraiba. The yields on a country-wide basis have varied from 40 to 44 metric tons per hectare; however, high yields of 55 metric tons per hectare and 66 metric tons per hectare have been achieved in the States of Sao Paulo and Parana respectively. The Government is following an active policy of expanding the acreage for sugar-cane production and of modernizing and increasing the capacity of sugar mills. This policy is partly tied in with the coffee diversification programme, since twenty-nine out of the fifty planned new sugar mills are to be built in areas where the coffee tree eradication programme has been under way.

Production rose more rapidly between 1958 and 1965 than the increase in acreage: by an average of 5 per cent per annum compared to 4 per cent per annum in acreage, indicating a steady rise in yields. Output reached 66.4 million tons in 1965 after 47.7 million tons in 1958.

The rise in exports in volume and value has even been more spectacular.

The volume of exports rose by more than one third between 1958 and 1966 to reach nearly one million tons (averaging an increase of nearly 6 per cent annually), while the value of exports reached $80 million, after lows of $33 million in 1959 and 1964, and averaged $52 million annually during the nine years. The volume of exports, prices, and the export value experienced substantial fluctuations during the period, reflecting the changing conditions of the international sugar market.

RAW BEET AND SUGAR CANE: PRODUCTION AND EXPORTS (SITC 061.1)

Year	Area[1] '000 ha.	Production[1] '000 m.t.	Exports (raw sugar)[2]		
			Volume '000 m.t.	Unit value US$ per ton	Value million US$
1958	1,172	47,703	640	74	48
1959	1,208	50,019	483	69	33
1960	1,291	53,477	700	75	53
1961	1,340	56,927	783	84	66
1962	1,367	59,377	440	89	39
1963	1,467	62,534	461	136	63
1964	1,509	63,723	252	131	33
1965	1,519	66,399	710	76	54
1966			998	81	80

Sources: [1] FAO Production Yearbooks, 1960, 1961, 1963, 1965.

[2] Issues of Annuario Estatistico do Brasil, IBGE, Conselho National de Estatistica, for 1966 CACEX preliminary figures.

Prior to 1960, Brazil's exports went to the low-priced unprotected, "free" world market[1] in which it maintained a basic export quota of 550,000 metric tons under the International Sugar Agreement of 1958. This Agreement was to be effective for five years beginning in 1959; it broke down, however, and the quota regulations were abolished. Brazil received a small allocation of Cuba's share in the United States market in 1961, which was changed to a basic quota of 180,000 short tons under the United States Sugar Act amendments of 1962 and to a basic quota of 341,000 short tons (309,000 metric tons) under the United States Sugar Act of 1965 which is effective until 1971. Brazil may also share in the deficit of quotas not filled by other suppliers; thus in 1966 it could supply a total of 434,000 metric tons to the United States.

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[1] Outside the higher price preference areas of the United States, Western Europe and the United Kingdom.

In 1967, Brazil's annual quota on the basis of a United States requirement of 10.4 million short tons (9.2 million short tons in 1965) was about 424,000 short tons (385,000 metric tons) at a unit price of 5.3 US cents per pound. This compares to a world market price which varied between 1.5 and 2.5 cents per pound in 1967.

Brazil's exports to the "free" world market fluctuated during the 1962-66 period between a low of 69,000 metric tons in 1962 and a high of 495,000 metric tons in 1965.

If a new International Sugar Agreement should come into operation in 1968, the Brazilian quota may be reduced to 280,000 metric tons until 1971, since Brazil's United States quota would be taken into account. The free world market price under such an Agreement could reach about 4 US cents per pound in 1970. Brazil's share of the market in 1971 would then be comparable to its 1961-65 average of 2.7 per cent, assuming that world exports would increase at 3 per cent per year. Based on these assumptions, Brazil's export earnings from raw sugar exports could amount to $70 million in 1971 which would be below the $80 million earned in 1966. ?

Of the total 1966 sugar exports, 71 per cent, valued at $57 million, were shipped to the United States; 15 per cent worth $12 million to developing countries; 14 per cent, valued at $11 million, to Western Europe, the main share - or $7.7 million - going to the United Kingdom.

COCOA

? in consuming countries

Cocoa production on a world basis suffers from the difficulties which are typical for tropical tree crops, such as relative inelasticity of demand with respect to income, inflexibility of supply in the short run, and the tendency of crops towards fluctuating output owing to changing weather conditions. x ?

The production area of cocoa in Brazil, which is located mainly in the State of Bahia, amounted in 1966 to an estimated 350,000 ha. consisting of about 350 million trees mostly between forty to sixty years old. Between 1957 and 1962 the average yield on the plantations decreased by 30 per cent to 300 kgs./ha. and it remained at this low level up to 1965. Production during the 1958/66 period reached a high of 199,000 metric tons in 1959; it consequently declined to 109,000 metric tons and began to rise again to 171,000 metric tons in 1965. It dropped again to 135,000 metric tons in 1966.

In 1966 a replanting programme was started with the goal of uprooting and replanting 10 per cent of the area in the period up to 1971. However, in 1966 only 2,000 ha. were replanted instead of the annual 6,600 ha. necessary in order to reach the 35,000 ha. goal in 1971. The returns of the plantations could be somewhat improved by better control of some disease problems and by better practices in fermenting and drying of the cocoa beans.

<u>COCOA BEANS PRODUCTION AND EXPORTS</u> (SITC 072.1)

Year	Production[1] '000 metric tons	Volume '000 metric tons	Exports[2] Unit value US$/metric ton	Value million US$
1958	174	103	868	89
1959	199	80	743	59
1960	122	125	553	69
1961	118	104	442	46
1962	109	55	440	24
1963	122	69	508	35
1964	118	75	464	35
1965	171	92	301	28
1966	135	113	449	51

Source: [1] UN, Statistical Bulletin for Latin America.

[2] Issues of Annuario Estatistico do Brasil, IBGE, Conselho National de Estatistica; the 1966 figure from CACEX, preliminary figure.

Exports in terms of volume rose by only 13 per cent between the 1958/59 and 1965/66. There was a sharp decline from 1960 to 1962 when a low of 55,000 metric tons was reached, but from then onwards exports rose again to 113,000 metric tons in 1966. The increase in volume was more than offset by price declines and the value of exports fell to $51 million in 1966, after $89 million in 1958, with lows in 1962 and 1965 of $24 and $28 million respectively.

x
? How

If Brazil is able to achieve the improvements planned in cocoa production, it may be able to increase its share in the world market from 6 per cent in 1962/65 to 10 per cent in 1971. Exports may then amount to around 120,000 metric tons. Yields in 1967 already showed an improvement over the previous years. The yield in bean equivalent had risen to 450 kgs./ha. and further increases are expected, the estimate being 510 kgs./ha. in 1969/70 and 600 kgs./ha. in 1974/75, when more of the newly-planted trees are to enter into production. It is expected that by then economics will also be achieved by improvements in the transportation system and by better port facilities. Since higher prices are forecast - the 1970 value is stated at $485 per metric ton of cocoa beans - foreign exchange earnings may amount to $58 million in 1970/71. Of the 1966 cocoa exports 62 per cent worth $31 million were shipped to the United States; the Latin American republics bought 22 per cent ($11.4 million), and Western Europe 7 per cent ($3.4 million), of which $2.8 million (6 per cent of the total exports) were imported by the EEC. The major market within the EEC was Holland, whose imports of Brazilian cocoa were valued at $1.8 million. Eastern Europe's imports were worth $3.8 million, of which $2 million went to East Germany.

TOBACCO

The acreage used for tobacco production in Brazil increased rapidly between 1958 and 1964 - by nearly 6 per cent per annum to 251,000 hectares - and output of tobacco rose at a slightly higher rate, from 144,000 metric tons in 1958 to 228,000 metric tons in 1966. About 40 per cent of this output originates in the State of Rio Grande do Sul; other important producing States are Bahia, Santa Catarina, Minas Gerais and Alagoas.

Roughly 75-80 per cent of the tobacco has been used for domestic consumption, the rest being exported mainly for the manufacture of cigars. Exports have thus increased at about the same rate as production; they rose in terms of volume from 30,000 metric tons in 1958 to a peak of 60,000 metric tons in 1964 and declined again to 45,000 metric tons in 1966. As tobacco prices remained relatively stable around $530 per metric ton, with a high of

$599 per metric ton in 1960, when Cuban supplies were cut off, and a low of $472 per metric ton in 1964, foreign exchange earnings from tobacco leaves followed roughly the same trend as the volume of exports: a high of $28 million was reached in 1964, followed by a gradual decline to $22 million in 1966.

The market for Brazil's tobacco is in the United States and in Western Europe where it was imported in increasing quantities with the falling away of imports from Cuba. A breakdown of export markets in 1966 shows that 85 per cent of Brazil's tobacco exports (valued at $20 million) were shipped to Western Europe. The EEC absorbed more than half of the total ($12 million) and within the EEC the most important markets were France ($4 million), the Federal Republic of Germany ($3 million) and the Netherlands ($3.7 million). The EFTA countries imported 17 per cent of Brazil's tobacco valued at $4 million. Another important market, in 1966, was Spain, where imports of tobacco from Brazil were valued at $3.3 million.

<u>PRODUCTION AND EXPORTS OF TOBACCO</u> (SITC 12)

Year	Area[1] '000 ha.	Production[2] '000 m.t.	Exports[3]		
			Volume '000 m.t.	Unit value $ per m.t.	Value million $
1958	181	144	30	507	15
1959	191	151	28	546	15
1960	213	161	31	599	19
1961	227	167	48	555	27
1962	232	187	41	576	24
1963	250	207	44	548	24
1964	251	210	60	472	28
1965		248	55	477	26
1966		228	45[4]	499	22

<u>Source</u>: [1] IBRD; Current Economic Position and Prospects of Brazil, Vol. III, 14 June 1966.

[2] UN, Statistical Bulletin for Latin America. Vol. IV, No. 1.

[3] Annuario Estatistico do Brasil, IBGE, Conselho National de Estatistica, except 1966 which is CACEX.

[4] Preliminary.

Estimates for the period 1966-71 indicate that the volume of exports could increase at more than twice the rate of growth of the United States tobacco market, which is expected to rise at 4 per cent annually. It is also estimated that the average price paid may rise to $550 per metric ton and that export earnings may thus increase to about $39 million in 1971.

RICE

The acreage for rice production in Brazil increased rapidly by an annual average of about 7 per cent between 1958 and 1964 to 4.2 million hectares. Production rose during the same period by nearly 9 per cent to 6.3 million tons in 1964, thus reflecting a small increase in average yields. If the record crop of 7.6 million tons in 1965 is included, when yields approached the peak reached in 1961, the average is somewhat higher; but this was an exceptionally good year and production declined again to 5 million tons in 1966.

The growth of rice production has thus been largely due to expanded acreage, most of which was associated with the cultivation of new land in Mato Grosso, Goias and Maranhao. Other important rice-producing States are Rio Grande do Sul, Minas Gerais and Sao Paulo. The yields have varied widely in these areas between 1,200 kgs./ha. for upland rice, which is cultivated throughout Brazil, and more than 3,000 kgs./ha. in the irrigated areas of Rio Grande do Sul.

Exports of rice, while fluctuating widely, rose by an average annual rate of 22 per cent between 1958 and 1966. However, most of this increase occurred in 1965 and 1966. The volume of exports rose to 320,000 metric tons in the latter year, while the price reached a peak of $114 per metric ton, thus providing $37 million in export earnings.

The markets of Brazilian rice are situated in other developing countries and in Western Europe.

The developing countries absorbed in 1966 57 per cent ($18.6 million) of Brazil's rice exports, of which nearly one half went to Peru and roughly the other half to India. Western Europe bought 24 per cent or $8 million worth of rice, of which nearly one half was imported by Italy. East European imports from Brazil amounted to $6.3 million, with the largest share going to the USSR.

A recovery in rice production after the 1966 decline is expected for 1968 and it has been estimated that the volume of exports could grow to about 730,000 metric tons in 1971, which would correspond to 8 per cent of world rice exports.

RICE: PRODUCTION AND EXPORTS

Year	Area/1 '000 ha.	Production/2 '000 m.t.	Volume '000 m.t.	Exports (milled rice)/3 unit value US$/m.t.	Value million US$
1958	2,515	3,829	52	108	6
1959	2,683	4,101	10	108	1
1960	2,926	4,795	-	70	-
1961	3,174	5,392	151	87	13
1962	3,350	5,557	44	108	5
1963	3,722	5,740	-	-	-
1964	4,170	6,345	12	71	1
1965		7,580	237	100	24
1966		5,072	320	114	37

Sources: /1 FAO Production Yearbooks, 1960, 1961, 1963, 1965.

/2 UN Statistical Bulletin for Latin America, Vol. IV, No. 1.

/3 Issues of Annuario Estatistico do Brasil, IBGE, Conselho National; 1966 is CACEX preliminary figures.

World rice prices were unusually high during 1965 and 1966 due to harvests of moderate size in the Far East as a result of unfavourable weather conditions. Assuming that world production and exports recover to a more normal pattern - the world market for rice is expected to grow at 3 per cent annually - the Brazilian rice price could decline to $94 per metric ton in 1971. Export earnings would then amount to about $69 million.

MAIZE

Maize is in terms of acreage planted the principal agricultural product of Brazil. The area planted amounted in 1965 to 8.5 million ha. as compared to 3.6 million ha. in coffee production, or 3.4 million ha. for cotton. Between 1958 and 1966 maize production increased steadily by over 6 per cent per year to more than 10 million tons in 1966 following a record output of 13 million tons in 1965.

The main maize-growing States are Minas Gerais, Sao Paulo, Parana and Rio Grande do Sul. During 1962-64, 65 per cent of the crop land of these States was used for maize production and provided 71 per cent of Brazil's total maize production. Also with respect to yield per ha. these States were far superior to the rest of the country, averaging 1.38 metric tons per ha. as compared to an average of 1.04 metric tons per ha. for the other States.

Sizeable exports of maize began in 1963, when 700,000 metric tons were shipped overseas. The severe drop to 62,000 metric tons in 1964 was due mainly to the severe drought which led to a marked increase of domestic demand. Foreign sales picked up again in 1965, when 560,000 metric tons were exported and they continued to rise to 621,000 metric tons in 1966. Export prices showed a favourable development during this period; they rose from $42 per metric ton f.o.b. Brazil in 1963 to $51 per metric ton in 1966.

Brazil's foreign market for maize lies in Western Europe, whose total imports of maize increased by 13 per cent annually between 1955 and 1965 due to the growing need for livestock feed. Western Europe's maize imports are expected to rise at the slightly reduced rate of 10 per cent per annum between 1967 and 1971. The forecast for Brazil is that it may account for about 6 per cent of the Western European market in 1971 if all of its exports continue to be directed towards this region. The share of Brazil's exports in the world market was 2.6 per cent in 1965/66; it may grow to 4 per cent in 1971. Trade with other regions, particularly in the Western Hemisphere, may be possible.

PRODUCTION AND EXPORTS OF MAIZE (SITC 044)

Year	Production[1] ('000 metric tons)	Exports[2]		
		Volume ('000 metric tons)	Unit value US$ per ton	Value million US$
1958	7,370	-	-	-
1959	7,787	-	-	-
1960	8,672	-	-	-
1961	9,036	4	45	0.2
1962	9,587	-	-	
1963	10,418	699	42	30
1964	9,408	62	47	3
1965	12,912	560	50	28
1966	10,240	621	51	32

Source: [1] UN, Statistical Bulletin for Latin America, Vol. IV, No. 1 February 1967, p.40.

[2] Issues of Annuario Estatistico do Brasil, IBGE, Conselho National de Estatistica; the 1966 figure comes from CACEX, preliminary figure.

While prices may decline again to $45 per metric ton f.o.b Brazil, the volume of exports may grow to 1.5 million metric tons, provided the expected improvement in the transportation system and ports is achieved. Export earnings from maize may then rise from $32 million in 1966 to $67.5 million in 1971.

DRY BEANS

Brazil is the world's largest producer of beans and also one of its largest consumers. While beans play such an important rôle in domestic consumption, the attention given to it by farmers with respect to improvements in production has been slight. The area planted between 1958 and 1964 increased by an average annual rate of 6.6 per cent, to over 3 million ha. in 1964.

However, production rose by only 5 per cent per annum (2 million metric tons in 1964), indicating that the yield per ha. has been declining. One of the reasons for this state of affairs may be that the prevailing level of prices to producers has not been conducive to a modernization of production. Due to the high domestic demand the export of beans was never seriously considered. Output is expected to continue to grow as a result of the increase in the area under cultivation in order to keep up with the rising domestic demand. It reached a peak production of 2.3 million metric tons in 1965.

