R

What are the reasons for the inflation? What can be done to stop it.

a) Budget deficits, prospects; Federal, State.
Are all Government expenditures in the Budget?
Does the Government or the states have subsidies outside their budgets?

b) Credit policy

c) Bottlenecks of industrial production.
Lack of raw material in any industries?
Lack of machinery or spare parts?
Lack of electric power.
Is anything done to increase electricity production?

d) Too much investments?
By the Government?
By the states? municipalities? by industry?
For Housing, including office buildings.
To what extent are these investments financed by the Banco do Bresil, directly or indirectly.

e) Can Government, state and municipal deficits be met by selling bonds to market? If not, to what extent has the B doB to give credits, directly or indirectly?

f) How much is sold of the cotton (and other stocks) held by the B do B or the Government.
How big were these stocks at end of 1953. Are these commodities now being sold at world market prices?
Are they sold against foreign exchange? Which currencies?
To what extent have they been sold for cruzeiros?
When this is done, is the exchange obtained by the Brazilian buyer, sold to BdoB if goods are exported.
Are there any Government support prices? If so, their relation to world prices.

g) Balance of payment situation.
Foreign exchange budget for 1954?
Is this realistic? How much is needed for Govt and other payments at parity.
Are the imports at too low a level?
Comparison between 1953 exchange budget and factual results of buying and selling. Do not forget to deduct forward transactions from holdings when computing reserves.

h) Inflationary effect of auction system.
Continuous payments to exporters. No payments for forward $ until
Much less sold to importers. when they are delivered.
Amounts bought from beginning to January 1st of various currencies.
Amounts sold " " " " " " " "

i) To what extent ~~are~~ is foreign exchange sold spot? forward?

I) (continued)

If exchange is sold spot, is the amount held at an account with the BdoB or with another bank?

When exchange is sold forward, has the buyer to pay the cruz. amoun t or part of it at once?

Is there a risk for BdoB selling more forward than it has?

How much is, on January 1, 1954, sold forward?

Are BdoB 's own dollar holdings reduced by that amount in the books of the Bank?

Even if not more dollars are sold forward than held by the Bank, there is the risk that after selling forward not enough is available for spot sales, after some months.

k) Prices

l) Wages

Need for foreign credits.

Brazilian attitude to oil, to electricity.

January 23, 1956

BRAZIL

I use below the new Table numbers, not those given in the memo of January 1956.

1. The extent of the present inflation since 1948 can be seen from Table I. (Show as Table I the three last series on Table V. Don't give the figures for 1948/49/50).

The main reason for the sharp rise of wages during the third quarter of 1954 is, of course, the doubling of the minimum wages.

2. The causes of the inflation, over and above the increase in the minimum wages, are the following:

a) Borrowing from the Banco do Brasil by the Federal Government and official entities such as State and Municipal Governments as well as the Autarkias in order to cover their deficits. (See Table II.) /Comment to the new Table II: The reader who is not well informed does not understand the footnote I in the present Table II. It ought to be re-written./

b) Increases of credits to the private sector of the economy by the Banco do Brasil and the commercial banks. (See Table III.) (Table II, III, and IV ~~and V~~ should be on the same page. Don't ~~give the percentages.~~)

c) The total increase of credit is seen from Table IV.

d) The deficit in the Government finances from 1953 - 1955 is seen from Table V. If the autarkias are included mention it. If not, give a table or an annex with the information available say for 1953, 1954 and 1955.

e) From Table VI is seen the rediscounting by the Rediscount Department of the Banco do Brasil. (I guess that in footnote 2 there are two mistakes. Should it not be 1951 instead of 1950 and 1955 instead of 1954?)

Credit was restricted from 1954. The restrictions were eased from 1955.

3. The volume of production is seen from Table VII.

4. The export or import surplus from foreign trade is seen in Table VIII.

5. Table IX gives the export of coffee to (a) dollar countries and (b) non-dollar countries.

6. Table X indicates the surplus and deficits in the balance of payments.

7. Table XI gives the quotations for the dollar on the free market.

Brazil.

8. From Table XII it is seen that the gold holdings of the Banco do Brasil amounted to U.S. $332 1/2 million at the end of November 1955. Thereof gold worth U.S. $204.6 is pledged as collateral for loans from commercial banks in th the United States. The gross holdings of foreign exchange at the same time were $33.6.

The Brazilian foreign exchange situation was very serbus up to the end of August, 1955 when coffee could not be sold to the United States. Sicee then coffee exports are moving rapidly mainly due to certain changes whereby a seller gets somewhat more in cruzeiros for his dollars, than before.

The indebtedness to the commercial banks in the U.S. for overdrafts (over and above the loan of $ for which gold is pledged) was on August 31, 1955 $. This amount has been repaid and Brazil had at the end of November, 1955, an amount of U.S.$ 33.3 million on its bank accounts in the U.S.

9. The foreign indebtedness of Brazil is shown on Table XIII.

From Table XIV will be seen the amounts that have to be repaid as interest and amortization on foreign indebtedness for some y8ars from 1956 onwards.

2) Would a floating buying rate for exports combined with auctions for imports lead to an over-valuation of the currency and distortion of production.
If the auction rate for cotton were 70 instead of 43 would not farmers grow too much cotton with pressure on Govt to buy what can't be sold on world markets.
The producer is just looking for more cruzeiros. The country for more

R's draft.

January 23, 1956

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Jan. 6, 1956.

Brazil

"Food, transportation, power" K's election platform
Reorg. of railways and mercantile marine? — electricity, oil

Improvement from coffee sales, 71 in Nov, 54 in Dec 1955; end Dec $30 in US banks

Fiscal mismanagement

Overinvestments

Too low public utility rates.

Fin. Min.: Mario Câmara appointed by Cafe Filho. Formerly in Wash. as Treas. rep.

Stocks of coffee
cotton
other products

Shortages of raw materials, spare parts, machinery? Other bottlenecks? Any arrears?

Exchange system — are production costs too high? windfall profits for certain exporters? — what rate of exch. needed?

Jan - May 1955 - 80% of BdoB credit exp.

Is inflation under control now; Budget, Federal, States, Municipals, autarkies

Is credit restrictions and rediscount policy (to customers) strict enough.
Too much credits to new houses

Has the doubling of the min. wage now permeated the whole structure

Wage problem . Are prices rising?

Are the increased salaries in the budget? Will prices rise as a consequence

Any profits of auction premia not yet used.

Too heavy costs of servicing the foreign loans?

new Agreements with bilateral partners.

Is the free market still narrow? Does BdoB buy much in the market (Rate about 65)

Buying rates for coffee (37,06, then 40 + increased weekly 12,5 centavos)
other commodities
for $
for other currencies

Will free market rates not rise if part of coffee proceeds are no longer

Present amounts of for. exch sold forward. Other short $ commitments.

More multilateralization. Payments in £ if countries don't want to join Hague club

To Braz. file

CONFIDENTIAL

January 5, 1956

BRAZIL

Mr. Paranagua told me the fdlowing:

Brazil has been able to sell a lot of coffee during the Autumn because the exporters are under-invoicing the coffee and are selling the difference between the actual price and the invoice price on the free market.

During November, Brazil exported coffee for $71 m. The last figure he had for December was about $54 m. The final figure may be slightly higher.

Brazil has now repaid all the overdrafts and has $30 m. on its American bank accounts.

To Braz file

CONFIDENTIAL

Talk with Mr. John Exter in New York on December 14, 1955.

BRAZIL

Banco do Bresil has now repaid all its outstanding U.S. dollar acceptances and also all its overdrafts with the American bankers.

Some of the New York banks had previously asked the Federal Reserve to rediscount the acceptances by Banco do Bresil. The ruling of the Federal had been that as that kind of paper was a finance paper and therefore not eligible they could not be rediscounted. After the repayment of all acceptances, the Brazilians have now asked the Federal to reconsider that decision.

From December 1st, the Banco de Bresil had increased its rediscount rate from 6% to 10% on promissory notes and to 8% on commercial bills.

To Braz. ~~staff~~ file

December 5, 1955

BRAZIL

Bulhoes on his way from the ECOSOC meeting in New York to Rio, told me that the problem that the new government had to deal with first was the exchange problem. He thought that they would, on the whole, follow the line that had been discussed with the Fund. He did not expect a decision until the beginning of February.

As reasons for the need of a change, he gave e.g. the following examples:

1) A foreigner wanting to invest in Brazil could send machinery without paying the premium at an auction that a Brazilian has to pay. The Brazilians are therefore discriminated against as far as purchasing machinery for investment is concerned.

2) As the auction prices vary very much for various currencies, goods imported from a country with a low price at the auction, have advantages compared with the same goods imported from e.g. a dollar country.

Bulhoes said that the reason why he left the SUMOC was that Whitaker insisted upon canceling the rule for the banks to deposit 60% of their new deposits with the SUMOC. Bulhoes had told Whitaker that he could agree to a reduction of the percentage. If he insisted upon canceling the rule, he was not willing to take the responsibility for the future. He tried to convince Whitaker of the necessity but Whitaker did not believe that the credits by the private banks had any influence upon the inflationary situation.

The money ~~deposited with the~~ SUMOC was deposited in notes at the SUMOC. Not only the commercial banks but also the Banco do Bresil had to make the same deposits with the SUMOC. In that way, the money was effectively sterilized.

The budget expenditures had been cut down by Gudin. Whitaker had followed the same line. The budget of the central government had been in fairly good order. The Autarquias, however, were still having fairly substantial deficits.

He did not know what would be done about the oil problem but he hoped that the new government would try to do something as soon as possible.

Brazil

COPY

From Crick
Dec 1955

Norwegian prices for codfish in terms of dollars are $18.00, $17.50 and $16.50 per half drum, depending upon the quality. The agio at the last auction was 33.60 per dollar; adding the official rate of exchange of Cr$20 per dollar, gives an effective rate of Cr$53.60 per dollar. Taking the lower priced fish at $16.50, this gives a Cruzeiro price of Cr$884.40.

Canadian fish (Newfoundland) is priced at $13.00 per half drum. The most recent agio is Cr$85.10 per dollar. Adding the official rate of Cr$20 per dollar, gives an effective rate of Cr$105.10. The Canadian codfish, in terms of Cruzeiro works out at Cr$1,366.30.

Because of the higher agio, the Canadian codfish, although it is 20% less in terms of dollars, is 54% higher in terms of Cruzerios.

Greece : agio for olive oil 85
Spain " " " " 40

1+1

To any Braz. file

Campos
2nd Aug. 55

Double debt within in year

$45 cr. submarinos

Called halt – T

IBRD reps in Lima Hlavlik + Chaufournier. Advisers on dept policy for a year

copper after 5 years. Com

Close

Elections in June. New pres. in Sept

Min of Agr. will become Min of Fin.