PRODUCTION OF DRY BEANS

Year	Area[1] ('000 ha.)	Production[2] ('000 metric tons)
1958	2,126	1,454
1959	2,379	1,550
1960	2,487	1,731
1961	2,461	1,744
1962	2,716	1,710
1963	2,982	1,942
1964	3,130	1,951
1965	n.a.	2,290
1966	n.a.	1,543

Source: [1] FAO Production Yearbooks, 1960, 1961, 1963, 1965.

[2] UN, Statistical Bulletin for Latin America, Vol. IV, No. 1.

BEEF PRODUCTS

Estimates of Brazil's cattle population indicate that it grew steadily at an average annual rate of 3 per cent per annum between 1955 and 1964. Exact statistics are not available. But these estimates show that Brazil has the third largest cattle population in the world. The estimate for 1964 was 84 million head~~s~~ of cattle.

Beef production figures are also based on official estimates since more than half of the slaughtering is done without inspection in small municipal abattoirs. The estimates show that beef production increased from 1.1 million tons in 1955 to 1.5 million tons in 1958, but that it stagnated at this level until 1964. Since the cattle population has continued to grow, while beef production remained constant ~~from 1958 onwards~~, the slaughter rate has declined from year to year.

Are there better estimates of production of cattle and beef?

Exports of beef ~~took~~ take place mainly in the form of frozen beef and canned beef. Compared to the size of the growing cattle population, foreign sales ~~were~~ are small and stagnating. In terms of volume, peaks of 31,000 metric tons and 30,000 metric tons of frozen beef exports were reached in 1958 and 1965 respectively, the average for the period being 16,000 metric tons. With prices remaining stable until 1963 foreign sales in terms of value stagnated around $6 million. As meat prices and the volume of exports began to rise in 1964 and 1965, foreign exchange earnings rose to $20 million in 1965. However they dropped again to $11 million in 1966. The picture is similar in the case of canned beef exports, which were at the low level of $2 million until 1957, reached a peak of $20 million in 1959 and declined again to $5 million until 1964. Foreign sales rose to $12 million in 1965 and fell again to $9 million in 1966. The picture is thus one of wide fluctuations in terms of volume and value.

Brazil's share in the world export market for beef is very small. The major import markets for this commodity are the United Kingdom and the European Economic Community. For the EEC the expectation is a 5 per cent annual increase of beef and veal imports, excluding live animals. However the emphasis in the EEC is on chilled meat rather than frozen meat. The EEC demand for canned and preserved meat has been about 10 per cent of total meat imports, excluding live animals, in recent years. It is not expected that this demand will increase. It is estimated for the United Kingdom that the increase in demand for beef and veal will be taken care of by higher domestic production and by imports of live animals for fattening. The United States is an important importer of frozen boneless beef and canned beef. Brazil will probably maintain its present position for frozen and canned beef in the developed markets; it may furthermore be able to expand its outlets for canned beef in the developing countries. The market for chilled beef is more promising. particularly in Europe, and Brazil has started exports that may continue to expand.

why?

ESTIMATED NUMBER OF CATTLE, PRODUCTION OF CARCASS MEAT AND EXPORT

Year	Cattle '000 head	Beef production in '000 tons	Average per head slaughtered kgs.	Exports			
				Frozen beef		Canned beef	
				Volume '000 m.t.	Value	Volume	Value
1955	63,608	1,131.8	187.7	1	0.5	3	2
1956	66,695	1,277.2	194.3	8	3	3	2
1957	69,548	1,318.6	187.5	25	9	3	2
1958	71,420	1,473.4	187.5	31	11	9	6
1959	72,829	1,458.9	187.4	22	9	28	20
1960	73,962	1,359.2	188.6	6	3	8	7
1961	76,176	1,369.0	191.7	14	7	13	12
1962	79,078	1,369.0	194.0	11	5	9	7
1963	79,855	1,360.9	192.6	10	4	6	5
1964	84,035	1,437.1	191.0	18	11	7	5
1965	n.a.	n.a.	n.a.	30	20	17	12
1966	n.a.	n.a.	n.a.	n.a.	11	n.a.	9

Source: Ministerio da Agricultura; IBRD, Current Economic Position and prospects of Brazil, Vol. III, 14 June 1966; Vol. III, 23 October 1967.

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How?

Brazil is in a good position to take advantage of the favourable world demand situation for beef if it is able to improve production by better breeding methods in order to improve the quality of its herds by a higher slaughter rate - it is as low as 14 per cent as compared to 40 per cent in the United States and 22 per cent in Argentina - and by better slaughter and transportation facilities. Since the outlook for world beef prices seems to be favourable - the 1971 prices may be comparable to the 1965 prices of $675 per metric ton of frozen beef and $727 per metric ton of canned beef - and since increases in chilled beef exports are to be expected, total beef exports may rise to $50 million in 1971.

IRON ORE

Large reserves of iron ore exist in most States of Brazil with the most spectacular in Minas Gerais, where most of the mining is taking place. The high-grade hematite found in that State averages over 66 per cent iron content and is of Bessemer grade. The largest iron ore producer and exporter is the Government-owned Companhia Vale do Rio Doce S.A., which accounted for nearly 80 per cent of Brazil's iron ore exports - when?

×

The production of iron ore has increased rapidly by 12 per cent annually between 1958 and 1966, averaging 11.6 million tons of metal content in 1965 and 1966. The volume of exports rose even more rapidly at a rate of 18 per cent annually to 12.6 million tons in 1966. Since iron ore prices have declined constantly from $13.8 per metric ton in 1958 to $7.8 in 1966, the increase in the value of exports has been less significant than the increase in volume. But at an annually increasing rate of 12 per cent to $100 million in 1966 this increase was still substantial.

The overseas markets for Brazil's iron ore are the United States, Japan, and European countries, mainly the United Kingdom, the Federal Republic of Germany, Czechoslovakia, Poland and the Netherlands. While nearly one third of the iron ore has been shipped to the United States, it is particularly Japan which has become a very fast-growing market for Brazilian iron ore.

PRODUCTION AND EXPORTS OF IRON ORE

Year	Production[1] '000 m.t. metal content	Exports[2]		
		Volume '000 m.t.	Unit value US$ per m.t.	Value million US$
1958	3,526	2,823	13.9	39
1959	6,057	3,958	11.0	43
1960	6,355	5,160	10.3	53
1961	6,950	6,237	9.6	60
1962	7,301	7,528	9.1	68
1963	7,629	8,207	8.6	70
1964	11,534	9,730	8.3	81
1965	12,348	12,731	8.1	103
1966	10,989	12,588	7.8	100[3]

Source: [1] UN, Statistical Bulletin for Latin America, Vol. IV, No. 1.

[2] Issues of Annario Estatistico do Brasil, IBGE Conselho National de Estatistica, 1966 is CACEX figure, preliminary, except for the export value which is from Boletin, Banco Central do Brasil, September 1967.

For the period up to 1971 recent negotiations with Japan resulted in a unit price f.o.b. Brazil of $7.70 per metric ton of iron ore with a 64 per cent metal content. The Rio Doce Company (CVRD) anticipates that its annual volume of trade will grow by about 10.7 per cent, which would lead to iron ore exports of 15 million metric tons in 1971, while other producers anticipate foreign sales of 6 million metric tons; total exports would thus amount to 21 million tons in 1971. Based on the price of $7.70 per metric ton, Brazil's export earnings from iron ore may amount to $162 million in 1971. The anticipated annual rate of growth would be 9.8 per cent over the 1966 figure.

TEXTILES

The significance of the textile industry in the national economy

The textile industry in Brazil consists of a relatively large number of plants (about 4,200) varying greatly as to the size of the unit, particularly since this is not determined by economies of scale, and the type of the plant and includes considerable artisan and cottage sectors.[1] It provides work directly for more than 300,000 employees or about one-fourth of the total labour force in the manufacturing industry. In 1960, value added in textiles production was 14 per cent of that calculated for manufactures which accounts for 25 per cent of national income. However, during the period 1961/66, the slower growth of textiles than that in the manufacturing industry as a whole, which is probably attributable to the low level of per capita consumption and the persistence of an income distribution which is generally highly regressive, made its contribution less than in the past.

Moreover, the textile industry made possible a large number of employment estimated at more than half a million in agriculture, stock farming and the chemical industry. In a region of poor economy like the Brazilian north-each, this is of significant social and economic importance. The yearly average purchases by the cotton sector which consumed about 80 per cent of total fibres, during 1960-66, was about 270,000 tons of raw cotton or 55 per cent of total production.

Production capacity

On the basis of latest estimates for the installed capacity on 31 December 1960, the number of spindles in the cotton, wool, man-made fibre, jute and flax sectors was 4.3 million and the number of looms totalled 132,000.[2] With this production capacity, accounting for about half of all installed spinning and weaving machinery in South America, Brazil plays an important rôle in the textile activities in this group of countries. The cotton sector which accounts for 89 per cent of spindles and 78 per cent of looms predominates, followed by wool (7 and 4 per cent), man-made fibres (2 and 13 per cent), jute (1 and 3 per cent) and flax (1 and 2 per cent).

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[1] The number of artisans and semi-artisan establishments employing less than 5 workers is estimated at 1,200 plants.

[2] See Table

According to estimates the production capacity in the textile industry has been virtually stable during the period 1960-66. In the cotton sector, the number of spindles and looms in 1966 fell by about 10 per cent as compared with 1960, and the level of activity in the spinning sector dropped below that of 1960.[1] However, this was more or less counterbalanced by more hours worked. It is to be noted that the weaving sector has been lagging behind the spinning sector and this is in line with the general trend towards a fast expansion in the knitting and carpeting industries. However, there has been an increase in the proportion of automatic looms from 26 per cent of the total number of looms installed in 1960 to 39 per cent in 1966.

Machine utilization and productivity

The intensity of machine utilization and the output per machine/hour reflects low performance of machinery, labour, etc. and indicates that the existing capacity, if better use is made of it, seems sufficient to meet the requirements of the domestic market expanded considerably beyond its present size. In terms of age of machinery, its level of automation and other technological features, it is estimated that 23 per cent of the cotton spinning sector and 39 per cent of the weaving sector are considered to be up to date. The respective percentage for wool are, 52 per cent and 38 per cent. In the man-made fibre sector the spinning equipment is fairly new, but most of the looms are non-automatic. The flax sector has the highest proportion of new machinery whereas jute has the lowest.

This high degree of obsolescence in the machinery is one of the main reasons for low productivity. It is estimated that an output of 4,300 grams of cotton yarn per man/hour is a reasonable standard for Latin America as against an actual average of productivity of 5,000 grams achieved in Europe. The actual level in Brazil is only 2,000 grams. With respect to cotton fabrics, productivity in Brazil is 30 per cent of what might be regarded as a suitable standard for Latin America and one-tenth of productivity in the United States:

Standard for Latin America	100
" " Brazil	30
" " Argentina	33
" " United States	289

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[1] See Table .

Developments in production

It is estimated that the total domestic output of the spinning and weaving industries in Brazil in 1960 was 275,000 tons of yarn and 260,000 tons of fabrics. The distribution of output according to the fibre of which it is wholly or mainly composed was as follows:

	Cotton	Wool	Man-made fibres	Jute	Flax and ramie
Spinning	69.7%	7.8%	1.6%	18.9%	2.0%
Weaving	73.7%	3.4%	9.8%	11.6%	1.5%

Though data available on production in recent years are rather fragmentary and the indexes presented are estimates based on piecemeal indicators, they however, help to trace the production trends in the last few years which commenced with a moderate growth between 1960 and 1962 and then the expansion was much less in 1963 than in previous years.

Estimated Textile Production

Index 1960 = 100

1960	1961	1962	1963	1964	1965
100	105.3	109.9	106.3	111.7	93.5

After progressing again in 1964 a slump assumed serious proportion in 1965 when output, heavily weighted by a substantial drop in the first half of the year, was far below the 1960 level. It should be pointed out that the textile industry in 1963 suffered the impact of a number of adverse factors and events, such as an increase in inflationary pressure and the rationing of electric power accentuated by the prolonged drought which affected the supply of raw materials. It was, however, in the Fall of 1964 that the textile industry underwent a real crisis as a result of the anti-inflationary measures and experienced the sharpest contraction during the first half of 1965. However, to mitigate the advent of a depression in urban economic activities, the policy applied to the private sector was relaxed. During the latter half of the year the industry was granted a moratorium on payment of consumption taxes. This, as well as other incentives offered by the Government, such as a strengthening of the investment programme, led to some recovery in the industry. Although the most critical phase of the crisis was over, the situation in 1966, was not yet back to normal.

On the basis of the figures for fibre consumption it would appear that the contraction affected both the cotton and wool industries although the latter bore the brunt of the impact. Sao Paulo's production of cotton yarn, which represents 60 per cent of the country's total, stagnated between 1963 and 1964 at a level of some 110,000 tons. Output in the wool sector, which achieved the greater expansion in the post-war period when yarn production almost trebled from 7,300 tons in 1946 to 20,600 tons in 1960, continued to progress in 1961. This upward trend swung the other way in 1962 and apparently persisted through 1965. In contrast, man-made fibres followed a more positive trend as total output, which accounted in 1960 for about 60 per cent of the aggregate production in South America, went up from 44,500 tons in 1960 to 56,300 tons in 1965 registering an increase of about 27 per cent. Cellulosics, which have been in use for many years, made moderate progress; yarns totalling some 29,500 tons in 1965 stood virtually at the same level as in 1960 whereas staple fibres increased by more than one-fifth. The most dynamic expansion was in the production of non-cellulosics; yarns more than doubled and staple fibres increased ten fold. Although non-cellulosics still constitute a small proportion of textile output their high unit value greatly enhances their share of the value of production.

Trends in consumption

Total mill consumption of textile fibres (cotton, wool and man-made fibres) during the period 1958-65 rose from 290,800 tons to 330,000 tons, an increase of 13 per cent.[1] There was a rather steady increase between

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[1] See table .

1958 and 1961 but the three following years showed a persisting downward trend; the most striking fall was in 1964. However, this trend was reversed when consumption picked up in 1965. There was no marked change in the composition of textiles over the period. Cotton predominates representing some 80 per cent of the total. A declining share of wool benefitted an increase in the share of synthetic fibres in line with the very rapid world-wide expansion in the consumption of these fibres.

Apparent per capita textile consumption has not kept pace with the high growth rate of population.[1] During the period 1958 to 1965 the average annual rate of consumption was some 4.4 kgs whereas the world average was about 5 kgs. In the three years ending in 1965 the downward tendency was more pronounced because of the weakening of the growth rate in output. This sluggish per capita consumption would tend to reflect, among other factors, deteriorating terms of trade and industrial protection policies which raised the retail prices of clothing and textiles. However, the increase in per capita consumption of synthetic fibres is of important significance particularly since it contrasts with the very low level of consumption of textiles as a whole and involves fibres with higher prices. This indicates that the market for textiles in Brazil is far from being saturated and other fibres might also be induced to expand by the stimulus of supply. Given the trend in consumption and the rate of population growth it is estimated that in 1970 total demand should reach 460,000 metric tons. This would mean a shortage in the spinning sectors which will have to be met by intensive investments.

Structure of production and costs

Market trends seem to be in line with the actual structure of production which covers a wide range as regards the "product-mix" and the fibres used. Cotton textiles predominate since these fibres lend themselves more to the country's requirements. Fabrics are produced from all yarn counts with

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[1] See Table

medium counts catering for the bulk of demand: the average count being in the order of 20 to 22.

The cost level in Brazil is relatively high. The indexes of the estimated "port cost" i.e. excluding capital costs for one meter of cotton fabric (yarn count No. 8,2000 picks, weighing 130 grams) in 1961 were:

Brazil	121
Colombia	94
Japan	100
US	128

The unsatisfactory state of machinery as described above has adverse effects on production costs. It is partly responsible for the high percentage of wastage which is about 20 per cent in Brazil whereas the normal standards vary from 10 -13 per cent. This, further accentuated by low level of labour productivity, offsets any advantage in the cost of the two main imputs, namely labour and raw materials which are relatively cheap in Brazil.

Against this background it will be seen that the rehabilitation of the industry is not required to meet a different composition of future demand that is undergoing fundamental changes, but to increase productivity and to secure better use of capacity which of course will embody improvements in the processing and the quality of the textile end products now prevailing. The remedying of the administrative and organizational defects of production could lend to an appreciable reduction in the present costs and consequently would help Brazil to compete successfully on the world markets for cotton goods.

Investment programme

With this end in view the Brazilian Government has worked out a textile re-equipment programme of the order of Cr.$ 263,6 billion, of which Cr.$ 58.4 will be supplied by the domestic industry producing textile machinery.[1]

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[1] See Table

The total cost of the investment programme is estimated at $264 million (including among other items $22.3 million for the professional training of personnel). In view of the fact that the Brazilian textile industry is owned by private enterprises, the Government in June 1964 set up an Executive Group for the Textile and Leather Industries (GETTEC) with a view to promoting the re-equipment and expansion of those industries, and to define public directives relating to them. In October 1965, the Government granted several credit and fiscal incentives to these industries, subject to the co-ordination and approval of the GETTEC, Although the five-year programme has been delayed due to the economic conditions prevailing in 1963 and 1964, some industrialists had planned reconditioning and expanding their plant on their own.[1]

Trade in textiles

In the light of the above, it will be seen that a substantial expansion in exports is needed. It would help to reduce domestic prices through increased output plus stimulating per caput consumption. It would also increase the earnings of foreign exchange needed for the re-equipment of the textile industry. Recent developments in trade confirm this direction;

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[1] A textile mill in Santa Cecilia in the State of Ceaua, planned to import more than 2 million dollars worth of textile machinery. In Natal, Rio Grande Do Norte, where raw staple cotton is grown, an integrated textile plant was to be erected at a cost of $2.5 million: its annual production of cotton popline is estimated at 12 million metres. In Sao Paula a textile firm planned to import from Germany (at a cost of 3 million marks) a complete spinning mill to produce pure ramie thread, synthetic fibres and wool, as well as machines for the completion and modernization of its installed capacity. A cotton spinning mill of 15,200 spindles based on the continuous automatic system was also installed in 1963. In Manaus, State of Amazon, total investment for new equipment for jute production is estimated at Cr.$ 400 million, which will enable the existing output to be doubled.

Brazil's imports have declined sharply whereas exports have recorded a considerable increase. Between 1956 and 1966, imports went down from $8 million to $1.4 million.[1] The main items imported are "lace, ribbons, tulle etc." and yarns of glass fibre, synthetics, wool and flax and special textiles for industrial uses. The bulk of imports come from Western Europe followed by the United States and some Eastern European countries. The relative importance of the various items imported showed considerable changes between the period 1962/66 with yarns declining from $1.3 million to $447,000, whereas costly items (lace etc.) and other fabrics treated with rubber or other material for industrial use remained virtually stable. The declining trend of imports and the high level of self-sufficiency is largely based on protectionist measures, in the form of tariffs or direct import controls.

In contrast, exports of textiles zoomed from $378,000 in 1956 to $15.4 million in 1966. Variations in unit-weights in products of different fibres and differences in the quality of the very wide range of textile-end products have a preponderant influence on the unit values and preclude, therefore an accurate appraisal of its trends, Nevertheless, a comparison of the average unit values of cotton fabrics showed that between 1962 and 1964 it went down from $2.200 per ton to $1070. In 1965 this downward trend was reversed and although further intensified in 1966 when it reached $1,300, it was still below the 1962 level. Cotton textiles make up the highest percentage of textile exports followed by jute fabrics and cordage. When reviewing the figures the evidence prompts the significant observation that between 1962 and 1965 the tempo of expansion was very rapid with exports almost doubling every year. In 1966, however, this rate of growth was arrested as exports

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[1] See Table

rose only by some 5 per cent over the previous year. The decline in exports of fabrics in 1966, although made good by increased exports of yarn, combined with the reduction in the overall output during the year, partly accounts for this deterioration in the rate of growth. Further examination of this trend would seem to indicate that, as a result of the anti-inflationary measures taken by the Government which were spurred on by considerable accumulation of inventories, many firms turned to exports in 1964 and 1965 where substantial increase in absolute figures were recorded. Thus, a relatively lower growth in 1966 would tend to reflect a depletion of stocks and consequential normalization in the relationship between production and exports. The re-equipment of the textile industry coupled with several measures including tax incentives to exports of manufactures and the devaluation of foreign exchange enforced in the Fall of 1965 would undoubtedly open up favourable possibilities for further expansion. When reviewing the flow of exports the picture revealed shows divergent trends over the last decade. In 1957 and 1958, shipments to Europe accounted for about 90 per cent of total exports; later, offtakes by LAFTA countries predominated. In recent years, exports to Europe have been renewed, and since 1964 those to the United States market have increased from $1.3 million to $11.7 million in 1966. Cotton textiles account for about 90 per cent of exports to the United States, cordage has also found its way into this market. In early 1966, Brazil occupied the fourth place among the largest suppliers of cotton textiles to the United States. This substantial increase took place inspite of the restraints imposed by the US, in accordance with the provisions of the Cotton Textiles Arrangement, on Brazil's exports of carded cotton yarn, and print cloth. Since 1963, exports of jute fabrics have begun to flow in increasing quantities to the Latin American markets, namely Argentina, These went up from $230,000 to $4.3 million in 1965, but in 1966 they suffered a considerable setback when totalling only $2.1 million. It is interesting to note that Brazil is practically the only producer of jute in all of Latin America, which together represent a market of more than 90,000 metric tons only. It is, therefore, possible for it to become the chief supplier of this area. The man-made fibre and wool industry supply practically the whole of the domestic market but little in the way of exports.

INSTALLED CAPACITY IN THE TEXTILE INDUSTRY (1960)

By fibres	Thousand spindles installed	Looms installed	By state (percentage of total)	Spindles	Looms
Cotton	38,400	102,760	Sao Paulo	44%	46%
Wool	3,019	5,500	Rio-Guanabara	22%	20%
Man-made fibres	600	17,500	Minas Gerais	14%	13%
Jute of similar fibres	600	4,500	Santa Catarina	2%	2%
Flax and ramie	330	131,860	Rio Grande do Sul	2%	2%
			Nordeste	15%	17%
			Others	1%	2%
	42,949	131,860		100%	100%

INSTALLED CAPACITY IN THE COTTON INDUSTRY
1960-1966

Year	Spinning			Weaving						
	Spindles installed ('000)	Spindles in operation ('000)	Hours worked (hour)	Looms installed			Looms in operation			Hours worked (hour)
				Automatic	Ordinary	Total	Automatic	Ordinary	Total	
1960	3,840	3,840	5,485	26,210	76,550	102,760	21,500	71,000	92,500	5,062
1961	3,880	3,505	5,409*	27,000	76,000	103,000	22,000	70,000	92,000	5,050
1962	3,700	3,000	5,411**	28,000	79,000	107,000	21,659	72,000	93,650	5,405
1963	3,950	3,300	6,075**	30,000	80,000	110,000	27,000	73,500	100,500	4,416**
1964	3,900	3,200	5,642**	32,000	65,000	97,000	29,000	69,000	98,000	5,695
1965	3,600	3,240	5,346**	34,000	59,000	93,000	29,000	63,000	92,000	5,300
1966	3,450	3,090	5,624**	35,000	55,000	90,000	32,000	57,000	89,000	5,611

*Sao Paulo only.

**Incomplete coverage.

MILL CONSUMPTION OF COTTON, WOOL AND MAN-MADE FIBRES PER CALENDAR YEAR

(Unit = 1,000 metric tons)

Calendar year	Cotton	%	Wool	%	Rayon					%	Other man-made	%	Total	%
					Filament yarn	%	Staple	%	Total					
1958	236.8	81.4	17.8	6.1	25.4	8.7	8.9	3.1	34.3	11.8	1.9	.7	290.8	100.0
1959	252.6	80.9	18.4	5.9	26.2	3.9	12.2	3.9	38.4	12.3	2.8	.9	312.2	100.0
1960	262.8	80.7	18.4	5.7	29.8	9.2	10.1	3.0	39.9	12.2	4.5	1.4	325.6	100.0
1961	275.6	80.9	18.4	5.4	31.3	9.2	10.1	3.0	41.4	12.2	5.4	1.5	340.8	100.0
1962	275.6	81.9	14.2	4.2	30.4	9.0	8.3	2.5	38.7	11.5	8.2	2.4	336.7	100.0
1963	271.0	80.7	14.1	4.2	29.0	8.6	11.0	3.3	40.0	11.9	10.9	3.2	336.0	100.0
1964	255.7	78.5	13.6	4.2	31.4	9.6	12.2	3.8	43.6	13.4	12.8	3.9	325.7	100.0
1965	260.6	78.9*	12.8*	3.9*	29.4	8.9*	12.3	3.8*	41.7	12.7*	14.9	4.5*	330.0*	100.0*

*Estimate.

APPARENT PER CAPITA CONSUMPTION OF TEXTILES 1958-1965

(Unit = kg.)

Year	Total	Cotton	Wool	Artificial fibres	Synthetic fibres
1958	4.6	3.7	0.3	0.6	0.03
1959	4.8	3.3	0.3	0.6	0.05
1960	4.5	3.7	0.2	0.6	0.06
1961	4.7	3.8	0.2	0.6	0.08
1962	4.6	3.7	0.2	0.6	0.1
1963	4.3	3.5	0.2	0.5	0.1
1964	4.0	3.2	0.1	0.5	0.2
1965*	4.0*	3.2*	0.1*	0.5*	0.2*

*Estimate.

RE-EQUIPMENT OF THE BRAZILIAN TEXTILE INDUSTRY

	Cost in Cr$ billion		% to be supplied by the domestic industry
	1965/66	1967/69	
Cotton	66.9	156.1	66.1
Wool	5.6	13.2	3.8
Artificial and synthetic fibres and silk	2.3	5.3	74.9
Flax	0.7	2.0	16.0
Jute	3.5	8.0	-
TOTAL	79.0	184.6	58.4

IMPORTS AND EXPORTS OF TEXTILES
1962-1966

(Unit = Thousand Dollars)

Year	Imports c.i.f.	Exports f.o.b.
1962	1,857	2,041
1963	2,238	3,744
1964	1,396	7,437
1965	1,285	14,720
1966	1,375	15,384

EXPORTS OF TEXTILES (BY FIBRES)
1962-1966

(Unit = Thousand Dollars)

Year	Yarns		Total	Fabrics			Total	Cordage and manufactures	Other textiles	Total
	Cotton	Other		Cotton	Jute	Other				
1962	130	53	183	945	107	12	1,064	587	207	2,041
1963	150	58	208	1,634	230	8	1,872	1,220	444	3,744
1964	355	158	513	2,912	2,838	26	5,776	614	534	7,437
1965	3,233	498	3,731	4,939	4,261	31	9,231	992	766	14,720
1966	8,127	608	8,735	2,176	2,093	22	4,291	1,656	702	15,384

Mr. Sweeney May 21, 1968

Maria O. Tyler

Inquiry by Central Bank of Colombia regarding the termination of the bilateral payments agreement between Brazil and Denmark

In accordance with official information contained in Announcement No.53 dated March 19, 1968 of the Exchange Operations Department of the Central Bank of Brazil an exchange of notes dated January 29, 1968 between the Government of Brazil and the Government of Denmark provided for the termination of the clearing agreement between the two countries on March 31, 1968. Effective April 1, 1968 payments relating to all trade transactions between Brazil and Denmark were to be made in convertible currency. It was provided, however, that the following settlements would continue to be made under the terms of the clearing agreement: settlements prior to March 31, 1968, and transactions for which exchange contracts were closed before the announcement of the termination of the agreement even if settlement takes place after March 31, 1968. Export transactions covered by letters of credit entered into prior to March 31, 1968 but liquidated after that date are also to be settled through the clearing account.

At the time of our recent consultations discussions the Brazilian authorities provided me with the following information regarding settlement of the outstanding Brazilian credit balance in the bilateral account.

Brazil and Denmark had agreed tentatively to reduce Brazil's outstanding credit balance by the repayments falling due in respect of short and medium term commercial credits to Brazil approved by Denmark prior to March 31, 1968 and registered prior to December 31, 1968. At the time of the consultations discussions the amount of credits agreed upon was estimated at Dkr 220 million. At the end of each quarter Brazil's outstanding credit balance in the clearing account was to equal 30 per cent of Brazil's outstanding short and medium term indebtedness to Denmark. Any excess over 30 per cent was to be settled by Denmark in convertible currency.

The information on possible settlement terms of the outstanding clearing balance was, of course, provided on a confidential basis. I was also told that the credits provided by Denmark were chiefly for ships which were highly priced by world market standards.

A copy of Announcement 53 and translation thereof are attached.

cc. Mr. Beza

Enclosure

MOTyler/vh
May 21, 1968

ETR-47,894
Translated by J.Kay

CENTRAL BANK OF BRAZIL

Exchange Operations Department

Rio de Janeiro, March 19, 1968

GECAM ANNOUNCEMENT No. 53

TRADE WITH DENMARK

We wish to inform those concerned that by an exchange of notes dated January 29, 1968 between the Government of Brazil and the Government of Denmark, the Clearing Agreement in effect between the two countries since April 27, 1951 will come to an end on March 31, 1968. From April 1, 1968 payments relating to all trade transactions between Brazil and Denmark will be made in freely convertible currency.

2. Nevertheless, we would point out that the following operations are to be carried out in accordance with the Clearing rules:

a) imports for which permits have already been issued or for which exchange contracts have been made prior to the date of this announcement, even if settlement takes place after March 31, 1968;

b) imports covered by permits obtained after the date of this announcement, if the exchange contract is to be made and settled prior to March 31, 1968;

c) exports covered by letters of credit for which the exchange has been contracted prior to March 31, 1968 and the exchange is to be surreneded in accordance with the regulations.

3. If covered by credits arranged previously by Danish banks with a clause to the effect that payment is to be made through the Clearing Agreement, export exchange contracts made after March 31, 1968 will be converted intact in the Bank of Brazil S.A. into freely convertible Danish kroner.

CENTRAL BANK OF BRAZIL
Exchange Operations Department
/s/
Mário Miranda Muniz
Manager

BANCO CENTRAL DO BRASIL
Gerência de Operações de Câmbio

Rio de Janeiro, 19 de março de 1968

COMUNICADO GECAM Nº 53

INTERCÂMBIO COM A DINAMARCA

Levamos ao conhecimento dos interessados que, por notas trocadas em 29-1-68 pelos Governos do Brasil e da Dinamarca, extingue-se em 31-3-68 a validade do Ajuste de Pagamentos entre os dois países e em vigor desde 27-4-51, passando a efetuar-se em moeda de livre conversibilidade, a partir de 1-4-68, os pagamentos relativos a tôdas as transações do intercâmbio brasileiro-dinamarquês.

2. Esclarecemos que, todavia, serão cursadas sob as normas do Ajuste as seguintes operações:

a) importações com guias já emitidas ou que tenham câmbio fechado até a data dêste Comunicado, ainda que a liquidação ocorra após 31-3-68;

b) importações amparadas em guias obtidas posteriormente à data dêste Comunicado, caso em que o respectivo contrato de câmbio deverá ser fechado e liquidado até 31-3-68;

c) exportações amparadas em cartas de crédito cujo câmbio tenha sido contratado até 31-3-68 e repassado nas condições regulamentares.

3. Os contratos de câmbio de exportação fechados posteriormente a 31-3-68, ao amparo de créditos anteriormente instituídos por banqueiros dinamarqueses com cláusula de pagamento através do Ajuste, serão repassados integralmente ao Banco do Brasil S.A. em coroas dinamarquesas de livre conversibilidade.

/mmls.

BANCO CENTRAL DO BRASIL
Gerência de Operações de Câmbio

Mário Miranda Muniz
Gerente

APPENDIX

Brazil-Yugoslavia

Terms: The present agreement, concluded on April 1, 1958, is valid for one year, with automatic annual extensions, unless renounced by one of the contracting parties three months prior to expiration of a yearly period. A supplementary protocol was signed on April 29, 1961 to lay the basis for an increase in trade between the two countries, in particular for larger exports by Yugoslavia to Brazil.

Payments on account of trade transactions, incidental costs related to trade between the two countries, and, subject to special approval, other payments are settled through an account expressed in U.S. dollars, and kept by the Bank of Brazil for the National Bank of Yugoslavia. The net balance in the account is subject to an interest rate of 3 per cent per annum, which is charged to the account every six months, or at the time the account is closed. A swing limit of $2 million is established. Excess balance over swing limit is to be settled at the request of the creditor, in a currency of limited convertibility.[1] The agreement provides, moreover, that at the end of each annual period the total outstanding balance in the account must be settled in a currency of limited convertibility at the request of the creditor. Upon expiration of agreement the account is to remain open for 90 days to permit (1) settlement of transactions already approved but not consummated, and (2) payments resulting from transactions made for the purpose of liquidating the outstanding debt. At the termination of the 90 day period the outstanding balance is to be settled by the debtor in a currency of limited convertibility or in any other currency agreed upon by the contracting parties, as follows: (1) excess balance over swing limit to be paid immediately, (2) 50 per cent of the remainder to be paid during the subsequent 30 days, i.e., 120 days from the expiration of the agreement, and (3) the remaining balance to be paid during the subsequent 30 days, i.e., 150 days from the expiration of the agreement.