Foley now Min of agriculture

Adm. will change but regime will continue

Two loan applications, port Montevideo, ~~swamping~~ ~~Not now.~~ Rather

Railways from bad to worse

Frigori

Modernization of live stock. Will do it in Spring.

Have taken 5 of the 60

30 for power (25 hydr + 5 steam) will come along

10 for railways

20 for livestock. Initially 7-8 m.

UK – the spread – better with wider – not able to deal in London no fluctuating rate

To Brazilian file

COPY -- **BRAZIL**, by Mr. Kafka, August 10, 1955, as reported by Mr. Merwin in his Report on Discussions at Merrill Center for Economics, August 1 - 12, 1955.

" Since the war, gross national product has been increasing 4 per cent and population 2½ per cent per annum. Growth now is widespread, whereas previously it had been in particular sectors (e.g., gold cycle, sugar cycle, coffee cycle). In the 19th century social overhead was created in advance of the need for it. The principal difficulties in the way of economic growth today are inflation caused by fiscal mismanagement and overinvestment; the overvaluation of the exchange rate (which has kept imports too cheap); exchange control (which has kept out manufactured goods); and too low public utility rates. Gross savings have been relatively high, but to maintain them monetary stability must be achieved. Inflation has resulted in a large increase in debts to foreigners (arrears). This has brought in resources, but cannot continue. "

p.1 Gov. deficits ~~Brazil~~ Steady improvement overstatement
p.6. Is 50 too much for coffee
Does Br. to begin with not need a higher import rate. Present rates much higher than 50.
~~bad buying at a low rate~~
4/7 act I move towards unifying import rates
7 II will a free rate not lead to inflation, cap. exp.
Should there be no licenses ~~[illegible]~~?
Why surcharge with fluctuating rates.
8. Future demand market worries me.
10. Auctions in certain currencies leads to low prices for some (Sw. Kr) and high profits. Selling prices the same (or almost) as for US products
16. Rediscounting
17. How to reduce shipping losses?

Consolidation
Too little about for. indebtedness and what to do about it
61 in 1961 – 42 in 1962 $110 in 1955 – 233 in 1968
Too little about the economic aspects of price differentials
Hardly anything from customs (1/4–1/5) of prewar
I cannot say if an increase of 100% is proper
Do you the effects of the easing of credit restrictions
warned by Whitaker
Too optimistic about restoring reserves.

Has Brazil not had any trouble in selling its cotton –
Is this due to bilateral agr. and multiple rates and arrears
What kind of private capital is coming to Brazil? II:15
How do you foresee the near future. Next demand for credit.

Easier to get credit after stabilization
Financing and buying of coffee ~~[illegible]~~ by several org.

Office Memorandum

TO : The Managing Director DATE: August 17, 1955

FROM : Jorge Del Canto JDC

SUBJECT : Brazil

As requested over the phone, I am attaching herewith some documents on recent developments on Brazil.

The situation as of today, as I understand it, is as follows:

1. On Friday August 5 Mr. Paranagua contacted Mr. Bernstein to report by phone that the Brazilian authorities were approaching a decision on a new exchange system and were interested in getting Mr. Bernstein down in Rio, prior to a final formulation of a plan.

2. Mr. Bernstein, who is vacationing in Maine, reported that he felt his personal services were not critically essential since he had already expressed his points of view (memo of E.M.B. to Mr. Whitaker of June 20, 1955). Instead, Mr. Bernstein dictated a memo over the phone for transmittal to Mr. Whitaker (Att. #2) and also a list of questions, mainly as to the effects of the frost on coffee (Att. #3).

3. On Monday, August 8, Mr. Paranagua received over the phone the text of draft SUMOC resolution embodying an exchange reform. This was transmitted to Mr. Cochran and Mr. Bernstein (Att. #4). Mr. Bernstein expressed his personal opinion in a memo dictated from Maine (Att. #5). On the same day Mr. Paranagua requested my views, but I excused myself from advancing any views until the matter had been raised formally with Mr. Cochran.

4. On Monday afternoon, August 8, Mr. Cochran requested Mr. Paranagua to consider these Brazilian matters as official and indicated that, because of the pressure of time (a change in the Brazilian exchange system is expected over the week-end of Aug. 20) he was going to ask the staff to get prepared to deal with this proposal.

5. Mr. Cochran set up a working party for this item on Tuesday, August 9 (Ferras, Brenner, and myself). It was agreed that clarification on some phases of the proposed system was needed.

6. The staff looked into all the obscurities of the proposed system and a list of 20 questions for the Brazilians was prepared for Mr. Cochran to be transmitted to Mr. Paranagua. A meeting was held with Mr. Cochran on August 12 (Friedman, Ferras, Brenner, and myself) to discuss these questions. (Questions as attachment #6).

7. Mr. Cochran informed Mr. Paranagua of these questions and asked Mr. Friedman and myself to go over to Mr. Paranagua's home on Friday evening to present and discuss these questions.

We stressed to Mr. Paranagua that all these questions were strictly technical, dealing with the working of the system, and not policy questions. The staff expected, however, a complete account of the policy reasons behind the proposed changes.

As far as we understand it, the proposal consists of:

a) Introducing a single fluctuating rate for exports and imports. This fluctuating rate would be strictly applied to trade transactions and distinct from the present free market for invisibles and capital, that will continue to exist.

b) The free market rate will be applied to all exports. For coffee there would be a deduction (we are puzzled by the type of deduction, since the Brazilian Constitution forbids export taxes) which will change with changes in the price of coffee and will disappear when the price of coffee goes below 50 cents per pound.

c) On the import side, the rate will be supplemented by a set of fixed surcharges. These surcharges would be absorbed into the tariff structure whenever Brazil undertakes a Tariff Reform. The fixed surcharges are those set forth by Law 2410 of January 29, 1955. The law reads: "The exchange surcharges obtained through the auction bids shall become the equivalent of the following percentages of the average auction bids in the auction held in the last 3 months: Category I, 35%; Category II, 50%; Category III, 65%; Category IV, 75%, and Category V, 100%.

The machinery of the existing auction would seem to be maintained to operate this free market. Although there are a number of technical questions as to how the system would operate (Att. #7). Besides these technical questions, there are, however, a number of policy questions that come to our minds. I would list you a few.

The staff of both ERD and our Department is working on Brazil. We are getting ready a report on the present external and internal position of Brazil and should a proposal come in, we should be able to deal with it expeditiously.

I have not discussed policy considerations on the draft Brazilian proposal within our Department, but perhaps I could put down in paper some of my tentative thoughts.

1. While there is some merit to the proposition that maybe the best suited exchange system for a country with a continued inflation (like Brazil or Chile) might be a fluctuating one, that would automatically correct any changes in the external purchasing power of the local currency, there is the danger that the present exchange shortage of Brazil--and the complete absence of reserves to smooth fluctuations in the market--might result in an unduly depreciated cruzeiro, which might aggravate the inflationary situation.

not if they only auction what they have as at present.

2. From the point of view of exports, an undue depreciation of the cruzeiro--particularly for coffee exports--would be labeled by the other coffee countries as competitive, and might lead to devaluation by other coffee countries, e.g., Colombia. While some relief might be granted to coffee exports for political reasons, there is no clear case for a big devaluation on coffee. International coffee prices are today the same as in October 1953, and the rate given to coffee exports has doubled (from 18.50 cruzeiros in October 1953 to 37 cruzeiros to the dollar today); it is doubtful that costs have doubled in less than 2 years.

A big devaluation might help minor exports, but only up to a limited extent. The record of our consultations discussions with the Brazilian authorities point to more basic handicaps limiting minor exports; transportation bottlenecks, storage facilities, marketing problems, etc.

3. We have been told that the major difficulty of Brazil is to remove the uncertainties concerning the exchange system (which the Minister has created since he took office by talking about the "exchange confiscation") to restore confidence in the coffee market and break the present policies of buying on a "hand to mouth" basis of all coffee traders. Is a fluctuating rate the best answer to break these uncertainties and resistance from the buyers to buy coffee?

During the period August-November 1954 the coffee rate was a mixing rate with a 20% link to the free market rate, but the authorities felt that this element of fluctuation had contributed to speculation in coffee and affected the stability of coffee prices abroad (see page 44 of Part II, Brazil, 1955 Consultations - SM/55/36). This conviction led the authorities in November 1954 to substitute the mixing system by a fixed bonus on coffee. The record of our discussions in Rio during the consultations reads as follows:

> "Mr. Bulhoes said that the reason why the export bonuses had been fixed was that the authorities did not consider the free market rates as having full economic significance, and they did not want to have export rates unduly influenced by the fluctuations of the free market rates. This was the principal factor behind the measures taken in early 1955 to fix the export bonuses."

4. The market would not appear to be entirely free since there are a number of administrative decisions (composition of the import categories, level of the surcharges, etc. For instance, the system would be opened with a prohibition of imports in categories IV and V.) But even with all these complications, the idea is to have a uniform fluctuating rate for all imports who pay the respective surcharges. With the present exchange shortage, the level of such rate is bound to be high, in spite of the import prohibitions, and this might cut down the import of essentials since importers of less essentials can stand a more depreciated rate. There might take place then an unfavorable change in the composition of imports, which is now preserved by the strict percentage allocation that the authorities follow in allocating exchange in the various categories, with very little exchange for the categories of less essentials.

How much [illegible] Do they g[illegible]

Will there be auctions for each curren[illegible]

goods those that can be sold with highest profit may be bought

On the whole, the system remains as complicated as it is today, and the only tangible result, which I believe is the only real reason for undertaking the reform, is the devaluation extended to coffee. It would seem that the same results could be achieved by shifting coffee from Category II (37 cruzeiros per dollar) to Category III (43 cruzeiros per dollar) or Category IV (50 cruzeiros per dollar) without overhauling the whole system when we are only a few weeks ahead of Brazil's elections.

basic Same Rate for all catego[illegible]

Reasons both for and against making changes before elections

On coffee, I am attaching herewith a note of Miss Lovasy on the effects of the recent frost in Panama on the coffee market (Att. #8). She points to the fact that the frost does not remove the danger of increasing surplus, but only reduces the size of such surplus for the crop year 1955-56. These views are similar to those of the U.S. Department of Agriculture (Att. #9). The Ministers of Finance of Brazil and Colombia, who concluded their talks on August 11, took a more optimistic attitude. While they are in favor of continuing the work done towards international action for the stabilization of coffee prices, they do not seem to agree on immediate action to dispose of existing stocks. (Full text of the Villaveces-Whitaker talk as attachment #10.)

SECRET DECLASSIFIED

Draft V
E.M.D.
6/20/55

R

The International Payments Problem of Brazil

A Report to the Minister of Finance

The situation in Brazil during recent months presents the paradox of an improvement in internal economic stability and a deterioration in the external payments position. The monetary authorities must find a prompt solution for the payments difficulties while continuing the progress being made toward internal economic stability. The more successful the monetary authorities are in dealing with the internal problem, the surer they can be that their payments policy will be effective. At the same time, the solution of the payments difficulties will strengthen confidence in the measures taken for internal economic stability.

1. The Present Economic Situation

The economy of Brazil has been disrupted by an inflation that has continued with only minor and temporary interruption for nearly 15 years. The inflation has been mainly the result of the interaction of two forces: first, the creation of bank credit to finance an excessive level of investment and public expenditure; second, massive wage increases to restore the level of real wages following every large rise in the cost of living. These two forces have become almost linked in the pattern of behavior of the Brazilian economy. Economic stability cannot be attained until credit is kept under proper restraint, the cost of living stops rising, and wage increases are given gradually and on the basis of greater productivity.

In the middle of 1954, Brazil was once more confronted with a massive wage increase, the doubling of the minimum wage. No country can possibly double the real wages of a large segment of its working force merely by raising money wages. Such an increase in wages, which cannot be matched with an increase in consumer goods, must result in a substantial rise in the cost ~~of~~ living. From April 1954 to April 1955, the cost of living rose by nearly 25 per cent. Furthermore, the wages and salaries of other groups, to whom the increase in the minimum wage did not apply, are still being raised to maintain customary differentials. The price effects of the wage increase of 1954, therefore, have not yet been fully manifested.

This wage policy could have been disastrous for monetary stability if bank credit had been expanded to the same extent on the grounds that additional funds were needed to meet the higher payrolls. Instead, following a first response to the new wage level, the monetary authorities have succeeded in keeping commercial bank credit quite stable. The increase in currency and demand deposits between October 1954 and April 1955 was about Cr$10 billion, an increase of 6.5 per cent in six months, all of it arising from the operations of the Bank of Brazil, although to some extent at the insistence of the government.

While noteworthy progress has been made in stabilizing the domestic economy, the international payments position has deteriorated sharply, particularly since November 1954. One factor has been the decline in the dollar price of coffee from the very high levels that previously prevailed. This would in any case have brought serious payments problems. The effects of the decline in the price of coffee have been intensified by measures undertaken to support the high price which have created uncertainty in the market and have encouraged speculative activity of a harmful character. Fortunately, the government is no longer adding to its coffee stocks, and the so-called minimum price is not being supported. There is no form of investment that is less useful to an underdeveloped country than the accumulation of large stocks of its own export goods.

Confidence in the exchange system of Brazil has been seriously undermined. On the one hand, exporters in Brazil expect that the cruzeiro price of coffee will rise; on the other hand, importers in the United States expect that the dollar price of coffee will fall. These seemingly contradictory expectations on the price of coffee are reconciled in the common attitude toward the exchange rate. In Brazil and in the United States, coffee dealers believe that a depreciation of the cruzeiro is impending. They are fortified in this belief by the fact that the rate of exchange applicable to coffee exports is less favorable than the rates for other exports.

The government has not been able to prevent such expectations from interrupting the orderly movement of coffee to the United States market. Roasters in the United States have reduced their own stocks at the same time that Brazil has added to its stocks. The price situation in the New York market is conducive to buying on a hand-to-mouth basis. Futures prices are substantially below the spot price of coffee. No roaster or dealer has any reason for carrying more than minimum inventories when later needs can be covered more cheaply by buying a futures contract than by carrying stocks.

This difficult situation is reflected in the actual exports of coffee. Receipts from coffee exports have been below expectations since August 1954. Following special action of the government, coffee exports rose in November and December 1954. They have since declined to quite inadequate levels. In recent months, total dollar export receipts, from coffee and other products, have been about $30 million a month instead of the more reasonable target of about $60 million. Apparently, there can be no hope that any substantial improvement in the export situation will come in the near future merely from waiting.

The payments situation has reflected the disruption of coffee exports. The available exchange resources have been sharply drawn down, until there is very little left to meet the impending dollar payments problem. In recent months, the allocations of dollar exchange in the auctions for private imports have been considerably reduced. This will have only a minor effect on the immediate dollar needs, however, as commitments on the 120-day "promises to sell exchange" are already fixed for the next few months and cannot be affected by restrictions on imports at this time. Furthermore, the obligations of the government to provide dollar exchange for other purposes are quite large and inflexible.

The dollar payments problem, although urgent, cannot be divorced from questions of over-all payments policy. The bilateral payments agreements that Brazil has with some countries have undoubtedly aggravated the payments difficulties. There have been large European re-exports of coffee to the United States and of coffee and other products to the United Kingdom as a consequence of disparate cross rates. These transactions have reduced somewhat the dollar receipts and reduced very substantially the sterling receipts of Brazil. The real cost of the disorderly cross-rates in disrupted and diverted trade and in higher prices of imports has probably been quite large.

The task confronting the monetary authorities is to find the means of solving promptly the urgent payments problem. The measures that must be taken should not interrupt the progress already made in halting inflation. Furthermore, the measures should be an integral part of a program aimed at establishing a strong international payments position at a unified and stable exchange rate. The broad principles that should comprise such a program are set forth in this report.

2. The Urgent Payments Problem

There can be no satisfactory solution to Brazil's payments problem through intensification of import restrictions. Every evidence from Brazil's recent experience is to the contrary. The one way to solve the immediate problem is to establish an exchange system that will inspire confidence -- the confidence of exporters in Brazil and of importers in other countries. While it is especially important to restore the flow of coffee exports, it is also desirable to encourage the general expansion of other exports. The immediate objective of a new exchange system should be to break through the barriers that impede coffee exports to the United States. The longer run objective should be to encourage the general expansion of exports of all products to all areas. There are large potentialities for export that can be realized through a better exchange system.

The present exchange system inevitably creates expectations that impede the flow of exports. The existence of three export rates, with the substantial difference of 13 cruzeiros per U.S. dollar between coffee exports and exports of some special products, leads to pressure for equal treatment of coffee exporters. This pressure is likely to become intense if markets weaken. When this occurs, exports may be sharply reduced until the exchange rate is adjusted. This is the situation in Brazil at the present time. If exports are to be resumed on a normal scale before a serious payments crisis emerges, the authorities must act promptly to establish a new exchange system in which traders have confidence. While there are a number of ways in which this could be done, two major alternatives deserve special consideration.

Alternative exchange adjustments

Unified export rate: The simplest method of adjusting the exchange system would be to raise the export rate for all products to approximately 50 to 55 cruzeiros to the dollar, to be applied uniformly to all exports paid for in dollars, sterling, or Western European currencies equivalent to sterling. This would be a profitable rate for all major exports. It might be inadequate, at present costs and prices, for a number of minor exports. While such exports, particularly minerals and certain products of the Amazon region, do not comprise a large part of the total, they have potentialities for expansion and their significance to the economy of Brazil may become greater as import needs rise.

It must be noted that an export rate of 50 to 55 cruzeiros to the dollar will bring large windfall profits to some speculators who have held back export goods. That is an unfortunate but inevitable by-product of any change in exchange rates. It may be possible to capture part of these windfall profits from coffee exports and to use the money for establishing a coffee stabilization fund. Although there would be considerable justification for such a measure, it would risk a resumption of the same sort of pressures for better treatment of coffee exports that have contributed to the present difficulties.

Along with the adjustment of the export rate, it would be desirable to place all favored imports at a rate not less than the uniform export rate. This would require raising the import rates for newsprint, wheat, coal, some machinery, and diesel and fuel oil. There is much to be said for allowing such imports to come in without an exchange surcharge or import duty. There is nothing to be said for subsidizing the imports of such goods at the general cost of the economy and with discouragement to domestic producers of similar goods. Government payments, and those of the autarchias, should also be made at this rate. There is no more reason for maintaining an artificial rate for the government than for any other sector of the economy. Public finances can be better managed when the real cost of public expenditure is properly stated. Outstanding contracts, of course, would be fully honored at the exchange rates at which they were made.

All other imports could continue to be supplied exchange under the present system with some minor modifications to be discussed below. Special auctions for agricultural producers would be given up and the special rates now applied to gasoline and certain other petroleum products eliminated. These products would be assigned to the import categories whose surcharges are nearest to those applied to these special products. Exchange for each of the five import categories would continue to be allocated by the monetary authorities and distributed through the auction system. The effective import rates for dollars and other convertible currencies and for sterling and other transferable Western European currencies would be kept within one or two per cent of each other. The prescribed minimum bids in the import exchange auctions would need no adjustment, as they are already far below the actual surcharges; but with the higher basic exchange rate the importers would bid somewhat lower premiums for any given amount of exchange, than they have hitherto bid. The effective rates of exchange for imports in the five categories--the new exchange rate plus the surcharges--would be about the same as at present.

Free export-import exchange market: Another alternative would be to abandon the present system of fixed rates for exports and fluctuating rates for imports and institute a free market for exchange applicable exclusively to exports and imports. There would be one free export-import exchange market in U.S. dollars and other convertible currencies and an independent but related free market in sterling and certain transferable Western European currencies equivalent to sterling. The exchange acquired by importers in the free market would be subject to surcharges, differentiated for the five import categories. The surcharges would be fixed in accordance with the formula already prescribed by law, at levels somewhat lower than those prevailing now. These surcharges would not be subject to variation through administrative discretion, although goods might be shifted from one category to another at the time the new exchange system is put into effect. The establishment of such a market for export-import exchange is already provided for under Law 2410.

why?

The export-import exchange market would be distinct from the present free market for invisibles. The present free market has permitted foreign capital to flow in and earnings to be remitted at fair rates and without burdening the official exchange market. The cross-rates for dollars and certain Western European currencies have approximated those prevailing in markets in other countries. This free market has been able to operate at a dollar-cruzeiro exchange rate that has shown considerable stability in recent months. The free rate, which was Cr$76 to the U.S. dollar in December 1954 was only Cr$75 to the U.S. dollar in mid-June 1955, despite the recent deterioration in the payments position. To a considerable extent, this relative stability in the free market rate is due to the stringent bank credit policy of the past few months.