In the event of substantial changes in the condition of the trade and payments arrangements that underly thepresent agreement or of infractions of the present agreement, negotiations are to be held at the request of one of the contracting parties so as to adapt the present provisions to the new situation. Should an agreement not be reached within two months after consultation is requested the present agreement may be renounced by either one of the contracting parties and termination of the agreement becomes effective one month after the other party has been notified.

Under the 1958 agreement merchandise originating in third countries or intended for re-export may only be settled through the agreement account when specific approval is given by the two official banks in each individual case.

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[1] Until January 1, 1959 the Brazilian exchange regulations distinguished, for purposes of prescription of currency, the "area of limited convertibility" consisting of the so-called Hague Club countries.

Appendix

The agreement also stipulates that Brazilian imports and exports settled through the account should receive exchange treatment in Brazil equal to that granted to trade transactions settled in externally convertible currencies. At various times in the past, however, discriminatory practices through the exchange system were used by Brazil to favor bilateral imports from Yugoslavia and discourage exports to Yugoslavia so as to reduce Brazil's credit balance in the bilateral account (see below). The agreement further states that the Yugoslav Government will endeavor to facilitate the financing of equipment goods payable in installments.

Specific provisions for such financing by Yugoslavia was made in the supplementary protocol of 1961. In addition to including an undertaking by the contracting parties to effect trade during the period 1962-1966 up to fixed annual quotas, amounting over-all to $120 million, Yugoslavia wasto provide credit facilities, covering 65-80 per cent of the value of goods purchased, with maturities ranging from 3-9 years, for importation by Brazil, before the end of 1966, of agricultural machinery, ships, industrial equipment, and other equipment, up to specified amounts. The rate of interest on these loans was to be 6 per cent per annum. A special account was established, but any credit balance maintained by Brazil in the old account could be used for liquidation of debits existing in the special account.

Position in respect of swing credit: Despite discriminatory practices used by Brazil through the exchange system at various times in the past to favor bilateral imports from Yugoslavia and to discourage exports to Yugoslavia as well as despite the above described facilities offered by the Yugoslav Government to exports to Brazil, the latter has maintained a consistent credit position vis-à-vis Yugoslavia. At the end of 1962 and 1963 Brazil's credit balance amounted to $6.0 million. It declined to $4.6 million at the end of 1964, but then rose to $8.6 million and $13.3 million at the end of 1965 and October 1966, respectively. In May 1964 Brazil agreed to permit the balance over the swing limit to exceed by the net amount resulting from transactions which have already been approved by the authorities but have not yet been consummated, the settlement of which was expected to take place within a period of one year; such transactions were to include installments due in respect of the above mentioned suppliers' credits granted to Brazil.

At present Brazil does not apply any discriminatory treatment through the exchange system to settlements though the bilateral account with Yugoslavia, beyond that implicit in providing bilateral payments facilities (swing margin plus excess balance over swing margin) on more favorable terms than to payments in convertiblecurrencies.

Mrs. Tyler

Mr. Sturc April 10, 1968

W. F. Hughes

Implications for Brazil of Argentina's possible move to Article VIII

You asked for our advice on the above subject, hopefully to provide a basis for your reply to Mr. Kafka's enquiry.

1. It seems that the legal consequence of the Argentine move in terms of Brazil's relations with Argentina through the Fund would be as follows:

(a) Brazil would be entitled (under Article VIII, Section 4, (a) (i) and (ii) to present to Argentina for obligatory conversion into Brazilian cruzeiros or gold any balances of Argentine pesos acquired as a result of current transactions or, if needed, for making payments for current transactions. Brazil would not, however, be able to present for conversion balances of Argentine pesos that were acquired prior to Argentina's move to Article VIII (Article VIII, Section 4, (b) (ii));

(b) Brazil would be entitled, when repurchasing cruzeiros from the Fund to use Argentine pesos for such repurchases to the extent that Fund holdings of pesos were less than 75 per cent of Argentina's quota (Article V Section 7, (a) (b) (c), Schedule B para 1 XIX (d)). In computing Brazil's obligatory repurchases pesos would not be included in the calculation for the year in which the currency became convertible (Schedule B para 3).

These legal provisions should perhaps be checked with Mr. Gerstein before your communicate with Mr. Kafka.

2. We are not aware of any implications for Brazil in the context of LAFTA. Brazil and Argentina have no bilateral relations through LAFTA. However, there might be an increase in the use of Argentine pesos in the movement of short-term funds; also given the greater degree of security that is implicit in Article VIII status Brazilian investors might then choose to take advantage of the higher interest rates obtainable in Argentina over those in the United States and there might be some capital movement from Brazil.

3. This same confidence factor might well have an effect on the investment plans and intentions of countries outside Latin America who were faced with a choice between Argentina and Brazil as investment outlets.

4. Notwithstanding the above the crux of the matter would seem to lie in the area of prestige and politics. Here Mr. Kafka is obviously far better informed than we. However, it is clear that Argentina's prestige would be likely to benefit from the proposed move both absolutely and in relation to Brazil's.

cc. Mr. Finch
Mrs. Tyler ✓

Mr. Sturc (through Mr. Hughes) March 6, 1968

Maria O. Tyler

Brazil--Switch transactions

During the period October-December, 1967 the following switch transactions were undertaken by Brazil, involving the sale of bilateral credit balances for convertible currencies in order to alleviate the sharp fall in convertible reserves which Brazil experienced in 1967. The monetary authorities sold to European banks U.S. dollar denominated credit balances accumulated in bilateral accounts in the amount of $59.4 million against payment of an equivalent amount in convertible currencies. In addition, the bank purchasing the bilateral balances was given, without any payment, a claim on coffee imports from Brazil in the form of a guarantee notice issued by the Brazilian Coffee Institute. The guarantee notice entitles the holder to import a stated amount of coffee from Brazil free of charge. The value of the guarantee notices, calculated at the prevailing minimum registration prices for coffee, corresponded on average, to 13.7 per cent of the bilateral balances purchased. Included in these transactions were sales of bilateral credit balances maintained by Brazil with two Fund member countries, namely ~~$14.5~~ 15.6 million from the bilateral account with Yugoslavia, and $1.0 million from the bilateral account with Israel. The attached table gives details of the transactions.

In 1967 Brazil's convertible net foreign reserves declined by $94 million; the loss in convertible reserves would have been higher by about $50 million, after allowing for the coffee exports described above, if Brazil had not acquired convertible currencies through the switch transactions.

Enclosure

cc. Mr. Finch

Brazil--Switch Transactions

October-December, 1967

Bilateral Balances (U.S. Dollars)	Amount (in thousands of U.S.Dollars)	Location of Bank	Average Premium Paid (Value of guarantee notice as per cent of bilateral balance)
Bulgarian	9.220	Geneva	13.93
Bulgarian	500	Amsterdam	12.20
Hungarian	2.500	Geneva	14.15
Israeli	1.100	Geneva	14.25
Yugoslav	9.500	Geneva	13.97
Yugoslav	4.000	Zug (Switzerland)	14.17
Yugoslav	1.000	Lausanne	13.00
East German	15.100	Geneva	13.66
East German	3.000	Zug (Switzerland)	13.67
Rumanian	1.500	Geneva	13.99
U.S.S.R.	10.000	Geneva	13.85
Total	59.420		

Oct 1967 - Dec 67

ARBITRAGENS EXECUTADAS COM PAGAMENTO DO PRÊMIO EM AVISOS DE GARANTIA EMITIDOS PELO INSTITUTO BRASILEIRO DO CAFÉ

MOEDA	VALOR DA MOEDA	P R A Ç A	PRÊMIO MÉDIO	
US$ BULG.	9 220 000	Genebra	13,93%	12,3
US$ BULG.	500 000	Amsterdã	12,20%	10,7
US$ HUNG.	2 500 000	Genebra	14,15%	12.3
US$ ISR.	1 100 000	Genebra	14,25%	12,3
US$ IUG.	9 500 000	Genebra	13,97%	12,3
US$ IUG.	4 000 000	Zug-Suíça	14,17%	12,3
US$ IUG.	1 000 000	Lausanne	13,00%	11,5
US$ RDA.	15 099 500	Genebra	13,66%	11,5
US$ RDA.	3 000 000	Zug-Suíça	13,67%	15,5
US$ ROM.	1 500 500	Genebra	13,99%	11,5
US$ URSS.	10 000 000	Genebra	13,85%	12,3

advanced guarantee receives free currency

R E S U M O

US$ BULG.	9 720 000
US$ HUNG.	2 500 000
× US$ ISR.	1 100 000
× US$ IUG.	16 500 000
US$ RDA.	18 099 500
US$ ROM.	1 500 500
US$ URSS.	10 000 000
US$ CONV.	59 420 000

2. A arbitragem consistia na troca simultânea da moeda livre pela divisa escritural, 1 x 1, com a entrega de Avisos de Garantia emitidos pelo I.B.C., em valor correspondente ao prêmio tratado. at the prevailing min. exp price for each type of coffee paid by IBC

+ $4 mill outstanding of operations entered into but not executed as yet

Mr. Sture (through Mr. Hughes) March 6, 1968

Maria O. Tyler

Brazil--Switch transactions

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Enclosure

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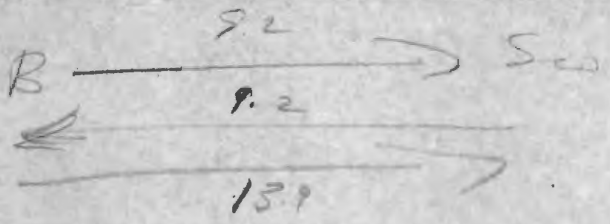
U.S.S.R.	10.000	Geneva	13.85
Total	59.420		



Mr. Finch

Exchange and Trade Relations
Department
No. 835 Date: 12/28/67

EBH

December 13, 1967.

MEMORANDUM FOR FILES

Subject: Meetings with the Minister of Finance of Brazil and Other Officials

This memorandum describes two meetings held at Fund's headquarters with the Minister of Finance of Brazil, Mr. Delfim Neto, and a team of his advisors. Mr. Del Canto and I participated in the first of these meetings held on December 6, 1967, which was of a technical nature, with some of the Minister's advisors; in addition, the Alternate Executive Director for Brazil and officials from other agencies[1] also attended the discussions. The second meeting was held by the management with the Minister and his group on December 7, 1967, in which Messrs. Del Canto, Finch, and I participated. A luncheon was offered by Mr. Schweitzer following this meeting, which was also attended by Messrs. Southard, Robichek, and Nicoletopoulos. The memorandum deals first with the technical meeting which provides some factual background to the policy discussions held with the management as described subsequently.

The meeting with the Minister's advisors[2] was far from fruitful in terms of obtaining a clear factual evaluation both of the current fiscal situation and of the financial program for 1968. They stated that at the end of November, the fiscal deficit stood at NCr$1.4 billion, but they believed that at the end of the year it would be reduced to NCr$1.2 billion with revenues of NCr$6.9 billion and expenditures of NCr$8.1 billion. However, they were not ready to discuss the estimates for the various components of revenues and expenditures, although they emphasized that the volume of expenditures carried over into 1968 would be maintained at NCr$700 million. In regard to the budget for 1968, they mentioned that the anticipated revenues and expenditures were, respectively, NCr$10.3 billion and NCr$11.3 billion, leaving a deficit of NCr$1 billion, half of which would be financed by the monetary authorities. (These targets for revenues and expenditures represent a revision from those given at the recent CIAP meeting, which, as can be recalled, were NCr$9.7 billion and NCr$10.7 billion, respectively.) They said that implicit in their projections was a price increase of 15 per cent measured from December to December and of 20 per cent on the average, while the anticipated annual growth in economic activity was 5 per cent.

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[1] Messrs. Lerdau and Holsen, from the IBRD; Mr. Krizei, from the U.S. Department of State; and Mr. Milley from the U.S. Department of the Treasury.

[2] Messrs. Pastore and Carvalho.

Noting that the revenue forecast implied an increase of about 50 per cent in current terms, the Brazilian technicians tried to explain it on the basis of the following factors: (1) the rates of the consumption tax on some luxury items were increased substantially in order to obtain the additional NCr$900 million required to cover the 20 per cent raise in salaries for public employees; (2) in 1968 an additional revenue of NCr$400 million would be obtained from the consumption tax, whose payment was postponed for one month in 1967; (3) higher returns are expected from import taxes and from an over-all improvement in the efficiency of tax collections. However, most of the participants in the discussion expressed serious doubts regarding the viability of such a drastic increase in the tax pressure. As regards the level and composition of expenditures, unfortunately the Brazilian technicians were not too explicit and kept emphasizing the still provisional stage of their calculations. However, they mentioned that in real terms the volume of capital expenditures in 1968 would be slightly reduced from the 1967 level, and that the obligations carried over into 1969 were anticipated to total NCr$700 million. (The U.S. Embassy in Rio has estimated at NCr$1.3 billion the amount of expenditures carried over into 1969 if the NCr$1 billion deficit target is to be met.)

When asked about the general financial program for 1968, the Brazilian technicians reiterated that it was still in a preparatory stage although they mentioned the ranges that were being considered for some of the variables. The net domestic credit expansion was envisaged as compatible with an increase in foreign reserves ranging between $100 million and $200 million (with an implicit exchange rate devaluation that at some point they quoted as 20 per cent) and a rise of 20 to 30 per cent in the money supply.

The discussion held by the Managing Director and the staff with the Minister and other officials[3] was, in general, disappointing insofar as it did not yield any conclusive assurance for decisive action in the field of financial stabilization in the near future. The Minister summarized the guidelines for economic and financial policies in 1968, in order of priority, as follows: (1) a rate of economic growth of 5-6 per cent per annum; (2) a deceleration of the annual rate of inflation to 15 per cent (measured from December to December, or 20 per cent on the average); (3) an accumulation of foreign reserves. In the context of the latter, the Minister suggested the possibility--although he emphasized it was merely hypothetical--of an initial adjustment in the exchange rate of 15 per cent early in the year, followed by smaller and more frequent adjustments in the course of the year, i.e. every five or six months. The staff pointed out the potential shortcomings of such strategy, but throughout the discussion the Minister made it clear that in the process of reconciling the three policy objectives he had previously outlined, that of accumulating reserves was of the least priority for the authorities.

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[3] Messrs. Kafka, Pereira Lira, Villar de Queiroz, Pastore, and Carvalho.

In this connection, he noted the possible unfavorable impact of devaluation on domestic prices--he insisted that higher exchange rates led both to a diversion of basic consumption items to the export market and to higher costs of essential imports, which together account for about 50 per cent of the cost of living index--and considered that a too large gain in reserves would only pose problems of excess liquidity in the banking system and in turn jeopardize the stabilization program. The staff pointed out that such a line of reasoning did not follow necessarily, insofar as the authorities could offset any of these developments by fiscal and monetary measures. However, he left the unequivocal impression that the planned adjustment in the exchange rate will fall short of our expectations, most probably in the range of 15 to 20 per cent.

Turning to a discussion of the fiscal outcome for 1967, the Minister mentioned the same forecasts made at the CIAP meeting of a deficit of NCr$1.2 billion. The staff noted that the deficit at the end of November was already NCr$1.4 billion and that in the last month of the year strong expenditure pressures arise. He reiterated, however, this forecast and added that the expenditures carried over into 1968 will not exceed NCr$700 million. The Minister went on to say that the deviations fromthe fiscal program in 1967 originated largely in commitments of the previous administration for which no allowance had been made in the program, citing in this connection the larger than anticipated carry-over expenditures from 1966 and the salary increase to military personnel. Concerning the fiscal program for 1968, he repeated the projections given by his technicians the day before. The staff again expressed some doubts as to the magnitude of the revenue projections for 1968, and noted that they implied a considerable increase in the tax burden. As regards the over-all financial program for 1968, the Minister stated that it would not be ready until January, when a more conclusive definition of policies could be made on the basis of the final results for 1967.

The timing of our mission was not set, although it was agreed that in any event it would take place only after the adjustment in the exchange rate was effected. Upon an enquiry by Mr. Kafka on the possibility of a mission in the second half of January, Mr. Del Canto pointed out the firm commitments the staff had already for that month, but explained that arrangements could be made in this respect, upon the Minister's request. What is important, the staff indicated, is that the authorities complete all necessary preparations for the forthcoming negotiations.

Jaime Daremblum
Economist
Eastern South American Division
Western Hemisphere Department

CONFIDENTIAL

Mr. Hughes
Mr. Finch

August 22, 1967

Maria Opasnov

Mid-term review

There have been two significant developments in respect of Brazil since the mission returned and Mr. Del Canto reported to the Managing Director on July 26, 1967. I think you should be aware of these, but I would be grateful if the information be regarded as confidential.