There is a great temptation to integrate a new free export-import exchange market with the existing free market for invisibles. For various reasons, this would be technically difficult and economically undesirable at the present time. The existing free market for invisibles, for example, is a spot exchange market; a new free export-import exchange market might for a time have to provide for spot sales by exporters and future purchases by importers. Ultimately, it will be possible to integrate the existing free market for invisibles and a new free export-import exchange market.

Comparison of the alternatives: The real differences between a free export-import exchange market and the alternative of a fixed unified rate for exports, as described above, are not very great. In either system, imports that now have preferential treatment and government payments would be made at the basic rate--the same rate as that applicable to exports--which would be fixed in one case and fluctuating in another. Under the first system, the export rate and the basic import rate would be fixed, but all other private imports would be subject to fluctuating rates, depending upon the availability and allocation of exchange to the various categories. Under the second system, the export rate and the basic import rate would fluctuate, but the surcharges for the different categories of imports would be fixed. In both systems, the export rate would be precisely the same and the import surcharges would be substantially the same for dollars, sterling, and Western European currencies equivalent to sterling.

With internal economic stability, a free export-import exchange rate would not differ substantially from an appropirate fixed export rate. Nor would a free export-import exchange rate be subject to greater fluctuation than are the present auction rates for imports, which have shown great disparity between currencies and considerable instability in their intercategory relationship. A free export-import exchange rate may even vary less than the dollar auction rates for imports, which have at times been subject to considerable fluctuation. A tendency for the rate to weaken in a free export-import exchange market might be limited by the inducement the depreciation would provide to expand exports and thus increase the supply of exchange.

With any type of fluctuating exchange rate--and the present Brazilian system is a type of fluctuating rate--seasonal or other movements in exports and seasonal or other movements in imports may bring a substantial change in the exchange rate. The simplest way for the authorities to minimize fluctuations in the supply of and demand for exchange would be to engage in operations designed to smooth the market--absorbing exchange during periods of relative plenty and supplementing exchange during periods of relative scarcity. The only other method of affecting the exchange market would be for the government, as the largest buyer of exchange, to time its purchases so that it is an active buyer in periods of plenty and a limited buyer in periods of relative scarcity.

Neither technique can be used to any significant extent at present. There are no disposable reserves that can be used for such operations; and the exchange payments of the government are even less flexible than most private payments. The difficulty of haphazard tightness in the exchange market under conditions of inadequate export receipts and inelastic import demand (including government payments) would be much the same under either system. The choice between the alternative exchange systems should, therefore, be made on the basis of the degree of confidence that each would inspire and the degree of freedom each would provide for international trade.

A fluctuating export rate might induce some traders to withhold exports when the exchange market is expected to become weaker. If credit is kept under restraint, however, a temporary weakness may call forth an extra flow of exports to take advantage of the exchange rate. On the other hand, with a fixed export rate, the weakening of the exchange market, evidenced by a steady rise in the auction rates, would widen the differences between export and import rates. This might generate the expectation that the export rate would have to be changed and lead to a recurrence of the present difficulties. Thus, an exchange system embodying a fixed export rate with fluctuating import rates might require frequent adjustment, depending upon the initial suitability of the rate and the pace of domestic inflation. A free export-import exchange system with fixed surcharges for imports would need only occasional minor technical adjustments until the monetary authorities undertake unification of the exchange system at a new parity.

Confidence in the continuity of the exchange system would be greater with a free export-import rate than with a fixed export rate joined to fluctuating import rates. This would be true because the former would adjust itself to market forces while the latter would depend upon more or less arbitrary decisions of the exchange authorities. Successive steps toward unification of all exchange transactions at a uniform fixed rate could be taken with less disturbance if there were a free export-import exchange market with fixed surcharges.

There is another advantage in a free export-import exchange system. The auction system involves the allocation of exchange to different categories of imports but not to specific import goods or to particular importers. Within each category, importers compete with each other to acquire exchange to import those types of goods that reflect consumer preference. Unless the present system is modified, as suggested later, there can be no competition between importers desiring to import goods in different categories. The relative premiums bid for exchange for different categories of imports show that the authorities have not always allocated exchange in proper proportion to consumer needs. It is too much to expect that administrative discretion could be as effective as the price system in allocating exchange to different categories of imports. A free export-import exchange system would enable importers to compete for the entire supply of exchange, subject to the different surcharges fixed in accordance with the law.

The surcharges on imports have provided revenue to the government and have an anti-inflationary effect. Whichever exchange system is put into effect, the surcharges will have to be continued until they can be incorporated in a revised tariff system and other sources of revenue found for the National Treasury. If the internal economic situation is kept stable, there need be no difference between the net receipts from surcharges under the two alternative systems. In either case, there will have to be some shifting of imports from prevailing rates to higher rates on the initiation of the new exchange system. These shifts can be made in such a way that the potential anti-inflationary effect of the present exchange system would remain virtually unchanged.

Merging the alternatives: There are obviously some attractive features in each of these alternative exchange systems. At the same time, there are also difficulties, perhaps only temporary ones, in operating some aspects of a free export-import exchange market and in the allocation of exchange to separate auction markets for five categories of imports. These considerations raise the possibility of merging within the new exchange system various features drawn from each of the two alternatives.

One of the difficulties that the monetary authorities must contend with in a free export-import exchange market is the lack of reserves to moderate unnecessary fluctuations in the exchange rate. Another difficulty with a free export-import exchange market, particularly one whose fluctuations cannot be moderated, is that a weakening of the exchange rate will lead to expectations of further change in the same direction and induce the withholding of exports. This is not likely to be as troublesome as the recent withholding of coffee exports; but it can lead to temporary difficulties under adverse circumstances. Because of these considerations the simplest exchange adjustment in the immediate future would seem to be to fix a basic rate applicable to all exports and to preferred imports and government payments.

On the other hand, the allocation of exchange to different categories and the auctioning of this exchange at variable premia have led to serious contradictions in the effective import rates, not only for individual goods but for whole categories of goods. This is inevitable in any system of administrative allocation of exchange. The auction system underlines these contradictions by translating them into actual rates. Thus in the dollar auction of April 11-17, the premium for Category IV imports was Cr$160 to the dollar, while the premium for Category III imports, presumably more essential, was Cr$200 to the dollar. To avoid such difficulties, it would be desirable to fix the surcharges for each category of imports and then to place the whole amount of available exchange in a combined import auction--one such auction for dollars and convertible currencies and another auction for sterling and transferable Western European currencies. The premium above the basic export-import rate would be in the nature of a uniform additional surcharge.

The new exchange system, even if it does not provide for a free export-import exchange market, should introduce some modifications in the method of conducting the import exchange allocations. At present, import exchange auctions are held periodically on the stock exchanges of various cities. While there may be some linking of these auctions, they do not constitute a true market. For this reason, considerable variation may emerge in the bids for exchange for different categories of imports in the separate auctions. A free import exchange market would be far superior, since it would provide a continuous auction. Furthermore, instead of being confined to a few cities with stock exchanges, a free import exchange market could extend throughout the country--wherever there are branches of authorized banks.

Finally, the proper relation between the dollar rate and the rate for transferable Western European currencies could be maintained with less difficulty through a free import exchange market operated in collaboration with authorized banks. There should be no great technical difficulty in converting the allocation of exchange from the present auction system to a modified free import exchange market.

Other currencies than the dollar: Whatever form the new exchange system takes, it will be necessary to institute certain reforms in the methods of dealing with currencies other than the dollar. At present, the agreed exchange rate is paid to exporters for all convertible currencies and sterling. For all other currencies the exchange authorities pay the agreed rate minus a discount of 4 per cent. Actually, in the exchange auctions, some payments agreements currencies must be sold at a much greater discount in comparison with the dollar. In a world steadily approaching de facto convertibility, Brazil can have no good reason for taking payment for its exports in inconvertible and non-transferable currencies which its importers value at a great discount compared to the dollar.

The proper policy for Brazil is to conduct its trade in U.S. dollars, sterling, or in currencies having transferability equivalent to sterling. The payments agreements with Western European countries should, therefore, provide for payment in currencies with the same transferability that these countries have with each other, and specifically for transferability to the United Kingdom. The bilateral payments agreements with Eastern Europe and with some Latin American countries involve payment in "currencies", generally payment agreement dollars, which Brazil's importers value at a very heavy discount. Such agreements should be modified to provide for payment in U.S. dollars, transferable sterling or its equivalent; and if a modification of this sort cannot be secured, other safeguards may have to be applied in such agreements to protect Brazil's economic interests.

When the new exchange system is put into effect, it is important to secure closer ties between the markets for dollars, sterling and Western European currencies equivalent to sterling, all of which should be given similar treatment. It is a serious deficiency in the Brazilian exchange system that it has provided no sterling at all in the past few months for private imports, and that German currency has sold in the auctions at a higher premium than the U.S. dollar for Category I, II and IV imports. The export rate should be the same for all convertible currencies and Western European transferable currencies. The import rates should be within one or two per cent of each other for all categories of imports paid for in dollars or Western European transferable currencies. The new exchange system should provide a means by which this relationship can be maintained. Otherwise, there will be diversion of exchange to less important imports and an encouragement to commodity arbitrage (on the import side) at considerable cost to the Brazilian economy.

Impending payments difficulties

The disruption of exports resulting from the expectation of changes in the exchange system has resulted in payments difficulties that may reach an acute stage during the next month or two. Because export receipts have been well below the normal level, commitments to provide dollar exchange are far in excess of probable availabilities. In June, these dollar commitments were for contractual payments amounting to $87 million, and payments for current imports and invisibles amounting to $9 million--$96 million in all. In July, August and September, the average monthly payments to be met out of dollar export receipts will be about $68 millions. They will fall to just under $60 million in the last quarter of 1955.

Because the auction market in exchange is a 120-day market, there is a lag between a reduction in the allocation of exchange for imports and the corresponding reduction in the commitments of the monetary authorities. The mere reduction in imports would not, in any case, be adequate to meet the impending payments difficulties. Unless and until dollar export receipts reach a normal level--close to $60 million a month on the average--obligatory payments will exceed available receipts. If the change in the exchange system were to result in a sudden increase in export receipts, the prospective deficiency might not arise. While this is a possibility, it is unlikely that goods can be moved so quickly and transfers be made so promptly as to bring a large and immediate increase in exchange receipts. More likely, with a new exchange system, there would be some immediate increase in exchange receipts, but the full effects would not be felt for two or three months. In any event, the monetary authorities cannot risk starting the new exchange system in an atmosphere of crisis. They cannot fail to honor their commitments to sell exchange without seriously undermining confidence in the financial integrity of the country.

Brazil must, therefore, find resources to meet maturing dollar commitments during the next few months. It is not possible at this time to determine with any degree of precision how much may be needed. The Brazilian authorities probably have enough resources to meet commitments until the end of July. Thereafter, their commitments could be met only if dollar export receipts run about $70 million a month in August and September and about $60 million a month in the fourth quarter. To the extent that receipts fall short of these amounts, supplementary resources must be found by the Brazilian authorities. Export receipts should begin to reach the required minimum figure by October if the exchange system is reformed during July. In such circumstances, the Brazilian authorities would need approximately $50 million to $60 million to tide them over the transition from the old to the new exchange system.

The monetary authorities must recognize frankly that it is not possible to continue to conduct their foreign payments on a hand-to-mouth basis, waiting for each week's receipts in order to meet maturing commitments. If the new exchange system is to operate in an orderly fashion, Brazil must reschedule its obligations so that they mature at a rate better suited to the prospective exchange receipts. Therefore, consideration will have to be given in the near future to an agreed refunding of long-term dollar obligations to the Export-Import Bank.

It is indispensable for the Brazilian authorities to begin to reconstitute the exchange reserves. Any extraordinary receipts, either from a sudden surge of exports or from the liquidation of the government's holdings of coffee, should be regarded as destined entirely to the rebuilding of reserves. The accumulation of at least $200 million in reserves during the next two years should be given priority over any increase in imports. Indeed, until Brazil has strengthened its net exchange position substantially, it cannot place a free export-import exchange market on a fully spot basis.

3. The Short-Run Inflation Problem

The reform of the exchange system, urgent though it is, cannot of itself provide a lasting solution to the payments difficulties that have troubled Brazil. The reform of the exchange system will be successful only to the extent that the monetary authorities give confidence to the public that the progress already made in dealing with inflation will be continued. Active and forceful measures to prevent the emergence of inflationary forces are all the more necessary because of an exaggerated expectation on the part of the public that depreciation must result in higher prices.

Provided the surplus of receipts from the sale of exchange over payments for the purchase of exchange (the local currency import surplus) is not reduced, there is no reason why the monetary effects of the exchange reform should be inflationary. On the contrary, if the exchange reform increases exports and imports, and thus raises the local currency import surplus, it will contribute to reducing inflationary pressures. This does not mean, of course, that local currency prices will not rise for export goods and for some import goods as a consequence of the exchange reform. Obviously they will, and such a rise is one of the means through which the exchange reform will operate to improve the payments position. But aggregate expenditure on home goods need not increase and may decrease, so that the upward pressure on domestic prices may be relaxed. This is more likely to happen if the monetary authorities accompany the exchange reform by appropriate measures to restrain public expenditure and the expansion of bank credit.

Private credit and public expenditure

From October 1954 to April 1955, credit from commercial banks has been maintained at approximately a constant level, without any increase whatever. This has not only helped in the stabilization of the economy, but it has shown that the monetary authorities are capable of implementing monetary policy if they are determined to do so. There is a great deal of justified pride in this achievement among those having supervisory responsibility for the monetay and banking system. This marked but limited success should encourage them to persist in a monetary policy that will halt inflation and lead gradually to the attainment of a stable and balanced economy.

The recent monetary policy, while suited to the period in which it was applied, should now be modified without relaxing the over-all restraint on the expansion of currency and demand deposits. It is undesirable to continue to prevent entirely any increase in credit from commercial banks to private business. Even in recent months, this was possible only because the economy as a whole was not too hard-pressed for credit. It must be noted that private business was not entirely deprived of some additions to bank credit. Between October 1954 and April 1955, aggregate credit from commercial banks remained unchanged, but the Bank of Brazil increased its credit to agriculture and industry by about Cr$2.8 billion.

The restriction of commercial bank credit did not result in a cash crisis. In fact, the public was adequately supplied with money. This occurred because the Bank of Brazil, in addition to its credit to private business, extended about Cr$9.2 billion in new credit to the National Treasury, the states and municipalities, and to the autarchias. Thus, the aggregate credit created by the Bank of Brazil resulted in an increase of about 6.5 per cent in currency and demand deposits in the six months from October 1954 to April 1955. With such an increase in money, business firms could maintain adequate liquidity by saving part of their profits in the form of cash balances. The need for additional cash balances helped to restrain business investment and the availability of currency and deposits made it possible to avoid deflationary pressures.

This policy should now be modified in two ways in order to continue the progress toward internal stability. An increase of currency and demand deposits at an annual rate of about 13 per cent per year may not be too much in the first stage of transition, the slowing down of inflation, when expectations of continued credit expansion are still exaggerated. It is too much for the second stage of transition, from inflation to stability. For the next few months, the monetary authorities should limit the increase in money to an annual rate of about 10 per cent--say, a 5 per cent increase during the second half of 1955. This should be accomplished, however, through the expansion of credit by the commercial banks rather than the Bank of Brazil, with more of the credit going to private business and less to the government. Special care will have to be taken not to increase bank credit too much if the change in the exchange rate brings an immediate increase in private exports and the exchange ~~is~~ required to replenish the reserves rather than to increase imports.

There has recently been some relaxation in the reserves required of commercial banks. To the extent that these reserve requirements were of an emergency character, some relaxation may have been necessary. The reserves freed in this way will ease the liquidity of the banks and may encourage them to expand their loans and investment. If the progress toward stability is not to be brought to a halt, however, the expansion of credit by the commercial banks must still be on a moderate scale and it must be accompanied by at least an equal reduction in the credit provided by the Bank of Brazil to the National Treasury, the states and municipalities and the autarchias. Such a shift in credit policy will require a reduction in government expenditures, since considerable time is necessary to increase taxes. This need not entail any real hardship, for there seems to be considerable public expenditure that can be postponed without impairing essential public services or impeding the normal development of the economy.

Public enterprises

The autarchias and other public enterprises have been a significant contributing force to inflationary pressures in the past. They draw heavily on the National Treasury, already burdened with excessive expenditure, and they have recourse to the Bank of Brazil for credits. If the autarchias would limit their expenditures, for current operations and for new investment, to their current revenues, an important breach would be closed in the defenses against inflation. This balancing of the financial accounts of the autarchias could be made to some extent by postponing expenditure for investment. Far more could be done, however, toward balancing their financial accounts by increasing revenues. Public undertakings of a business character, like private enterprise, should charge the full cost of the services they provide. This is desirable not only for financial reasons, but also because it would result in a more economic use of the resources at the disposal of the autarchias. Needless to say, inefficient public enterprises should be liquidated or reorganized so as to put them on a profitable basis.

There is an unreasoned prejudice against raising the prices for the services of public utility enterprises—those operated by the government and those privately operated. This prejudice consists in regarding higher prices for such services as inflationary although, in fact, the reverse is true. When prices are too low, so that government enterprises are operated at a loss, the public finances are burdened and the budget deficit is increased. When prices are too low, so that normal profits are not secured from public investment, the expansion of capacity must be financed by borrowing and bank credit may be unduly increased. Furthermore, when prices are too low, so that there is an excessive and wasteful demand for these services, new investment must be undertaken to expand capacity even though resources are inadequate for private investment of far greater social and economic importance. The prices charged by all government enterprises should be reexamined and revised to place the autarchias on a self-supporting basis by charging the full present cost of producing the services they provide.

In summary, the additional latitude that may be given to the commercial banks to expand credit to the private sector in the next few months should be offset by an equal or greater reduction in the demands for credit by the government sector on the Bank of Brazil. Admittedly, there are difficulties of several kinds in carrying out such a policy. It must be borne in mind, however, that to the extent the government sector is unable or unwilling to curtail expenditures to offset the expansion of bank credit to the private sector, the monetary situation in the second half of 1955 may become more inflationary. This will make it more difficult, even with a new exchange system, to secure sufficient stability in the exchange market and adequate improvement in the payments position.

4. Long-Run Stabilization Policy

The establishment of stability in the internal economy and balance in the external payments of Brazil will require much more than an emergency exchange reform and certain immediate financial measures. Economic policy in Brazil has had a bias toward inflation. This bias must be eradicated and the natural direction of economic policy changed toward stability. Only in this way can a deep and strong foundation be provided for new policies dedicated to economic development with stability.

Resources for investment

The principal cause of inflation in Brazil, as in some other countries, is the great urge for rapid economic development. It is undoubtedly true that Brazil is capable of applying modern methods of production on a far greater scale than the resources available to it permit. Furthermore, its bold and enterprising business men are eager to push forward rapidly with development, despite the lack of resources. The urge for development and the spirit of enterprise could be great constructive forces for economic progress if they were disciplined by sound economic policies. Unfortunately, the mistake has been made of confusing the creation of credit with the provision of real resources. The consequence has been a steady inflation which has disrupted the economy and led to repeated payments crises. Economic development in Brazil has been achieved not because of inflation, but in spite of it.

The scale of economic development will be determined by the amount and the economic use of the real resources available for investment. The amount of real resources for development can be increased by giving greater encouragement to domestic saving and by providing an attractive environment for foreign investment. The best encouragement for increased saving is a stable economy in which the value of savings is not undermined by inflation. The best encouragement for increased foreign investment is an exchange system which provides a fair exchange rate for converting incoming capital into local currency and an assured means of transferring abroad the profits from investment. The free market for invisible transactions does provide facilities for bringing in new funds and for transferring earnings at a fair exchange rate. The reform of the exchange system, as applied to exports and imports, should give further encouragement to foreign investors.

One of the unfortunate consequences of inflation is the distortion in the direction of investment. In Brazil, as in some other countries, this distortion is strikingly manifested in the excessive proportion of total investment that goes into construction. The recent bank credit policy has been accompanied by a marked decline in building, although credit policy has not necessarily been the sole or the principal cause of the reduction in construction. The monetary authorities should discourage the commercial banking system from using too much of its resources for financing real estate, directly or indirectly. Attention should be given to providing better institutional facilities for directing bank credit and the savings of the public into industrial and agricultural enterprise.

An important factor in the availability of resources for development will be the policy on oil. The slow and inadequate development of the oil industry in Brazil has kept the national income far below the level warranted by its natural resources, its technical capacity, and the skill and enterprise of its people. It is difficult to see how a strong and satisfactory payments position can be maintained in the future, except at an enormous real cost, so long as Brazil excludes from its exports the oil it is capable of producing and includes in its imports vast quantities of petroleum products that could be extracted from its own soil. Even Canada, with its far greater wealth and its far wider experience in modern technology has found it desirable to open the development of its oil resources to foreign companies. There is no reason why Brazil could not do the same without in any way compromising its national economic interests.