Firstly, on August 17 the Brazilian authorities introduced restrictions on operations in the "manual market" where previously sales of foreign exchange were made freely without any statement of purpose being required of the purchaser. As I see it the new arrangements will be hard to administer effectively. But they do represent a sharp tightening of the system.

Furthermore, the Western Hemisphere Department is having second thoughts on the desirability of a Board discussion on Brazil at this stage. They are in fact proposing to the Managing Director that he suggest to Mr. Kafka that such a discussion would be inopportune. They are thinking in terms of circulating to the Board the cable from Brazil notifying the change in the exchange system, and stating that the matter will be considered in the staff report on the mid-term review. The suggestion is, in other words, that the review paper will be circulated for information but not included, at this time, on the Board's agenda for discussion. It remains to be seen, of course, whether or not Mr. Kafka will agree. (You will recall that when in Brazil he was in favor of a Board discussion before the Annual Meeting [page 2 of Mr. Del Canto's memorandum to the Managing Director of July 26, 1967]).

A draft memorandum to the Managing Director outlining the above was given to me by Mr. Beza for my personal comments. I attach a copy of the redraft. Mr. Beza asked that it not be "circulated."

Attachment

August 22, 1967

The Managing Director

Jorge Del Canto

Brazil

Attached is the translation of a cable we have received from Brazil regarding changes in the operation of the manual market (the market for foreign currency notes and travelers' checks).

We propose sending this cable to the Board with a covering note from the Secretary indicating that this matter will be treated in the forthcoming staff report on Brazil. If you agree with this procedure, please return the attached to me so that we can prepare it for the Secretary's Office.

Describing the new measures briefly, access to foreign exchange in the manual market for Brazilians is to be limited to travelers, who must prove, moreover, that they have complied with income tax regulations. Apparently, there are no limitations on the amount of foreign exchange that residents may buy for genuine travel. Foreigners will be allowed to purchase foreign exchange up to the amount they have sold during their stay in Brazil, but they must secure prior approval from the Central Bank for purchases exceeding 30 per cent of the amount they had sold previously.

The principal effect of the new measures will be to curb the export of capital at the official exchange rate, as has been possible over the last three years by virtue of the authorities' unlimited support for a free manual market. Last year, Brazilian technicians estimated that ~~40~~ 30 per cent of the authorities' net sales of foreign exchange to the manual market went for tourism and the remainder for capital transactions; much of the outflow has taken the form of purchases of U.S. dollar notes by Brazilians as protection against the depreciation of the cruzeiro. Our experience indicates that the habit of saving in U.S. dollars is so engrained in Brazil that the new regulations on operations in the manual market will probably result in the development of a black market with a more depreciated cruzeiro. How much this rate will diverge from the one in the rest of the market will depend to a large extent on how tightly the manual market is controlled under the new rules.

It appears that the recent deterioration in the foreign reserve position spurred the authorities to take action to curb operations in the manual market. In the period July 1-August 11, the net reserve position declined by nearly $60 million, following a loss of approximately the same amount in the previous six months. The principal factor behind this weakening in the foreign reserve position appears to be the sluggishness of exports this year, particularly of coffee; in the first six months of 1967 coffee exports ran about $60 million below the level recorded in the corresponding period of the previous year, and it is reported that coffee shipments continued to lay lag in July and August. While the authorities' net sales of exchange to the manual market have been heavy, averaging about $19 million a month in the period January-July 1967, they have not been any higher than in 1966, when they totaled $260 million over the year as a whole. Apparently, however, the authorities felt that the only action they could take to alleviate the balance of payments difficulties they confront--without adjusting the exchange rate--was to try to diminish pressures emanating from the manual market.

¶ Mr. Beza and I talked yesterday with the Head of the World Bank mission which has just returned from Brazil, and he told us that the Minister of Finance has been under pressure from a number of military officers who are disturbed by the decline of reserves [redacted] and who view losses resulting from sales to the manual market as the result of pandering to "evil speculators."

He also informed us that in discussions relating to the timing of the eventual change in the exchange rate, the Minister of Finance told him that he hoped it would be possible to maintain the present rate until December, after several major wage contracts in the private sector had been negotiated.

Our view is that the measures described above are not likely to provide much balance of payments relief, inasmuch as the Brazilian experience indicates that such measures do not curb appreciably the outflow of capital. To state the obvious, what is needed in the present situation is the pursuit of a tight domestic program coupled with exchange rate adjustments whenever called for on balance of payments grounds.

Returning to the discussion we had the other day on the question of a Board Meeting on the stand-by review paper we are now preparing, I discussed this matter with Mr. Beza yesterday and we do not see the utility of a meeting on this subject. As we see it, the paper will inform the Board of the departures from the program and describe the intentions of the authorities to reverse the disquieting trends in the fiscal and credit fields, indicating that what is really needed now is a period of testing (the staff plans to pose the problem in this way) to determine whether the authorities can carry out their plans. A Board discussion at this stage would probably center on the departures from the program and on speculation over the feasibility of the authorities carrying out their program for the second half of this year--subjects that are not likely to lead to a fruitful discussion. In these circumstances, it would appear appropriate to point out to Mr. Kafka that a Board discussion at this time might not be opportune, although it should be made clear to him that we are not opposed to a Board meeting.

Mr. Hughes August 10, 1967

Maria Opasnov

Brazil--Blocked Balances for Petroleum Imports

In the Board discussion of the 1966 Article XIV Consultation on Brazil Mr. Wass, the Alt. Executive Director for the U.K., questioned closely the arrangement under which exchange contracts for the purchase of crude oil and petroleum products from a single foreign supplier in excess of specified quantities and terms of delivery may be closed only if the foreign supplier assumes the commitment to use at least 20 per cent of the value of total imports contracted for one of the following purposes:

(1) to arrange for exports of Brazilian products,

(2) to finance exports of Brazilian products,

(3) to invest in risk capital of companies domiciled in Brazil,

(4) to finance Petrobras in its exploration, refining, and production activities, and

(5) other uses that may be approved by the National Trade Council (CONCEX).

Mr. Wass asked that the Fund staff go into this question closely at the time of the next consultation. A copy of the relevant section of the draft minutes of the Board meeting is attached.

It turns out that the information given us last year was not fully correct. As this was a matter of some contention at the Board, I am attaching the explanation I am proposing to suggest for inclusion in the mid-term review, following the new information given us in Brazil. You may wish to look at it before it goes to the Western Hemisphere Department.

Mr. Gill, the Technical Assistant to the U.K. Executive Director, came to see me about this matter a week ago. I gave him verbally the explanation outlined in the attached draft. He thought that it might be easiest to discuss this matter fully with the Brazilian authorities at the time of the next consultations or stand-by negotiations.

Attachments (2)

c.c. Mr. Finch

MOpasnov:map

Second draft containing Mr. Hughes' suggestions

Decree 59430 of October 27, 1966, containing certain provisions governing payments for imports of petroleum and petroleum by-products has continued to remain in effect. The Decree stipulates that exchange contracts for the purchase of crude oil and petroleum products from a single foreign supplier in excess of specified quantities and terms of delivery may be closed only if the foreign supplier assumes the commitment to use at least 20 per cent of the value of total imports contracted for one of the following purposes: (1) to arrange for exports of Brazilian products, (2) to finance exports of Brazilian products, (3) to invest in risk capital of companies domiciled in Brazil, (4) to finance Petrobras in its exploration, refining, and production activities, and (5) other uses that may be approved by the National Trade Council (CONCEX). Preferences are, moreover, given to those foreign suppliers who, while providing a competitive price, are willing to assume in respect of part of the value of the contract any one of the obligations described above, even though the contract is for an amount below the level for which a commitment is obligatory.

In SM/67/15 it was reported that in practice balances corresponding to the value of a commitment required of the foreign supplier are released after a maximum period of 180 days if within that period it proved impossible to use these balances for the purposes defined in the decree. At the time of the 1966 consultation the Brazilian authorities indicated that they were planning to issue regulations specifying release of the balances within 180 days. During the review mission the Brazilian authorities explained to the Fund staff that such releases have, in fact, been made only in cases where the commitments have been voluntary ones referred to in the final sentence of the previous paragraph. No releases have been made of balances of foreign suppliers retained under the obligatory arrangement unless the commitment has been fulfilled.

In the first half of 1967 the equivalent of US$10.3 million of blocked balances were released as a result of arrangements made by petroleum suppliers for exports of Brazilian goods, mainly manufactures, in accordance with the above Decree. On December 31, 1966 and June 30, 1967, the amounts outstanding in blocked accounts as a result of commitments required of foreign suppliers were US$384,405 and US$473,849, respectively.

Mr. Del Canto May 2, 1967

S.T. Besa 828

Meetings with Mr. Delfim Neto--Minister of Finance of Brazil

This memorandum describes two meetings the management and staff of the Fund held last week with the new Minister of Finance of Brazil, Mr. Delfim Neto, and some other Brazilian officials. Mr. Robichek and I participated in the meeting on Tuesday, April 25, and Messrs. Finch, Daremblum and I attended the lunch given by Mr. Schweitzer on Thursday, April 27. A summary of recent developments in Brazil and a briefing on the issues for discussion with the Minister of Finance are contained in a memorandum sent to the management on April 21, 1967, prior to the visit of the Minister.

There appeared to be two contradictory themes running through the Minister's presentation of recent developments and policy intentions: on the one hand, he said that the new administration planned to continue the program described in the letter of intent to the Fund, but on the other hand, he presented a number of arguments which would indicate that he did not consider it feasible to continue the program. All in all, the Minister was neither impressive nor reassuring.

Responding to specific questions regarding the deviation from the fiscal target in the first quarter of this year, the Minister acknowledged that the deviation was large (the deficit was NCr$430 million compared with a programed amount of NCr$130 million for this period), and he explained that this was due to unexpectedly large payments against obligations carried over from last year and sizable transfers to some states whose revenue performance with the new value added tax had been rather poor. He added that he thought the situation could be reversed in the coming months, and he indicated that the target for the fiscal deficit for the whole of 1967 had not been changed. However, we were not able to elicit from the Minister any details of how fiscal performance would be brought within the guidelines established in the original program.

On coffee policy, the Minister said that the most recent forecast is that the 1967-68 coffee crop will be about 24 million bags, and he indicated that the authorities are contemplating some increase in the price. He seemed to feel that the decline in the real income of the coffee producers had been too severe in the current crop year, and he attributed the recession in industrial activity in part to the drop in the real income of the coffee sector. He went on, however, to play down the possible increase in the coffee price which would be permitted. Replying to a question posed by the Managing Director, the Minister said that the coming year's coffee policy would probably be decided by the 20th of June, 1967.

With regard to wages, the Minister stated that it is the intention of the new administration to continue the existing policies, and he noted that contracts were still being settled in accordance with the established formula. He mentioned that annual contracts negotiated during the past month had involved settlements with increases ranging from 22 per cent to 25 per cent.

To recapitulate, in discussing specific elements of the program, the Minister appeared to be saying that the policies of the previous administration would be carried out, although he was not forthcoming in spelling out how these policies would be implemented. However, when we turned to a discussion of general stabilization strategy, the point of view expressed by the Minister would indicate that the program will not be followed. In projecting price movements during 1967, the Minister said that he would be satisfied if the increase could be held in the range of 30-35 per cent. This surprised us, particularly in view of an earlier statement by the Minister that extrapolating the movement of prices in the first quarter would result in an annual increase of 28 per cent. Mr. Robichek noted that a price rise in the range indicated by the Minister did not appear to be consistent with maintenance of the fiscal, credit, wage, and coffee policies described in the letter of intent, and I pointed out that we had been repeatedly told that the price rise in 1966--when prices ran far ahead of credit and money--was due to special circumstances and that with an improved food supply situation this year, in combination with full implementation of the program, it should be possible to bring about a sharp decrease in the rate of inflation.

The Minister did not respond directly to these points, but in defense of the price target that he thought would be feasible he argued that Brazilian industry was plagued by high costs. He said that interest costs continued to remain high and that the general problem of high costs was aggravated by virtue of many industries having to operate at much below their capacities. At times he seemed to be hinting that an expansion in demand would lower the rate of increase of costs and prices, but he did not state this flatly. The Minister also indicated that some further corrective price increases were still needed, but the magnitude of the rise contemplated in the example he cited (steel prices) was in fact consistent with a much lower rate of price inflation than his projection.

Referring to some of the difficulties the Minister cited--particularly high interest rates and the limited volume of saving channeled through the banking system--the management noted the difficulties of achieving progress in these areas with the gradual approach to eliminating inflation. They observed that these problems would not be solved until the rate of inflation had been brought down sharply and the public were convinced that it would not be resumed. They added that they did not believe that reducing the inflation rate from 40 per cent last year to 30-35 per cent this year would convince anyone that inflation would soon be halted.

I cannot say that I would make much sense of the arguments that the Minister advanced, and it does not appear that he has developed a coherent and consistent strategy regarding the policy mix he would favor. Indeed, he appeared to be listing a number of the problems that bother him, but he did not give a clear indication that he has a point of view or approach that would form the basis of policy.

We took up with the Brazilian officials the interruption in the reporting of data under the stand-by program, and they indicated that some problems that they have had have been resolved and that now we should be receiving the cable on a regular basis. Mr. Gomes, of the Central Bank of Brazil, brought to Washington the most recent data he had available, and toward the end of last week we received a data cable from Rio de Janeiro.

We did not fix the timing of the mission that is to review developments under the stand-by. The approved travel schedule calls for a mission in the period June 10-25, which would appear to be appropriate in view of the indication from the Minister that coffee policy would be decided by the 20th of June. However, I will not be able to take that mission as originally planned, because of the delays we have had in scheduling the mission to Uruguay. Nevertheless, I feel that we should try to make other arrangements so that the mission goes near the date originally planned in order to maximize the chances of exerting our influence on policy in this critical area.

More generally on the subject of our role in Brazil, while the performance of the Minister in the meetings last week was disappointing, I feel that we have to continue making every possible effort to help prevent a serious deterioration in the country's financial situation. I recognize the difficulty of exercising influence over the Brazilian authorities in view of the small amount of the present stand-by arrangement and the country's limited use of Fund resources, but I feel that we have to continue pressing in every way possible to make sure that our views are put forward to the authorities. Much progress has been made in several areas of policy in the last few years, and it would be very discouraging and difficult to begin a new program if serious reversals in policy were to result in a major weakening in the country's performance in the coming year.

STBeza:ab

Mr. Finch
Maria [illegible]

The Managing Director
The Deputy Managing Director

April 21, 1967

E. Walter Robichek

Brazil

This memorandum is intended to provide a brief summary of recent developments in Brazil and to indicate the principal issues that it would be useful to focus on in discussions with Mr. Delfim Neto, the new Minister of Finance. I should note at the outset that the task of surveying recent developments has been complicated by the interruption of data reporting from Brazil. We have not received the weekly data cable for more than two months and there has been a lag in the receipt of other information. Despite our requests that the cable reporting be resumed--directed to the former and the present President of the Central Bank--the situation has not been corrected; this matter will be taken up further later in this memorandum. In compiling the information used in this memorandum we have had to rely heavily on reports received by the U.S. State Department from the Embassy in Rio de Janeiro.

Brazil has not drawn against the present stand-by arrangement for $30 million, which entered into force on February 13, 1967, and at the present time the Fund's holdings of new cruzeiros stand at 103 per cent of the quota of $350 million.

1. Recent developments

Over the first quarter of 1967, the net foreign reserves of the monetary authorities improved by more than the minimum amount that had been programed, but the expansion in credit from the monetary authorities and the fiscal deficit exceeded by wide margins the limits established in the stand-by program. The net foreign reserves declined sharply in the first six weeks of this year, but following the depreciation of the cruzeiro by 23 per cent in mid-February there has been a steep increase in reserves, which more than offset the previous loss. The fiscal deficit in the first quarter of this year has been estimated at more than NCr$400 million, compared with the target figure of NCr$130 million set out in the program. This deterioration in the fiscal situation appears to have reflected primarily an increase in expenditures rather than a shortfall in revenues. It has been reported that budgetary transfers to the states have been advanced ahead of schedule and payments against expenditure obligations carried over from last year were larger than had been anticipated. The net domestic credit of the monetary authorities increased by 7 per cent in the first quarter of 1967, compared with a planned reduction of about 2 per cent for this period. Most of this very large expansion in credit appears to have resulted from the extension of credit to the Government to cover the fiscal deficit.

The rise in prices over the first three months of this year was slightly less than 9 per cent, compared with an increase of nearly 14 per cent in the corresponding period of 1966. Following an increase of more than 4 per cent in January--the month in which many of the prices of the state enterprises and autonomous entities are adjusted--the average rise in prices in the next two months was about 2 per cent. In the first quarter of 1967 food prices rose only one half as fast as in the corresponding period of the previous year, when food supplies were adversely affected by weather conditions.

Only fragmentary data are available on recent trends in economic activity. These indicate that the recession that began late in 1966 deepened in the first quarter of 1967, but it has been reported that activity began to pick up again in March. To some extent, the slump in output in recent months was due to the severe floods that affected the Rio-Sao Paulo area and led to the rationing of electricity.

2. Issues for discussion

In the light of recent developments, the immediate issue for discussion with the Minister of Finance is the fiscal outlook for 1967. The principal questions are whether the original fiscal program can be gotten back on the tracks, and what measures the authorities plan to take in this area. It has also been reported that the income tax law has been revised, mainly providing for an increase in exemptions that may be expected to have an adverse impact on revenues.

The most important decision that will have to be made in the next few months concerns the coffee policy to be established for the coffee year beginning July 1, 1967, inasmuch as a firm policy in this area is critically important for the successful implementation of the stabilization plan. The coffee policy adopted last year has been successful in eliminating inflationary pressures from this sector, and officials of the previous administration indicated to us (in December 1966) that it was their view that the guaranteed purchase prices of the Brazilian Coffee Institute in the coming coffee year should be maintained at the same level as in the current crop year. They projected an increase in the size of the crop, and together with the maintenance of the price this would result in a stable real income for the coffee sector. Recent press reports indicate that the coffee sector is exerting strong pressure on the Government to raise substantially the guaranteed purchase price of the Brazilian Coffee Institute, and some statements made by the new President of the IBC, to the effect that coffee prices have been too low, are disquieting. It would therefore be useful to obtain from the Minister of Finance an idea of the current thinking of the new economic team with regard to prospective coffee policies, and to indicate to him the importance that will be attached to this decision as a major indication of the new administration's policies.

The increase in wages for public sector employees this year was fixed at 25 per cent, effective from the 1st of January, and in March the minimum wage was adjusted upward by 25 per cent. The decree setting the minimum wage specified that the new level is to be maintained for three years. While we do not want to appear to be questioning at every turn the determination of the new authorities to maintain the policies established by the previous administration, attention could be drawn to the existing policies in this area, thereby inviting the reaction of the Minister of Finance to the present policies.

The interruption in reporting under the weekly cable is an issue important enough to be taken up with the Minister of Finance. If this problem is not corrected right away, we may soon be unable to assess developments in Brazil. We would also recommend that it be proposed to the Minister that we send the deskman working on Brazil to Rio de Janeiro for a period of ten days to two weeks in May to gather information on recent developments. This suggestion is partly related to the recent problems arising from the interruption in the flow of information from Brazil, but it reflects more basically the difficulty of doing an adequate job of covering Brazil from Washington.

Finally, we could indicate to the Minister of Finance that we are planning to send a mission to Brazil within a few months to conduct a mid-year review of developments under the stand-by program. Unfortunately, we cannot, at this time, be specific about the timing of such a mission. In our travel plans we had tentatively scheduled this mission (headed by Mr. Beza) for the period June 10-25. However, the delay in the mission to Uruguay has complicated our travel schedule, and it now appears that Mr. Beza will not be able to go to Brazil before early July. The disadvantage of postponing the mission from June to July is that it diminishes our chances for influencing coffee policy, but the importance we attach to policy in this area could be brought out clearly in the discussions we will be having with the Minister. We are still searching for ways to hold to our original schedule for the mission, but we cannot commit ourselves at this stage, particularly in view of Mr. Del Canto's absence from Washington this week and next.

cc. Mr. Finch
Mr. Nicoletopoulos

STBeza:ab

Meeting on Bilateral Agreements

October 1966

This note sets out background information on each of the agreements.

Agreement

Brazil-Denmark

Terms: The agreement is an interbank one between the National Bank of Denmark and the Bank of Brazil. Originally signed on April 27, 1951, it may be terminated on 60 days' notice by either party.

Payments are made through a krone account kept by the National Bank for the Bank of Brazil. There is a swing limit of DKr 100 million ($14.3 million) with any excess payable in sterling.

Upon termination of the agreement, the liquidation of the outstanding balance is to be in goods and services at world prices.

Balance Outstanding: There has been a sizable balance in favor of Brazil for several years; as of December 1965, it was of $14 million.

Commodities involved: The principal Danish import is coffee. Of the total Danish and Faroese exports to Brazil about 28 per cent consists of fish; the remainder comprises mainly chemicals and machinery. All Faroese exports to Brazil consist of dried salted cod (klipfisch).

Danish (including Faroese) Exports to Brazil - 1965

(In millions of Danish kroner)

SITC No.		
03	Fish (from Denmark)	8.4
	(from Faroe Islands)	15.5
04	Grain	10.0
51	Chemical raw materials	13.6
54	Pharmaceuticals	2.4
64	Paper	2.6
71	Machinery	20.0
	Other	12.4
	Total	84.9

Trade between the two countries does not represent a large proportion of their total trade (no more than 3 per cent) but in the case of the Faroes, exports to Brazil constitute about 8-9 per cent of their total exports.

Attitudes toward the agreements:

Denmark:

Under the arrangement with Brazil, Danish exports have benefited until recently from the existence of preferential guarantee deposits and a favorable exchange rate. These preferences were not considered vital except in the case of klipfisch exports from the Faroe Islands, which is an important though declining product of the islands: the Faroese have been able to exert considerable political pressure on the Government in Copenhagen. The preferences referred to above have now been removed and the Faroese no longer enjoy any advantages.

Denmark's import system affords a slightly preferential position to Brazil (and Colombia). If the system were abolished coffee imports from other countries might increase. The present arrangement is that coffee from Brazil (and Colombia) is licensed freely. Licenses for imports of coffee from other countries are issued jointly--the total value of such licenses represents a proportion of the value of imports from Brazil in a previous period. Coffee imports from Brazil amount approximately to 75 per cent of total coffee imports and those from Colombia, to about 5 per cent.

Now that the preferences previously granted by Brazil have been removed there would seem no longer to be any substantial obstacle from the Danish point of view to the elimination of the agreement. This is particularly so since many of the Danish Economic Ministries and the Danish Central Bank wish Denmark to undertake the obligations of Article VIII. What appears to be needed is the existence of pressure on the Government, which will give the Government the excuse it needs in its relations with the Faroe Islanders.

At the last consultation the Danish authorities stated that "... as regards the payments agreements with Brazil (and Colombia) ..., there are special difficulties involved as it has so far appeared the only possible way of ensuring adequate market opportunities for the fish exports from the Faroe Islands ..., where special economic social conditions prevail.

"The Danish Government is not unmindful of the concern of the Fund with regard to the two payments agreements. On the occasion of the present consultation with the Fund the Government has reviewed the whole matter and ... the Danish authorities will be prepared to take part in multilateral consultations about the whole matter with the aim of finding a solution that would be acceptable to all parties concerned."

Brazil:

At the last consultation, the Brazilian authorities indicated that they would be in favor of the elimination of bilateral payments agreements with Fund members, provided that they would receive a reasonable assurance that the partner countries would import Brazilian coffee on a competitive basis.

Position of the staff

The question could be raised as to whether the removal by Denmark of the licensing of all coffee imports would provide the basis for a solution satisfactory to the Brazilians. The European Department suggest that the staff should, as far as possible, leave the negotiations to the parties concerned. The staff's general attitude should be that Denmark should not, especially in view of its superior economic position, be a recipient of credit from Brazil, nor should it take advantage of any preferential arrangements afforded by Brazil (and Colombia) that discriminate in those countries against other Fund members. The staff should encourage the Danes to assure the Brazilian (and Colombian authorities) that they can rely on nondiscriminatory treatment in the Danish market.

Agreement

Colombia-Denmark

Terms: The Danish-Colombian agreement was signed on November 24, 1955; it replaced a similar trade and payments agreement of January 1951. The agreement is valid for one year and renewable annually unless denounced by notice three months prior to its expiration.

Payments arrangements are through an account in terms of U.S. dollars by the National Bank of Denmark for the Banco de la Republica to be used for settling trade and related transactions. There is no swing limit. At the expiration of the agreement, the balance is to be settled in goods. Imports from third countries may be paid through the account subject to approval by both Colombia and Denmark.

There are no commodity lists or quotas and both countries agree to take measures to maintain a balanced trade. Denmark is not to re-export coffee to any American country or to countries having trade agreements with Colombia. Prices of goods exchanged are not to exceed world prices. Individual barter operations may be authorized. A previous agreement assured import licenses for trade up to $2 million in each direction.

Balance Outstanding: There has been a consistent small balance in favor of Denmark ($0.6 million in July 1966).

Commodities involved: The principal Danish import is coffee; Colombia imports machinery and chemicals.

Danish Exports to Colombia - 1965

51	Chemical raw materials	1.9
59	Other chemicals	1.4
71	Machinery	8.9
72	Electrical machinery	2.0
	Other	3.2
	Total	17.4

The amount of trade under the agreement is relatively insignificant in terms of total exports (not more than 3 per cent).

Attitude toward the agreement:

Colombia:

According to Mr. Zassenhaus, on last contact with them the Colombian authorities did not attribute great importance to the maintenance of the agreement, though they would welcome the simultaneous expiry of the Brazilian-Danish agreement. Mr. Zassenhaus does not foresee major difficulty in persuading Colombia to terminate the agreement.

Denmark:

In the view of the European Department, the Colombian agreement is less sensitive than the Danish agreement with Brazil though it possibly affords some preference to Danish exporters, and the Danish authorities would also certainly agree to terminate the agreement.

As with Brazil, Denmark's import system affords a slightly preferential position to Colombia.

Position of the staff: See notes on Brazil, page 3.

Agreement

Colombia-Finland

Terms: The Finnish-Colombian agreement, signed on November 29, 1957 replacing a trade and payments agreement of March 6, 1951, was valid for one year starting January 1, 1958 and renewable annually by exchange of letters. Trade transactions are settled through noninterest-bearing accounts in terms of U.S. dollars maintained by the central bank of each country. There is no swing limit. At the expiration of the agreement, settlement is to be effected in merchandise in so far as possible and is to take place within a year and a half.

The agreement states that the Colombian authorities will grant licenses for the export of at least $4 million a year worth of Colombian coffee to Finland. On the Finnish side, the Finnish authorities undertake to issue licenses for the export of Finnish goods up to the amount of their coffee imports. Prices of goods exchanged are not to exceed world market prices and except for goods on the Colombian prohibited list both countries undertake to import goods from the parnter country without restriction. All Colombian payments for Finnish exports, but only Finnish payments for coffee, go through the clearing account.

Balance Outstanding: Colombia is a growing creditor: at the end of July 1966 the outstanding balance in favor of Colombia amounted to $8.9 million.

Commodities involved: Finland's exports to Colombia in 1963 and 1964 were as follows:

Finnish Exports to Colombia

(In thousands of Finnish markkas)

		1963	1964
Total of which:		20,961	22,276
SITC No.			
25	Paper pulp	6,129	5,106
51-59	Chemicals	1,652	573
64	Paper, cardboard and products thereof	5,325	4,747
67	Iron and steel	--	43
68	Other metals	2,641	3,134
69	Products of nonprecious metals	1,109	1,783
71	Nonelectrical machinery	1,216	1,534
72	Electrical machinery, etc.	345	1,460
73	Transport equipment	2,513	3,895

Attitudes toward the agreement:

Finland:

The Finnish authorities have repeatedly stated that they are fully prepared to terminate the agreement in accordance with its provisions (i.e., through exchange of goods), despite their expectation that Finnish exports to Colombia would diminish further if discrimination associated with the bilateral agreement were to stop.

At present coffee is free listed and any special preference given to Colombian coffee results from the policies of private firms in Finland interested in exporting to Colombia.

Finnish exports to Colombia considerably exceed the minimum amount stipulated in the payments agreement, but are not large enough to balance the bilateral account.

Colombia:

According to Mr. Zassenhaus, the Colombian authorities are apprehensive that, should the agreement be terminated the Finnish authorities may take measures which in effect would discriminate against Colombian coffee. Colombia attributes a considerable importance to its market for coffee in Finland, and it may be difficult to persuade Colombia to agree to termination of the agreement, unless effective assurances can be given that Finland will not discriminate.

Position of the staff:

The foregoing is one aspect to consider; the European Department considers that the staff should press the points that it is not appropriate for Finland to accept credit from Colombia nor for Finland to participate in arrangements which discriminate against other Fund members. The staff should not suggest the use of the Fund resources to facilitate the termination of the agreement, but might suggest that Finland's case for a drawing in the credit tranches would be strengthened if the bilateral agreement were terminated. This latter suggestion would depend on what the staff hears from Governor Waris concerning Finnish plans for a drawing on the Fund in early 1967.

Mr. Sturc September 15, 1966

R. J. Familton

Bilateralism Meetings--
Brazil, Colombia, Denmark and Finland

Further to my memorandum of September 8, I attach background notes on the arrangements among the four countries. The notes were prepared in consultation with the European and Western Hemisphere Departments.

cc: Mr. Finch

INTERNATIONAL MONETARY FUND

September 19, 1966

TO : Mr. Sturc

FROM: Maria Opasnov

I attach copy of a memorandum to Mr. Schelin. The memo was prepared upon his request to be forwarded by him to the Danish authorities in preparation for the forthcoming meeting on bilateralism.

tachment.

MO/sl

Mr. Otto Schelin September 14, 1966

C. David Finch

Review of certain discriminatory exchange and trade practices in Brazil

I refer to your inquiry concerning Brazil's recent discriminatory exchange and trade practices involving preferential treatment to imports from bilateral payment agreement countries. The following is a brief review of such practices as they had been applied until the recent past.

(1) Differential exchange rates. For selected "agreement" currencies exchange rates for imports in the general category (primarily raw materials, goods for use in production, and some essential consumption goods) were quoted at a discount from rates quoted for convertible currencies. The discount was applied to those "agreement" currencies in which Brazil had accumulated large credit balances and the number of such currencies varied in accordance with the prevailing balance on the respective clearing account. In early 1961 the discount amounted to 10 per cent; it was subsequently reduced to 5 per cent, and was entirely eliminated in September 1965. According to available information, the discount was applied to Danish kroner throughout this period for payment of general category imports under the agreement.

(2) Preferential treatment of Special Category imports (all other imports). Since the exchange reform of March 1961, Special Category imports required import licenses which were granted to holders of "promises of licenses". These were sold at auctions and were expressed in two currencies: in free U.S. dollars, valid for imports from any country with which Brazil did not maintain bilateral payments agreements, and in "agreement" currencies, valid for imports from any bilateral payments agreement country. At the beginning, a minimum bid was established for these auctions at Cr$662.20 per U.S. dollar, which applied to all "promises", whether expressed in U.S. dollars or in "agreement" currencies. For "promises" expressed in convertible currencies, however, actual bids were always above the minimum bid, and this gap widened as the "free" market rate was being successively depreciated (see below). In contrast, actual bids for "agreement" currencies hardly ever exceeded the level of the minimum bid. In 1963 the inoperative minimum bid for "promises of licenses" in convertible currencies was abolished. [There was no adjustment for several years in the minimum bid for "promises of licenses" in "agreement" currencies, neither to the considerably higher actual premiums for licenses in convertible currencies, nor to the successive depreciations of the "free" market rate (the "free" market selling rate per US$1 was depreciated as follows: from Cr$318 at the end of 1961 to Cr$475 in September 1962, to Cr$620 in April 1963, to Cr$1,450 in February 1964.] The preferential treatment in respect of the cost of "promises of licenses" for imports payable in bilateral currencies was eliminated in April 1964 when minimum bids for auctions of such "promises" were set at levels corresponding to the weighted average bid of the preceding week in auctions for the U.S. dollar.

(3) Difference in guarantee deposit requirement. In addition to the two discriminatory practices described above, bilateral imports had also been favored through a preferential guarantee deposit requirement. This practice became significant only since September 1964 when the guarantee deposit requirement for most private imports payable in convertible currencies at commercial banks was raised from 10 per cent to 100 per cent of the value of the foreign exchange contract. For contracts in "agreement" currencies the required guarantee deposit was 20 per cent, or 10 per cent if concluded at the Bank of Brazil. The guarantee deposit requirement for imports payable in convertible currencies was reduced from 100 per cent to 25 per cent on January 14, 1966. In accordance with the decision of the National Monetary Council of April 29, 1966 the guarantee deposit requirement in respect of sales of foreign exchange by commercial banks was entirely abolished as from that date.