Financial reforms

In the long run, economic stability can be attained by a country only if the monetary authorities regard this as an important objective of economic policy. Such an objective need in no way conflict with the objective of economic development and it will, in fact, contribute toward achieving it. The government must be prepared to sacrifice the needs of the moment where they conflict with the longer-run purpose of economic development with stability. The extent to which this objective is achieved will depend far less on institutional arrangements than on sound policy and on a national will for economic stability. Nevertheless, better institutional arrangements can help in implementing sound economic policy.

The budgets of the Federal Government and of the states and municipalities present a constant threat to economic stability. There is no way in which inflation can be avoided if budgetary deficits persist on the same scale as in the past. Monetary policy cannot function properly if the banking system is under constant pressure to provide credits for the Federal Government and the states and municipalities. An authoritative study of public finances should be made to determine how the tax system of the Federal Government and of the states and municipalities could be improved to provide larger tax revenues without discouraging enterprise. It would be desirable in this study to consider the possibility of reducing some public expenditures without adversely affecting essential government services.

Recent experience has shown that it is possible to put into effect a sound credit policy if the monetary authorities are determined to do so. It is difficult, however, to secure proper direction of policy with the divided responsibility and administration that prevails in the monetary and banking system in Brazil. A commercial bank, even one largely owned by the government, is not an ideal agency for initiating and carrying out monetary policy. The bank may itself confuse the broader interest in monetary policy and the narrower interest in its banking operations. Furthermore, an effective monetary policy requires forceful leadership in the banking system. It is extremely difficult for a publicly-owned commercial bank, competing with other commercial banks, to provide such leadership. A modern central bank could be a powerful influence for sound monetary policy in Brazil.

Unification of the exchange system

When further progress has been made toward economic stability and after international payments have become reasonably well balanced, a unified exchange system should be established. If the new exchange rates that are to be put into effect function properly, they should provide the basis for transition to a permanent exchange system. The first step should be in the merging or elimination of the exchange surcharges, so that all exchange transactions for imports and exports are conducted at a single rate. The exchange surcharges are in the nature of tariffs. In the short-run they can be justified by the government's need for revenue. In the long-run they can be justified only as part of a tariff system suitable for Brazil. The existing tariff system, which is principally on a specific basis, is now wholly out-of-date. A new tariff system should be prepared which would absorb all exchange surcharges on imports. Needless to say, the new tariff system should be consistent with the international obligations of Brazil.

By the time Brazil is ready to put a unified exchange system into effect, the principal currencies of Western Europe may be convertible. If this is so, there will be no need to continue the bilateral payments agreements with these countries. In fact, the Government of Brazil should have a study made of the desirability of terminating all bilateral payments agreements and carrying on its trade in terms of U.S. dollars, sterling, and currencies of equal transferability, at least when convertibility is introduced and in some cases before.

Once Brazil has unified its import and export rates and terminated the use of payments agreements currencies, it will be ready for a permanent exchange system conforming to the objectives of the International Monetary Fund. All that would remain to be done would be to join the two markets--the export-import exchange market and the free market for invisibles. The rate prevailing in this single market could then be declared the new parity of the cruzeiro.

5. Technical Assistance on Exchange and Monetary Measures

This report contains the broad outline of a program to deal with the urgent payments problem and to prepare the way for a permanent exchange system operating in a stable economy. If the Government of Brazil finds that this report provides a practical means of dealing with these problems, it will wish to prepare concrete measures putting the suggestions of this program into effect and to present such measures to the Fund for its approval. The technicians of the Government of Brazil are best qualified to prepare specific measures conforming to the laws of the country and the institutional arrangements to which the people are accustomed. There will be questions of a complex character on which the Brazilian technicians may desire the collaboration of members of the Fund staff. The Fund will, of course, try to make available to the Government of Brazil the technical assistance that it may need to implement this report.

E. M. Bernstein

21/8 55

new regulation
1) If par value withdrawn, Br. cannot draw. Rules for fluctuating rates to be applied. Should the rules be changed.

2) Will auctions only take place in Rio.? no / Different auctions for different currencies?

4) Will the Govt pay only the rate at the auction on the same day? or also surcharges? ~~no~~ on wheat, newsprints

5) Min. bids fixed by BdoB

7) Surcharges to be paid within 3 weeks,
more risk for not getting all goods needed, an advantage that only one $ price

Eddies PM

I do not see Eddies reasons against the "export tax"

Eddies proposal will lead to holding back sales before the change in the levy.

would like to see draft instructions.

Staff questions.

~~Don't understand~~ 9.?

May 16, 1955

the draft of

Comments on the Paper on Brazil.

(consultations)

1. Page 28.

The 1954 balance of payments deficit is not due to a severe decline in coffee exports. On page 24, you say that the exports in '54 totaled \$1.56 billion as compared with \$1.54 billion in 1953. It is correct, on the other hand, that the direct exports to the U.S. were substantially smaller than in 1953 and that Brazil therefore got less dollars. A lot of coffee bought for Europe was, as you remember, resold to the U.S. The reason for the balance of payments difficulties with the dollar area is thus clear but it cannot be said that a reduction in total coffee exports lead to the deficit. The total deficit over and above the \$ deficit was due to the food (the imports that were too high. This ought to be brought out in the paper.

You say that the allocation for imports from the U.S.A. were reduced. However, nothing is said about how much of the incoming dollars that had to be used for:

a) service of loans
b) for government purchases.

I do not remember if it clearly comes out of that chapter how many dollars have been used for oil. I believe that a small table giving the important figures both for imports and other payments and ~~the~~ for exports would be useful. (Only the most important categories should be mentioned.)

Your memorandum about Colombia also makes the mistake of attributing the 1954 external deficit to reduced exports. Your own figures do not show this. I am pretty sure that Colombia's difficulties in 1954 were mainly due to their very high imports. I shall later on return to the Colombian paper.

2. On page 19, it must be said that according to a statement in the New York Times of May 14th, Mr. Whitaker has decided to discontinue at least part of the credit restrictions and that as a consequence, Mr. Bulhoes has resigned.

3. You ought to have some figures about the present arrears.

4. Does not the Banco do Bresil at present have any profits from the spread between the selling and buying rates? Previously, the profits were very big and a substantial part of the profits were, according to previous information, used for wiping out the losses of the Banco do Bresil from cotton.

In the budget chapter, there must be something more about the losses of the Autarquias. The chapter must also be rewritten; now different figures are given on different pages.

6. If the dollars auctioned to be delivered after 120 days were set aside at once, the risk for extra pressure on the Banco do Bresil would be reduced. As it is now, these payments have to be drawn on the credits given by the private banks. I do not know if they always see to it that a part of these credits is earmarked for the total amount of dollars sold under the 120 day scheme.

The Banco do Bresil seems to count on the possibility of increasing the swaps. Even if this should turn out to be possible, I think it is too optimistic to base its policy thereon. I would, on the contrary, be inclined to count on the necessity of reducing the swaps. This would mean another pressure on their dollar holdings.

You ought in the text to say something about the economic necessity for Brazil to increase prospecting for oil. If Brazil is not able, within some years, to increase oil production rapidly, its foreign exchange situation will become even worse. You should, of course, not say that they have to get assistance from foreign companies in order to do it. This should only be implied.

7. You do not say anything in your paper about the "German dollars" and the economic effect for Brazil of the ~~result thereof.~~ transactions in such dollars.

answer: Not done as we did not discuss it, CR

O.P.

Brazil

~~20~~ 24/5 -35

All reports at 45   45 of Rev yesterday

Mid June need of another 30m.   Now $1m a day

85 def - r

56 small

59-60

20 $ def

No [illegible] def

Then stab. loan

Plan needed

Business mentality

Other coffee countries will not make an agreement; if so they want keep it

Cut down payments

3m. bags now.

1908 9m. 3 Hbg 2 Le Havre 1 Triest ~~2 3~~ Paid during war London fin.

1916 4m.

1924 ?   Roth, Baring Schroder

The following notes have been prepared for you on the speech made by Dr. Maria Whitaker, the new Minister of Finance, on taking over the Ministry on April 13:

He returns to the Ministry after 24 years.

Most serious problem is the increase in the cost of living.

The inflation is reflected in and spurred on by note issues.

A balanced budget is not enough. There must be abstention from new loans, investments.

Certain expenditures should be covered by the issue of government obligations, up to now impossible because the interest the state can pay is less that what individuals pay. It would be necessary to force a reduction in interest rates in the country. This is ambitious and difficult but he would try to show it is not impossible.

He refers to "exchange confiscation." Sometimes the weight is such that the export products become "gravosos." Even when the product is exported the "exchange confiscation" takes income away from the exporter. This inequity must of course end. This will be easy for most products but unfortunately very difficult for coffee in view of the repercussions abroad of any brusque change. This must therefore be studied with time.

more production, less inflation.

TRANSLATION
August 17, 1955

The press yesterday published the following results of the conversation held between the Brazilian Minster of Finance, Mr. Jose Maria Whitaker, and the Colombian Minister of Finance, Mr. Carlos Villaveces:

1. The conversation between the two ministers was very profitable, and they reached full agreement on all points discussed about the coffee situation.

2. They agreed that the frost which affected the State of Parana balanced the statistical position of coffee. Is this correct?

3. They agreed that if conditions in the world coffee market are modified in the near or distant future, a study will be undertaken to establish quotas in proportion to the production of each country, which would be effected only through mutual accord, to limit exports from the producer countries.

4. They further favored studies in conjunction with the FEDECAME ? countries to establish an international coffee office, taking into consideration the report that is now under study by the Special Coffee Commission of the Social and Economic Council of the Pan American States and in accordance with instructions given by the Conference of Quintandinha.

5. The National Federation of Coffee Growers and the Coffee Institute of Brazil must maintain an interchange of statistical information concerning the laws and by-laws of production and exportation. For this purpose, a representative from each of these institutions will be appointed.

6. They agreed to the necessity of promoting coffee consumption by an advertising campaign to be held through the Pan American Offices in the United States, Canada, and through special agencies in Europe and the rest of the world. They agreed that the other countries should collaborate in this undertaking.

7. They agreed that for a world coffee agreement participation should be extended not only to the Latin American countries, most of which are affiliated with the FEDECAME, ~~but also~~ to the colonial producers. Therefore they decided to send observers to the forthcoming September meeting of African Coffee Producers which is scheduled to be held in Brussels.

8. They agreed that in order to promote future stability of the coffee market, it would be necessary:

   (a) to guaranteed adequate financing to producers in order to regulate exports abroad;

   (b) to discourage coffee production outside the actual ecological coffee belt;

(c) to reduce taxes on coffee imports; very unlikely

(d) to persuade consumer countries to increase their import quotas where they have such restrictions.