MOPasnov:jak
September 14, 1966

Mr. O. Schelin 11 January, 1966

M. Opasnov

Brazil

I refer to our conversation of last week on Brazil's exchange practices. According to information received during the recent consultations discussions the only remaining cost restriction maintained by Brazil which involves a preference to imports from countries with which it maintains bilateral payment agreements consists of the differential in the guarantee deposit requirement. For most imports the importer is required to deposit, at the time of the closing of the exchange contract with the Bank of Brazil or the commercial bank, a guarantee deposit of 100 per cent of the value of the foreign exchange contract. For contracts in currencies of countries with which Brazil maintains bilateral payment agreements the required guarantee deposit is 20 per cent, or 10 per cent if concluded at the Bank of Brazil. Deposits may be used for payment for foreign exchange when the contract is liquidated. The usual period for liquidation of foreign exchange contracts for imports is up to 120 days. The cost of the deposit depends therefore on the length of the period of the exchange contract. At an interest cost of 2.5 per cent per month the cost per U.S. dollar of a 100 per cent guarantee deposit would be Cr$56 for each 30 day period. It would amount to about Cr$11 per U.S.$1 for a 20 per cent guarantee deposit.

cc. Mr. Sture
Mr. Sacchetti
Mr. Elmholt
Mr. de Looper

JUNE 12, 1966

The Present Auction System in Brazil

1. Since 1956 three developments involving the auction system may be noted:

(1) Coverage of the system still remains quite substantial; actual imports effected under the system are only a small proportion of total imports. In 1965 perhaps not more than 2 per cent of the total value of imports were auction imports (special category imports).[1]

(2) In March 1961 the multiple currency aspect of the system was eliminated. Importers were thereafter required to purchase a promise of import license which would entitle them to obtain an import license for a total value equal to the amount of the "promise". The exchange could be obtained either from the Central Bank or from the free market. The price paid for the promise of license amounted to a surcharge on imports, whereas prior to 1957 exchange certificates were bought at auctions, entitling the importer to obtain exchange at par value. The price of these certificates amounted ~~from~~ to an exchange tax.

(3) Some changes in the administrative rules regarding minimum bids have been made. Since 1957 the minimum bid applied to inconvertible currencies has become dependent upon that applied to convertible currencies. This change in procedure has tended to discourage the use of inconvertible currencies in favor of convertible currencies.

2. Otherwise, the same procedures basically still apply: importers must purchase a "promessa de licensa" on a stock exchange where promessas are offered in global amounts for auction. Each week the exchange department of the Bank of Brazil determines the amount to be offered at auction.

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[1] In August 1957 a new customs tariff law, containing provisions affecting the auction system, was signed by the President. The five categories of imports under the auction system were reduced to two: General and Special. Auctions applied to imports in the Special category only.

Auctions are held weekly in 20 cities; about 30 per cent of the supply is reserved for both Rio de Janeiro and Sao Paolo. The promessas are expressed in only two currencies, "free U.S. dollars" and "agreement dollars" and are offered in lots of US$100's and US$500's. There is a minimum bid for promessas expressed in agreement dollars; such minimum bid must equal the weighted average bid of the preceding week at the free U.S. dollar auctions in Rio de Janeiro and Sao Paolo. A promessa entitles the holder to obtain import licenses for a total value equal to the amount of the promessa.

3. The Fund staff has taken the position that the auction system as it has been operated has tended to extend undue protection to local industries and hence the movement of imports from the special category to the general category, which is not subject to auctions, was welcomed as one step towards rationalizing the Brazilian import system.

June 16, 1966

Summary of Article by A. Kafka: "The Brazilian Exchange Auction System" [1]

1. Description of the auction system

This system was introduced in October 1953. Certificates representing the available exchange are sold by the monetary authorities at auction. These certificates confer upon their purchasers the right (a) to obtain an import license in the amount of the certificate and (b) to purchase this amount of exchange at par. The effective import rate thus became the par value (plus a remittance tax whenever applicable) plus the variable auction premium. Excluded from the auction system are certain essential imports and the foreign purchases of the Government. In 1954, imports excluded from the system constituted about 50 per cent of the total value of imports.

For the purpose of the auctions, all imported commodities are classified into various categories. Separate auctions are held for U.S. dollars and for the currency of each country with which Brazil maintains a payments agreement. The available supply of each currency is allocated to the several categories. For each category there are established minimum bids, the minimum being higher for categories of lower priority. The supply of each currency allocated to each category is then auctioned off to the highest bidder.

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[1] The Review of Economics and Statistics, (August, 1956)

2. Working of the system and some practical problems

(i) The system was generally welcomed--importers could at least bid for foreign exchange instead of having to plead for it.

(ii) On the whole, classification of commodities into the various categories evoked few protests. They were infrequently ~~frequently~~ changed.

(iii) Minimum bids were introduced to minimize attempt to rig the auctions but these minimum bids reduced the effectiveness of export subsidization.

(iv) The auction premia have fluctuated widely and frequently. Also, discrepancies have developed among the premia on different currencies in one category, among the auction premia prevailing at different stock exchanges and between the daily maximum and minimum accepted bids for given categories of a currency.

(v) The system has also given a decisive competitive advantage to importers and import-consuming industries with greatest financial strength, since the full auction premium must be paid before the import license is issued and the premium is the major part of the cost of most imports.

3. Theoretical problems of the exchange system

(1) Normal multiple rate features

(i) Spread between buying and selling rates

There exists a relatively large spread between the average export rate and the average effective import rate (including non-auction imports). In practice, however, the spread has tended to shrink, rather than grow, so that this system is less restrictive of trade than was its predecessor.

- 3 -

Regarded as a <u>general tariff</u> designed to improve the terms of trade, the spread between export and import rates could not much increase Brazil's real income since, with the exception of coffee, the foreign price elasticities of demand and supply facing Brazil do not seem to be low. Similarly, the spread could not be justified as a means of denying to traders those <u>windfall profits</u> which would arise were Brazil's price elasticities of demand for import and price elasticities of supply for exports both very low. There is no reason to suppose low elasticities, except in the very short-run, even in respect of the demand for imports.

The <u>general protective effect</u> of the spread may, however, attract foreign investment in production for the Brazilian home markets and as such may be a means of overcoming fears of expropriation which may have hindered the inflow of investment into Brazil. ~~Also~~ But, there seem to be indications that the spread and other features of the exchange system have afforded a greater degree of general protection to production for the home market than would be necessary merely to offset the change in terms of trade. There may be a case for an export tariff on coffee and cocoa but not for a general export tariff.

However, one may argue that the mere convenience of taxing exports and imports justifies the exchange rate spread.

(ii) <u>Multiplicity of rates for exports and imports</u>

The exchange rate discrimination among Brazil's exports, except for coffee and cocoa in the short-run, does not seem a promising way to improve the terms of trade; there is no reason to believe that foreign price elasticities of demand for Brazil's supplies differ significantly from the other commodities.

The multiple import rates may be regarded as a set of subsidies and tariffs. The most serious immediate result of the various subsidies applicable for example to wheat, fuel, cement, and fertilizers was over-importation, financed by the accumulation of short-term and medium-term debt. On the other hand the auction system, acting as an additional tariff on other imports, has tended to stimulate the production of raw materials and producers' goods more than did the system of direct controls. The auction rate structure and its predecessors have both discouraged imports of finished goods, particularly of luxury goods. However, in the long-run this may be self-defeating unless accompanied by domestic excise taxes.

(iii) Separation of commercial and financial exchange markets

The average of auction rates has increased more than the free market rate. Yet, the free market rate is still very much above the highest effective export rate. Under these conditions, invisible imports and financial remittances are subsidized relative to general commodity imports while invisible exports and capital imports are subsidized relative to commodity exports. But as most financial remittances are less essential than imports in general, there is very little to be said for the subsidy. Nor can much be said for subsidizing exports of services as against exports of goods.

The differentials which exist between the import and free market rates may affect capital imports in various ways. One might make a case for a general subsidy of capital imports as such as compensation for the special risks of foreign investment or for differences between the rates of time discounts of foreign investors and of the country in which they invest. Such a subsidy might be granted by applying a less-depreciated rate to the remittance of earnings than to the capital import itself. It would be completely free from the possible disadvantages of protection, as well as from the disadvantages of subsidization of imports of foreign equipment. Nevertheless, protection may after all prove to be the most effective incentive to foreign investment because it offers not only the stimulus of profits but also the threat of loss of market.

(2) Fixed export and fluctuating import rates

Under inflationary conditions, discontinuous revisions of export rate are inferior to automatic flexibility. Administrative adjustments are dramatic events which almost invariably disrupt the flow of exports.

(3) Bilateralism

Auction premia have been lowest for the weakest currencies. But ~~then~~ these low premia, by comparison with those prevailing for harder currencies, constitute subsidies not taxes. Because the countries with weak currencies lack trading alternatives, they probably in general confront Brazil with its lowest elasticities of export demand and import supply. Hence their trade with Brazil should be taxed not subsidized. However, on any correct estimate of the elasticities one must conclude that a continuation of the bilateral arrangements involves an unnecessary and substantial distortion of trade.

(4) The auction system proper

With respect to each of its distinct categories, the auction system might be regarded as the analogue of a point-rationing regime. It might also be viewed as a fluctuating tariff and as a tariff designed to maintain a given volume of groups of imports rather than a given domestic price of imports. This combination has little virtue except in those periods when a country is about to achieve monetary stability so that further depreciation of the currency will become unnecessary. At that time, however, it may be of great usefulness; expectations may, at such time, still be inflationary, a fact which could lead either to depreciation with the consequent deterioration of the terms of trade (if the export rate were flexible) or to overimportation (if the import rate were fixed and in the absence of restrictions). The combination of fixed export and fluctuating import rates would avoid both effects. As long as inflation continued, this combination would, however, tend to overvalue the export rate in relation not only to unwarranted expectations but to its equilibrium level, and would thus be positively harmful.

4. Conclusions

(1) The auction system represents a vast improvement over its predecessor, mainly because it limits substantially the administrative ~~direction~~ discretion existing earlier and because it recognizes the depreciation of the currency.

(2) Multiple rates hide the real cost to the community of different types of imports and different ways of earnings exchange.

Any theoretical advantages of multiple rates are in practice offset by uneconomic administrative measures and by unintended distortions of the structure of production to which the multiple rate system leads.

(3) The combination of fixed export and fluctuating import rates has little virtue except when monetary stability is about to be achieved.

(4) The system makes explicit the subsidization of exports to and imports from weak currency countries inherent in other bilateral systems. To that extent, it may have the virtue of leading to an earlier abandonment of bilateral arrangements than would other systems.

(5) The auction system, as such, has certain advantages under moderately rapid inflation--from the point of view of income distribution and the protection of home industries. However, these advantages may be neutralized to the extent that the flexible tariff is not reinforced by flexible excises.

(6) No system of exchange control will be found wholly satisfactory over a long period. A floating rate, or occasional adjustments in par values, as the case may be, will be found best in the long run.

June 22, 1966

Brazil: Debt Renegotiations 1964

Continuous balance of payments deficits and mounting external indebtedness by the fall of 1963 had led again to a severe burden of external debt service despite the relief obtained under the 1961 agreements. Political pressures at home arose urging a unilateral declaration of suspension of payments upon Brazilian authorities, struggling with the domestic problems created by inflation and near-stagnation of the economy. Large commercial and financial arrears had already accumulated and the Fund was informally approached with a request for a postponement of repurchase obligations.

In October 1963 Brazil began preparations for negotiations with creditor countries. The Fund, and especially the Executive Director for Brazil were to play a key role in these negotiations, and the Fund staff soon initiated informal contacts with some of the creditor countries.

The total external debt at that time amounted to nearly $4 billion, including arrears on import bills of $170 million, swap obligations of $170 million, suppliers' credits to the public and private sector of nearly $1,250 million, IMF net drawings of $167 million, compensatory loans to the Bank of Brazil $1,450 million, and other official debts of $350 million. Except for loans obtained through AID, Eximbank, IBRD, and IDB, those external debts were of short or medium-term maturity. Debt payments scheduled for 1964 to 1966 were as follows:

1964: $996.5 million
1965: $433.7 million
1966: $376.1 million

There was some likelihood that these figures represented a certain overestimation as it proved difficult to obtain reliable information on the extent of utilization of suppliers' credits. Nevertheless, against available foreign exchange of $1.1 billion expected on the basis of balance of payments forecasts (average export earnings $1.3 billion) the urgency of renegotiation was widely recognized when Brazil in January 1964 proposed to convene a meeting of the major countries.

In February 1964 a Fund mission to Brazil discussed the possibility of repurchase postponement, and before even the report of this mission was issued, the Fund participated as "observer" in a meeting of the "Hague Club" in Paris (March 16, 1964).

The oral report by the staff representative as given to the creditors did not suggest any realistic prospect for an imminent stabilization of the Brazilian economy. It stressed, that in view of Brazil's immediate payments problems relief on debt payments was urgently required, but that in view of improved coffee export receipts and a recent exchange rate change a reasonable level of debt servicing seemed feasible. The Fund representative therefore suggested that a quick rather than/large amount of relief was important.

Brazilian requests for 100 per cent postponement of interest and principal payments on all development credits and for a funding of arrears was termed unacceptable by the representatives of creditor countries. With a revolution in Brazil, the meetings were adjourned without agreement. There was, however, a suggestion of possible compromise in the form of a U.S. proposal for 60 per cent refinancing of principal due between May 1964 and December 1965 under governmental or government guarantee credit contracts.

After another Fund mission had visited Brazil in May 1964, the extended

"Hague Club" (Spain and Canada in addition to previous participants) reconvened in Paris in early June. The Fund representative reported on the mission's findings but in view of the uncertain political situation could not hold out much hope for an early stabilization of the Brazilian economy. Brazil made requests which were notably moderated as against the previous meeting. They centered on the request to provide for a declining portion (80 per cent in 1964 to 35 per cent in 1968) of relief on payments under suppliers' credits maturing during 1964 to 1968, with a grace period of 5 years, and 5 year repayment period for the postponed portion of the debt payments. Brazil proposed to undertake effective control of new suppliers' credits.

The meeting led to a reformulation of these requests so as to include only 1964 to 1966 maturities, but under French leadership and with strong support from the U.K. and Italy, theemerging consensus of creditors envisaged a debt rearrangement merely for 1964 and 1965 maturities. The U.S., on the other hand, seemed to have been prepared to accept a rearrangement of wider scope.

The third round of meetings June 30 - July 1, 1964 substantially lead to the adoption of the earlier U.S. compromise proposal.

Until January 1966 Brazil undertook to limit total suppliers' credits to the level registered at the end of May 1964. The Fund was to act as intermediary in the supervision of this commitment. Brazil would give monthly reports on suppliers' credits to the Fund, and the Fund would transmit this information to the creditor countries.

Payments of capital and interest were to continue but nine creditor countries represented at the meetings agreed in principle to refinance 70 per cent of payments due in 1964 and 1965 on suppliers' credits received from official sources or under government guarantees. (Belgium, representing a relatively small debt, did not participate in the refinancing.)

The payments on these refinancing loans would be made in equal installments over five years beginning, for 1964 maturities, on January 1, 1967, and for 1965 maturities, on January 1, 1968. The refinancing arrangement of May 1961, which provided for refinancing of 50 per cent of 1964 maturities and 35 per cent of 1965 maturities against suppliers' credits then outstanding, would continue in force. It was, however, to be supplemented by new financing to the extent necessary to raise the assistance on those debts to 70 per cent. Including the amount relating to the 1961 arrangement, the total refinancing obtained for 1964 and 1965 amounted to an estimated $190 million. It was agreed that every effort would be made to complete bilateral agreements with creditor countries before September 1, 1964. It was also understood that Brazil would endeavor to negotiate similar refinancing with private suppliers' whose credits were not guaranteed and with governments of other creditor countries. Finally, note was taken on the desire of Brazil to have further discussions during 1965 on maturities in 1966.

Mr. [illegible]
Mr. Woodley
Mr. [illegible]
Mr. Mookerjee

February 1, 1966

MEMORANDUM FOR FILES

Subject: Brazilian Commitment to Repurchase Compensatory Drawing

Early today Messrs. Bicalho and Coutinho called on me in order that Mr. Coutinho could explain some second thoughts which Finance Minister Bulhoes had had about the commitment given to the Fund mission and mentioned in the papers before the Executive Board, to repurchase the $60 million stand-by arrangement in June when it will have reached three years. Mr. Coutinho said that there was no doubt at all that the commitment had been given but he explained that Minister Bulhoes had become familiar with the new paper on compensatory financing and he thought that this rather changed the situation. True, it was understood that Brazil would roll over the repurchase by drawing under the new stand-by. However, Brazilian officials had long argued for a floating compensatory tranche. Therefore they would really prefer to follow the lead of the new paper and let the compensatory drawing run on and not make the roll-over drawing under the new stand-by. The Finance Minister would like to know what the Fund management's reaction would be to this.

I said that I would mention the matter to Mr. Schweitzer at once. But my first reaction was that some Executive Directors would not be happy at a suggestion coming from Brazil or the management, or both, that the paper on compensatory financing be a basis for a change in the arrangements made with Brazil during the negotiations. After all, the paper had had only an informal discussion in the Board so far. I also pointed out that the logic of the situation, if the repurchase scheme contained in the paper was to be followed, would be to determine what Brazil's repurchase commitment would have been in the past three years, taking account of Brazil's export earnings year by year.

Mr. Bicalho and Mr. Coutinho at once said that the Finance Minister would expect that Brazil would follow any such repurchase arrangement rigorously. They then explained that Brazil hoped to avoid drawing under the new stand-by, using it as a second line of reserves only to avoid a decline in Brazilian reserves. From this point of view, to avoid drawing for the purpose of rolling over the compensatory drawing was possibly desirable.

I then said I would speak to the Managing Director and be in touch with Mr. Bicalho during the day. I discussed this matter with the Managing Director before the Board meeting. His reaction was that it would be unwise to mention this matter in the Board meeting on February 2 in connection with the Brazilian stand-by. It would raise doubts and worries in the minds of some Directors. However, Mr. Bicalho could be informed that if progress was made before June in Executive Board consideration of the compensatory paper, then the Managing Director would not regard it as a breach of faith if the Brazilians were to discuss with him the pros and cons of leaving the compensatory drawing outstanding or of repurchasing. In the meantime, there could be discussions with the staff on the technical aspects--i.e., what would the

Brazilian repurchase obligation have been had the proposed new arrangements been enforced in 1960?

I reported the Managing Director's view to Mr. Bicalho and Mr. Coutinho before the Board meeting and they at once said that it was quite satisfactory. Mr. Bicalho repeated this to Mr. Schweitzer after the Board meeting.

Frank A. Southard, Jr.

cc: Mr. Schweitzer
Mr. Gold
Mr. Polak
Mr. Del Canto
Mr. Sturc
Mr. Koo

Mr Mookerjee

September 22, 1965

Mr. Sturc

Evan Hannay

Since preparing this memorandum for you, in which I pass along the opinion of Mr. Nicoletopoulos that action is not required urgently, I have heard from Mr. Guenther of W.H.D. that the European countries are making a big issue of discrimination in favor of AID-financed imports. The U.K. and some other European countries are believed to have made protest in Rio. Even so, he and I think the matter needs thorough exploration, with a review of all important precedents by the Legal Department, before we can know whether or not the present Brazilian practice is defensible. If it is not, we should probably try to develop an acceptable effective alternative method which can be recommended to the Brazilian authorities either during, or in advance of, the Article XIV consultations now scheduled to begin late in October.

Mr. Mookerjee

Mr. Ernest Sturc September 22, 1965.

Evan Hannay EBH

Procedural Questions Raised in Board Consideration of Brazil Papers--September 17, 1965. (EBS/65/154;EBS/65/157).

1. The attached memorandum from Mr. Nicoletopoulos brings out one question discussed by the Board--delay in staff reports. For the Department, I suggested to the Board that there is a dilemma: On the one hand, if the staff transmits information of changes promptly when received, there are problems of making, without delay, an accurate appraisal of their significance. On the other hand, if the staff waits until it can give a well-considered appraisal, the Board may consider there has been undue delay.

The problem becomes important if we are not merely to inform the Board of the action taken, but also to recommend temporary approval. We are certainly not going to be able to get an opportunity to consider each of the many changes which in principle--under the Fund agreement, and under the current Stand-by--should be approved by the Fund in advance. My feeling is that in the future, all we can really expect to do is to circulate information memoranda promptly to the Board (with a minimum of interpretation), and recommend approval by the Board only when there is an opportunity for all of the exchange practices to be fully described, on the occasion of Article XIV Consultations, the consideration of a new Stand-by agreement, or the introduction of a major change.

In the case of coffee, mentioned by Mr. Nicoletopoulos, the system is so complex that the schedule of minimum registration prices, and cruzeiro payments per bag (under various circumstances) for various qualities of coffee and ports of shipment has never, during the last several years, been described in detail to the Board. I have now prepared such a table for my own information (copy attached). Worse yet, the President of the Central Bank told us in April that the Bank of Brazil was then instituting an official facility, for exporters who are willing to buy up to 2 cents per pound of coffee exported in order to make up for an actual export price below the minimum registration price (designed to replace an illegal practice which had become general). Neither in April, nor in July, however, were we able to get a copy of an official regulation on this point; we are not yet able to inform the Board confidently as to the true exchange rate applicable to coffee export proceeds!

2. One other significant point emerged in the discussion. Several directors expressed great interest in the report that Brazil gives especially favorable treatment on payments for imports financed out of loans of more than twenty years' maturity. Mr. Wass in particular stated that his support for the recommended action is to be considered qualified by his request for satisfaction on the point. Only Mr. Mansour spoke in defense of the idea that developing countries should, with the encouragement of the Fund, make efforts to ensure that their essential imports are financed on an appropriately long-term basis, but even he conceded that technical violations arising from discriminatory procedures should be avoided.

In the past, Fund representatives have taken some pains to advise the Brazilians not to give privileges to AID-financed imports as such, but to <u>any</u> imports on terms comparable to AID. Mr. Nicoletopoulos thinks a report to the Board will be required, but that it can wait a few weeks. It will obviously have to find a way for LDC's to give preference to long-term financing over imports for cash or short-term credit. My impression is that Brazil has gotten into technical difficulty with the Fund because its preferences have been applied in a general form through its exchange and banking system (exemption from advance deposits and exchange surcharges, reduction of guarantee deposits) in line with general Fund objectives. If there had been resort to the more arbitrary and less economic method of direct import licensing, this could easily be justified on balance of payments grounds. These latter methods have regularly been used by recipients of U.S. aid, including the U.K., to ensure priority use of the aid financing.

At any rate, I said I was not prepared to comment immediately but that the staff would study the problem presented by Brazil's regulations on this point, and would report at a later date. Perhaps Brazil will have to modify its regulations--confining its preferences to guarantee deposit requirements--which might be interpreted as credit regulation, not direct exchange restriction.

Attachments--2

cc: Mr. Finch
Mr. Mookerjee
Mr. Woodley

Mr. Jorge Del Canto

G. Nicoletopoulos

September 17, 1965

Brazil

As you know, at today's Executive Board meeting the Alternate Executive Director for the United Kingdom criticised the long delay in informing the Board about the change in the minimum registration price for coffee which was put into effect on April 22, 1965. He correctly pointed out that under the provisions of the stand-by arrangement with Brazil the member is under the obligation to keep the Fund informed of developments in the exchange, trade, credit, and fiscal situation through reports at intervals, etc. Other Executive Directors associated themselves with Mr. Wass' criticism.

As I understand it, the Brazilian authorities informed us about the change in the minimum registration price for coffee in question some time towards the end of April 1965. This means that the Brazilian authorities have carried out their obligation under the stand-by arrangement to inform the Fund. Therefore, it is us, i.e., the staff, that has failed in its responsibility to inform the Board in accordance with the Fund's Rules. As you know, changes in the exchange practices of a member, including multiple currency practices, should be communicated to the Board as soon as possible so that the Board may take whatever action it deems appropriate.

I must say that I was surprised, and somewhat embarrassed, at our failure to inform the Board about the change in Brazil's exchange system which, obviously, is one of considerable interest to our Directors and to our member countries. While a small postponement, especially where the change is of minor significance, may be inevitable, there can be no justification for a delay of five months in transmitting the information to our Board.

cc: Mr. Robichek
Mr. Sacchetti
Mr. Finch
→ Mr. Hanney

BRAZIL

Implicit Coffee Exchange Rates

For Sales at applicable minimum registration price

CATEGORY	June 2, 1964[1]	Dec. 1, 1964	April 22, 1965	June 5, 1965	Sept.1, 1965
1. "Despolpado"					
(a) Cruzeiro payment per bag exported;	Cr44,842	Cr49,000	Cr45,000	Cr47,000	Cr47,000
(b) minimum registration price;	$0.45	$0.45	$0.42	$0.42	$0.41
(c) calculated implicit exchange rate	$=Cr755	$=Cr825	$=Cr810	$=Cr846	$=Cr866
2. Any Port (Free of "Rio Zone Taste") (a)	Cr41,639[2]	Cr45,000	Cr45,000	Cr47,000	Cr47,000
(b)	$0.43	$0.43	$0.42	$0.42	$0.41
(c)	$=Cr732[2]	$=Cr791	$=Cr810	$=Cr846	$=Cr866
3. Paranagua and Antonina (a)	Cr40,037	Cr43,000	Cr43,000	Cr45,000	Cr45,000
(b)	$0.42	$0.42	$0.41	$0.41	$0.40
(c)	$=Cr721	$=Cr774	$=Cr795	$=Cr829	$=Cr851
4. Rio de Janeiro and Niteroi (a)	Cr35,235	Cr37,000	Cr37,000	Cr38,000	Cr38,000
(b)	$0.39	$0.39	$0.38	$0.38	$0.37
(c)	$=Cr683	$=Cr717	$=Cr736	$=Cr756	$=Cr776
5. Vittoria, Salvador, Recife, etc. (a)	Cr32,029	Cr33,000	Cr33,000	Cr34,000	Cr34,000
(b)	$0.37	$0.37	$0.36	$0.36	$0.35
(c)	$=Cr654	$=Cr678	$=Cr695	$=Cr714	$=Cr734

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[1] Under this regulation, the cruzeiro payment per bag was not completely fixed, but increased with increases in exchange rate up to, but not exceeding, Cr$1210 per US$1. It is assumed, for this calculation, that the free rate was Cr$1550 per U.S. dollar (well in excess of Cr$1210).

[2] Under this regulation, a larger basic contribution quota was fixed (and, therefore, the cruzeiros the exporter could get in the free market for the remainder were less) for old crop coffees than for the current 1964/65 crop. For example, for the most important grade (#2, any port), the payment to the exporter was only Cr$34,984 per bag, giving an exchange rate of Cr$615 per U.S. dollar.

PRESS REPORTS

FOR INTERNAL CIRCULATION ONLY

Mr. Irving Friedman
Room 911
(1)
#11

O Estado de S. Paulo
Brazil
April 29, 1964

Translation

CAMPOS DISCLOSES MEASURES FOR STRENGTHENING FINANCES

RIO, 23--Ambassador Roberto Campos, Minister of Planning, said today in a telecast that at the first meeting of Ministers he diagnosed the Brazilian economy as being an "engine of chaos." He pointed out that this picture resulted from a sharp inflation, which amounted to more than 80% in 1963; a state of stagnation, with average income in 1963 increasing by less than 1% against the previous year; an exchange crisis which compelled the country to admit insolvency and to ask creditors for a debt adjustment; and the absence of psychological motivation.

He stressed this last point in particular, stating that the entrepreneurial classes were frustrated and incapable of making further investment efforts; the working classes were also frustrated and embittered; and the classes with greater reserves of energy, such as students, were being oriented toward a hysterical struggle.

Inflation

Minister Roberto Campos stressed that inflation was no longer necessary to the process of development in Brazil, but that the problem was complicated and difficult. It had to be eradicated by ending the constant deficits, reorganizing government expenditure, increasing revenues, curbing public expenditure, and disciplining private credit. He made a point of explaining that he was not speaking of a contraction of credit, but of discipline to avoid the risk of an industrial depression, defining the anti-inflation effort which he recommended as disinflation, not deflation.

Development

Stating that Brazil was now characterized by "inflation with stagnation," he added that the Government's program was not one of deflation, but that the question was to activate the economy of Brazil by noninflationary methods. Among the methods cited by Mr. Campos were the encouragement of private saving, control of public expenditure, the essential climate of stability, and an increase in the supply of agricultural commodities. He stressed repeatedly the need for prudence in the application of these measures, referring to the Minister of Finance, Mr. Octávio Bulhões, as a symbol of that prudence, a man capable of applying a firm, complex, and prudent plan.

Expansion of Credit

The Minister of Planning said that there was no hyperinflation in Brazil; that inflation was acute; that it could not be stopped instantaneously, but that it could be cured by effort, courage, determination, and prudence.

He added that it was a cost inflation and therefore the method of combating it was not to cut off private credit suddenly but to discipline it. And it had to be recognized that there was a need to continue the credit expansion, but to taper it off in such a way that merchants and producers recognized that the Government could not assimilate the entire cost increase.

Decline in Production

He stated that the artificial demand for merchandise for speculative or merely precautionary purposes created by the steady increase in prices would tend to cool off. He said that this was painful but necessary, and that the Government would try to apply other noninflationary stimuli to production, such as encouragement of demand on foreign markets and of exports. In this connection, Mr. Campos said, Brazil had penalized exports with an unrealistic exchange system and with taxes.

He stressed the need for reversing that system. As to the exchange rate, he felt that the problem had already been solved; as to red tape, he said that that was no longer an issue. The problem of exports at the moment was more a matter of a punitive tax burden.

He felt that it was perhaps not necessary to provide subsidies for exports and that it would be sufficient to eliminate taxes and provide a realistic exchange rate.

He also said that real economic emancipation would be possible only through exports which would make it possible for Brazil to buy without resorting to credit from other countries. Anything else, he said, was wishful or hysterical thinking.

Monetary Fund

In connection with relations with the IMF, the Minister of Planning said that the population was now ready to abandon the taboo against the Fund. He added that 4/5 of the members of the IMF were underdeveloped countries and that the IMF could not, therefore, be against development. He cited the examples of Egypt, whose Minister of Finance is a former official of the Fund, and Yugoslavia, a communist country which is a member of the Fund, with which it negotiates and discusses problems of finance. He added that there were programs supported by the IMF which succeeded and those which failed.

In his opinion, it was necessary to rid ourselves of our inferiority complexes and have the courage to discuss our problems with foreign economists.

"What we should not do," said Mr. Campos, "is accept measures which are not technically correct or which, even if correct, are not in accord with the political and social realities in Brazil."

He also recalled that the United States had 23% of the votes in the IMF, but that the Europeans had 38% and that the weight of the underdeveloped countries was large.

Exchange Subsidies

As to the elimination of subsidies on the import of wheat and petroleum, the Minister of Planning said that no decision had yet been taken. Minister Bulhões had merely mentioned the matter in his statement to the Ministry.

He pointed out that the subsidy means that the Government sells wheat and petrolium at a price below what it pays. He drew attention to the fact that this difference does not grow on trees. He cited the following objections to the elimination of subsidies:

a) the impact on the cost of living;
b) it would affect workers more than it would affect the well-to-do classes;
c) it would cause an inflationary spurt.

He then said that prices would actually rise but that those who criticized the measure suggested no alternatives. And he added: "If the Government does not increase the prices of gasoline and wheat, it will issue money. If the Government does not eliminate subsidies, it will have to issue 250 billion cruzeiros to pay the difference in prices represented by the subsidies. The inflationary impact of this issue will be three times greater. In addition, the inflation caused by the elimination of subsidies will be corrective, localized, topical, and with a wise monetary policy it can be arrested. However, the maintenance of subsidies will mean an inflationary spiral."

As to the harm which would result for workers, he said that inflation really harms the less fortunate because everybody pays for the benefits which are granted to only a few. With the elimination of the subsidies, the increase in the cost of gasoline and wheat represented by the difference previously paid by the Government would be paid by consumers of gasoline and by higher-income urban strata of the population. Finally, he indicated that the exchange readjustment is not the cause of all our ills, recalling that we had inflation for 16 years with a fixed exchange rate.

Recovery of Petrobrás

He pointed out that the increase in fuel prices will also have positive effects on Petrobrás, which had transformed itself into a political party and was only secondarily an industrial enterprise. Petrobrás, whose future had been compromised, would now have an opportunity to recover.

Import of Food

He then referred to the fact that it was impossible to import some foods without aggravating the exchange crisis, bearing in mind that this can be done for payments in cruzeiros in a period of 40 years [sic].

Reforms

Minister Campos stated that President Castelo Branco is giving priority to reforms he considers essential: reform of the housing sector, where a solution cannot be provided through privileged classes causing a standstill in the civil construction industry; agrarian reform, which should be carefully planned without antagonizing producers; and fiscal reform, which should provide a rationalization of the tax system and not an increase in taxes.

The problem of these three reforms is being faced in a realistic way, and discussion and solution are at an advanced stage.

Within a Month

He noted that the jobs facing the Government are enormous, "since the state of disintegration we have arrived at is tremendous." Therefore, he stressed that he would ask the people to have a little patience, since in a little less than a month we would have a government program along realistic rather than demagogic lines.