9. In order to maintain stability in the world coffee market, the main goal of both producers and consumers, they agreed to provide ample coffee provisions for consumption.

June 15, 1955

Brazil

Notes on pages 6 to 12.

Page 6. I guess that you have to mention the rate of Cr. 50 in the paper. I doubt if you should mention it in the Board.

If you feel that there is any chance of getting back part of the windfall profits by some kind of taxation, it might be a good idea to mention it.

Page 7. First full paragraph. The second sentence speaks of petroleum products. Do you refer here only to diesel and fuel oils mentioned on page 6? I do not have any view as to whether any changes are needed in the prescribed minima.

In the same sentence you say "although the actual premiums that importers would bid would be less", I do not understand your reasons for this statement I therefore cannot have any idea if it is correct.

Last paragraph. After "the exchange required by importers" add: "in the free market."

Is there a formula for the surcharges in the present law? If it should be introduced only in a future law, I think you should substitute "a" for "the."

Page 8. Are pages 8 to 11 only discussing dollar transactions?

Even if the differences between the two types you discussed are not very great, there may be a great difference between the rates in the free export import market and fixed rates.

Can you say that the same rate is applicable to exports although it is fixed in one case and fluctuating in another?

Page 9. The sentence beginning at the end of page 8 may be correct. You should perhaps mention that there are great variations of the import rates for the time being, even for the dollar imports.

Page 10. You say that a free exchange system would need no adjustment until a new parity is introduced. This sentence has to be coreected as intermediate steps will be taken. The statement in the last sentence in the last paragraph is correct.

Page 10, last paragraph. At present there are auctions for various currencies. Is it your idea that if a free export-import exchange system is introduced, you should-already from the beginning-not have different auctions for various currencies?

I have read with interest your proposals for changes in the rate system. I do not know enough about the actual situation, the Brazilian Laws, etc. to be clear in my own mind whether there are no other possibilities than the two that you have mentioned. I am not able at present to say to which of these two I would give the preference.

To the paper as a whole: -

Can any new long-term policy be decided in Brazil before the elections?

What kind of a promise to follow any policy can this Government give? If no general promise can be given, will the funding of the Ex-Im obligations and the new credits be given?

Page 5. Line 7.I suggest that you add the word "aiming" or something like it after the words "payments position."

Nothing is said in the paper of what the profits to the B of B from the spread between selling and buying rates should be used for. Do you intend that to begin with, they should be used for offsetting losses perhaps already made by the B of B or that might be sustained when the Bank has to pay the new export rates but is, for a period, obliged to sell at the rates previously fixed? Another possibility is, of course, that the money be sterilized; a third that it be used for budgetary purposes; a fourth that it be used for subsidizing agricultural prices as laid down in the law. There are, of course, other possibilities.

You have not mentioned anything about the possible economic consequences of the law passed when Gudin was Minister of Finance, to the effect ~~that~~ a the buyer of coffee would be refunded the difference between the price ~~made~~ he had paid for coffee and a new lower price. I am not in a position to have any idea of the amounts that may be involved and if there is a time limit to the period during which such payments have to be made.

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P

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5/16/55

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7. You do not say anything in your paper about the "German dollars" and the economic effect for Brazil of the transactions in such dollars ~~result thereof~~.

What bottlenecks in Br. economy

Present profits from spread betw selling and buying rates (if any)

Who buys

Min. system 20.38 will remain

Exporters get credit of 80%

Producers of 100%

Not enough coffee to be moved

Either bought by Govt or not in the market

INTERNATIONAL MONETARY FUND

TO :

FROM:

Strictly Confidential DECLASSIFIED

January 20, 1955

Some Aspects of the Brazilian Problem.

The possibility of doing anything sensible with the Brazilian foreign exchange rates depends, of course, upon the possibility of bringing the economy in balance. We know that Gudin and his associates have tried hard to reduce the inflationary effects of the present Brazilian economy policy. It goes without saying that everything cannot be done at once. As other countries in a similar situation, Brazil will, of course, have to take one step after another along as many lines as possible. Too sharp a policy might, of course, lead to an economic crisis. Two banks in Sao Paulo have been forced to close. Is it correct that it has been impossible to merge them with other commercial banks and that the Banco do Brasil has been obliged to intervene? What is now happening to these banks? Is there any ~~reason~~ risk for further bank failures?

1. In the long run, the only way to avoid currency crises as often as at present is to develop oil with foreign assistance. Gudin has tried to convince the Brazilian people of the necessity of doing so. He still seems to be optimistic that something can be done with oil this year; others including Paranagua, have no hope for a change in the law until after the new president has taken over in February, 1956. Unfortunately, the military aide-de-camp to the president, the previous chairman of the Petrobras, General Tavora, has been delivering speeches in the country against Gudin. General T. is said to be nationalistic and against changes in the law. Paranagua says, however, that he is a sensible man and that his main point has been that as long as the present law is on the books, it should be followed. General T. has been spoken of as a possible successor to Gudin.

It will no doubt take at least three years after an agreement is made with foreign companies before a substantial production from new wells can be expected.

2. It will be impossible to solve the actual foreign exchange problem as long as coffee and other products are not moving and inflation is continuing.

3. a) At present the producers and exporters can get credit from the commercial banks and

b) from the Banco do Brasil

c) The Coffee Export Institute is buying coffee

d) The Banco do Brasil is buying coffee and certain minor export goods. (I have not seen the list.)

e) The Production Financing Commission is also buying coffee.

& the multiple currency rates or with

It is not known to what extent the organizations under (c), (d), and (e) have bought export goods nor is it known how long the Banco do Brasil will have to continue advancing money against coffee under the present rules (b).

4. Many things have to be done in order to have export goods moving. For the time being, I am not dealing with the unfortunate effects of the payments agreements with certain countries, that divert export goods from the regular channels and lead to shunting of the goods.

5. Other decisions that have to be taken or contemplated seem to me to be the following:

a) The policies must be flexible.

b) How long will it be necessary, for political or other reasons, for the authorities to buy coffee? There should only be one organization buying export goods, if that is considered necessary, and not three as at present.

c) The Banco do Brasil and the commercial banks should aim at reducing their advances on coffee.

d) If the commodities are not exported by the exporters, I believe that e.g. the following things should also be contemplated:

i) Export from stocks owned by the Banco do Brasil or government authorities.

ii) The limit for credits on new export goods should be reduced. It should also be discussed whether credits already given on such export goods could be reduced.

iii) The rate of interest should be increased both for old loans and new ~~loans~~ on such goods.

iv) The cost for warehousing should be increased.

6. It is said that the Banco do Brasil is aiming at a reduction of both direct credits and rediscounts. Have the commercial banks so far stopped increasing their credits or reduced them;, or are they still rising?

7. Gudin is said to be aiming to cut expenditures both for the government and the Autarchias. Any results so far?

It is said that the federal budget for 1955 has been approved with income of Cr.$ 53.5 billion and expenditures of Cr.$ 56.7 billion. The deficit would thus be Cr.$ 3.2 billion. Is this really the overall deficit for the government and its agencies? Gudin said sometime ago that the receipts had been over-estimated and that there were deficits in the state enterprises that had, at the previous stage, not been taken into consideration. Is this approved budget not too optimistic? x

8. What was the total amount of the increased taxes that the Government had asked for.

How much did the Government expect to get through improved tax collections?

How much of these increases were approved by Parliament?

9. Is there any possibility of financing the deficit or part of it by borrowing in Brazil without any inflationary effects on the economy?

10. The wage problem and the wage-cost-of-living relationship will, of course, be dangerous to the stability which Gudin is aiming at. Therefore we should try to get information on this point.

11. I understand that Gudin has tried to reduce the issuing of new paper currency. What economic effects of such a measure are expected and is there any result so far?

12. It is believed that approximately $50 million in arrears remain unpaid. There is also a float of dollar certificates for future exchange delivery which have been auctioned, estimated at between $80 to $100 million.

It is important that Brazil should try to see to it that the prompt payment system is not sacrificed.

During the first part of 1954 Brazil had a surplus of $67 million in its trade in inconvertible currencies. This was more than offset by a negative balance of $100 million in trade with convertible currencies.

13. It is reported in the press that Brazil is having discussions with the U.S. Government about a, say, 5-year loan from the Exim Bank for financing exports of various goods to Brazil. If such an agreement is reached, it will ease the situation during the period when the goods otherwise should have been paid. The Exim Bank can probably only give credits for capital goods exported to Brazil.

Brazil is also believed to discuss purchasing wheat from the U.S. for payment in Cruzeiros to be used later on for purchases of strategic materials.

Brazilian needs of wheat are, according to Paranagua, about 2.4 million tons for 1955. Brazil hopes to get 1.2 million tons from Argentina out of its bumper crop. There seem, however, to be some difficulties in that agreement which are not yet solved. The Brazilian crop is optimistically expected to be some 600,000 tons. It is said that the negotiations with the U.S. at present concern 200,000 tons of a value of about $18 million. Brazil will probably have to ask for more wheat from the U.S. Argentina seem to fear that these purchases from the U.S. may upset its sales of wheat.

x I understand that Gudin has said that he could accept the budget if it was not not mandatory for him to make all those expenditures. He would see to it that not more expenditures were made than those that could be paid for with the receipts of the govt

14. Paranagua has told me that Brazil is not contemplating any drawing on the Fund for the time being but is intending to use this possibility as a last resort.

15. Brazil may also try to negotiate temporary credits from U.S. commercial banks during the coming year. I think such credits should have no collateral. I think it was a mistake to offer collateral for more of the credits given by the U.S. and commercial banks than the $160 million that had to be repaid to the Federal Reserve Bank of New York.
On the other hand Brazil could not have got a 5-year loan from these banks without collateral

R

See also Memo of Oct 5, 1954 with annex.

I gave a copy of it to Andy before he left for Brazil on Monday Feb 7, 1955

Strictly Confidential

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It will no doubt take at least three years after an agreement is made with foreign companies before a substantial production from new wells can be expected.

2. It will be impossible to solve the actual foreign exchange problem as long as coffee and other products are not moving and inflation is continuing.

3. a) At present the producers and exporters can get credit from the commercial banks and

b) from the Banco do Brasil at 80%

c) The Coffee Export Institute is buying coffee not since June 15

d) The Banco do Brasil is buying coffee[x] and certain minor export goods. (I have not seen the list.) from BdoB is still buying minor exp.

e) The Production Financing Commission is also buying coffee. from the farmers at 100% (prob

wool, veg. oil etc

15/6 3.5 m. stocked by Institute 1 m bags in Santos unknown if it belongs to Institute or exporters.

x) only adv. financing 80% not 100% as before

 & the multiple currency rates or with

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6. It is said that the Banco do Brasil is aiming at a reduction of both direct credits and rediscounts. Have the commercial banks so far stopped increasing their credits or reduced them;, or are they still rising?

7. Gudin is said to be aiming to cut expenditures both for the government and the Autarchias. Any results so far?

It is said that the federal budget for 1955 has been approved with income of Cr.$ 53.5 billion and expenditures of Cr.$ 56.7 billion. The deficit would thus be Cr.$ 3.2 billion. Is this really the overall deficit for the government and its agencies? Gudin said sometime ago that the receipts had been over-estimated and that there were deficits in the state enterprises that had, at the previous stage, not been taken into consideration. Is this approved budget not too optimistic? y

8. What was the total amount of the increased taxes that the Government had asked for.

How much did the Government expect to get through improved tax collections?

How much of these increases were approved by Parliament?

9. Is there any possibility of financing the deficit or part of it by borrowing in Brazil without any inflationary effects on the economy?

10. The wage problem and the wage-cost-of-living relationship will, of course, be dangerous to the stability which Gudin is aiming at. Therefore we should try to get information on this point.

11. I understand that Gudin has tried to reduce the issuing of new paper currency. What economic effects of such a measure are expected and is there any result so far?

12. It is believed that approximately $50 million in arrears remain unpaid. There is also a float of dollar certificates for future exchange delivery which have been auctioned, estimated at between $80 to $100 million.

It is important that Brazil should try to see to it that the prompt payment system is not sacrificed.

During the first part of 1954 Brazil had a surplus of $67 million in its trade in inconvertible currencies. This was more than offset by a negative balance of $100 million in trade with convertible currencies.

13. It is reported in the press that Brazil is having discussions with the U.S. Government about a, ~~say, 5-year loan~~ from the Exim Bank for financing exports of various goods to Brazil. If such an agreement is reached, it will ease the situation during the period when the goods otherwise should have been paid. The Exim Bank can probably only give credits for capital goods exported to Brazil.

Brazil is also believed to discuss purchasing wheat from the U.S. for payment in Cruzeiros to be used later on for purchases of strategic materials.

Brazilian needs of wheat are, according to Paranagua, about 2.4 million tons for 1955. Brazil hopes to get 1.2 million tons from Argentina out of its bumper crop. There seem, however, to be some difficulties in that agreement which are not yet solved. The Brazilian crop is optimistically expected to be some 600,000 tons. It is said that the negotiations with the U.S. at present concern 200,000 tons of a value of about $18 million. Brazil will probably have to ask for more wheat from the U.S. Argentina seem to fear that these purchases from the U.S. may upset its sales of wheat.

y I understand that Gudin has said that he could accept the budget if it was not mandatory for him to make all those expenditures. He would see to it that ~~he~~ not more expenditures were made than those that could be paid with the receipts of the budget

14. Paranagua has told me that Brazil is not contemplating any drawing on the Fund for the time being but is intending to use this possibility as a last resort.

15. Brazil may also try to negotiate temporary credits from U.S. commercial banks during the coming year. I think such credits should have no collateral. I think it was a mistake to offer collateral for more of the credits given by the U.S. and commercial banks than the $160 million that had to be repaid to the Federal Reserve Bank of New York. On the other hand Brazil could not have got a 5-year loan from these banks without collateral.

January 12, 1955

BRAZIL

Paranagua asked for some help by the staff for a memorandum on certain of the Brazilian problems. He told me that the President had asked him for his view and that he had told the President that one of the most important things in Brazil was to stop inflation. As coffee could be sold now, Paranagua did not feel it was of first necessity to withhold the foreign exchange system. The reason for taking a decision on the exchange now had, by some Brazilians, been stated to be the following:

In order to reconquer markets that Brazil had lost, something had to be done. Paranagua, on the other hand, felt that there was not enough reason to make a devaluation only in order to increase the export of some certain marginal products.

What Paranagua was anxious to have in the memorandum was:

1) The inflationary developments in Brazil.

2) Would a real floating buying rate combined with auctions ~~for~~ for imports not lead to an over-valuation of the currency? Would that not lead to a distortion of production? If, for instance, a certain quantity of cotton is sold at Cr. 43 per US$ but the auction rate is about Cr. 70, everybody will try to sell at the auction rate. The result will be that more cotton will be grown than can be sold and that there will be pressure on the Government to buy the crop. This will be a case where the producer looking for as many cruzeiros as possible, will follow one line whereas the economy of the country as such which is interested in getting dollars, will lose.

for Roth Confidential

Summary of a note, for official use only, by Knoke and deBeers on their visit to Rio in October - November, 1954

The foreign exchange budget for 1955 was computed on coffee exports of $60 million monthly. However, they believed that this figure was too high and that a likelier figure was something between $30 and $50 million.

The dollar needs during the first half of 1955 was $520 million but dollar proceeds less than $300 million. The deficit from 1st November, when they got the last figures, until the end of June, 1955, might be as high as $350 million. Their minimum figure would be $200 million.

The outstanding amount of swaps was $110 million, of which $37 million had to be reduced before July 1st, 1955.

Cocoa had been sold to Germany for reshipment to the United States and Switzerland. That was one of the reasons why the dollar receipts had been low.

R [It was not mentioned in the report, but I have been told that previously substantial quantities of coffee had been sold first to Holland and then to France that was being trans-shipped to the United States and Switzerland. Commodity shunting should be avoided.]

The tight credit situation had led to increased swaps, from April through September by $50 million. Only after the return of Knoke and deBeers has Brazil decided not to permit any new swaps.

R [The swaps were an easy way for U.S. concerns working in Brazil to get credits for cruzeiros and, at the same time, hedge against appreciation of the cruzeiro rate.]

The Banco do Brasil reduced the rate of interest on swaps from 6% to 3%. No reason has been given for it.

The Banco do Brasil is no longer supporting the free market. From June 20 to November 1953 the Bank, however, sold 42 million dollars on the free market.

They stress the pressure on the free rate from the auctions. On November 9th, dollars had been auctioned at rates from 85 to 250. The free market is thin. Even a fairly small demand will raise the price.

During 1955 Brazil hopes to be able to sell ten million bags of coffee to the United States, which would give them $660 million. Other goods should, according to the Brazilians' calculation, give them another $150 million.

The coffee year begins on July 1st. For the present coffee year, estimates for registering for export are the following:

	million bags	
The United States Embassy	14.5	(for next coffee year 16 million)
The Brazilian Coffee Institute	13.5	(the President of the Institute - 13.0 million)

The coffee stocks for export on June 1st/ 1954 amounting to 3.3 billion bags were the lowest stocks since 1949.

The exports to the United States from 1st July to December 31,1953 were:	3.12	million bags
During the same period, 1954:	1.236	" "
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The stocks at the ports were 3.8 million bags on September 30, 1954.

The Brazilian coffee stocks in the United States are below normal, both with the dealers and roasters.

The market expects lower coffee prices next summer.

Knoke and deBeers said that it was necessary to further stimulate minor exports, with the exception of cocoa. The rate then prevailing of 36.5 was considered to be inadequate.

The Banco do Brasil buys and sells some of these minor export goods, mentioned in a list which is limited. It is not known how much of these goods have been bought by the Banco do Brasil.

They tried to find out, if and when there should be a strain on the economy, if the [redacted] imports would be continued at the low figure of \$10 million per month. Some people told them that difficulties may come within three months, others mentioned six to nine months.

They expected that the need for dollars for oil would be 20 million a month. When the new refineries start working at full capacity the dollar amount may be reduced \$2.5 million monthly. If Brazil could buy oil for sterling, the amount might be further reduced. (\$240 m or \$210 m, if paid within 45-55 days)

The Brazilian authorities in November were discussing the oil imports with the oil companies. They wanted to pay for the oil within 120 days.$ If, however, they would have to pay, as at present within 45 to 55 days, the need for dollars for oil payments would be \$50 million more during 1955 than calculated by the Brazilians.

They mentioned that less oil was needed in Sao Paulo as they had lately increased the electricity supply.

The Brazilians were discussing an increase of the price for petrol by a tax or rationing petrol.

$ No figure for total oil costs during 1955 is given in the paper

The Government exchange budget allotted \$4 million a month for Government imports. The previous rate for Government imports was 26; now the Government has to pay the minimum premiums for the various categories. For newspapers, movies and books the figure is \$2 million a month. The rate of exchange for newspapers was slightly below 19; the rate for books was then 26 and for movies 35. These rates are very favourable.

Gudin hoped that it should be possible to have the oil law changed in 1955 when the new Parliament begins. Others (including Paranagua) were afraid that nothing could be done until the new President had taken over in February 1956.

Brazil is trying to get a contract from the American oil companies for developing the Brazilian oil interests in Bolivia. Such a contract might later be suggested for the development of the Brazilian oil.

The reserve requirements for the banks have been increased for sight deposits from 4% to 14%; for time deposits from 3% to 7%. In addition commercial banks, except the Banco do Brasil, must maintain reserves of 15% on sight and short-term deposits and 10% on long-term deposits.

The rediscount rate on promissory notes is now 10% instead of 8%.

The rate for commercial loans against collateral is still 8%. The Banco do Brasil had, however, rejected some loans lately.

The Banco do Brasil was aiming at the reduction of both the direct credits and the rediscounts.

On July 31, the Banco do Brasil had given loans of 3.4 billion cruzeiros on 2.2 million bags of coffee.

They were given no figures about how much coffee the Banco do Brasil had bought under the programme instituted July 22.

Nor did they get any information about how much had been purchased by the Production Financing Commission.

Lower maximum rates of interest for time deposits had been introduced. Previously the rate had been 8%; the new rate is 7%. The reason given was that they wanted to compensate the banks for the higher reserve requirements.

Gudin was aiming at cutting expenditures both by the Government and by the Autarchias.

The Government had introduced new taxes and improved tax collections. The laws had not been passed when the mission left. It was said that a decision should be taken by Parliament before the end of November. One tax proposal was on undistributed profit. Excise taxes should also be increased.

Gudin had reduced the issue of paper currency.

Prices had risen partly because previously they had had too low price ceilings, and partly because of the higher rate for imported goods.

Annexes: Part of the report dealing with coffee prices and dollar receipts 1950-54.

IR:dlr
Jan. 17 '55

only for R & MC

Excerpt from a report on Visit to Rio de Janeiro by L. Werner Knoke
and John S. deBeers. November 1954

....

The failure of the coffee to move into export channels in normal volume is generally attributed to the minimum price policy of the Brazilian government. Decree No. 35,612 of June 3, 1954 guaranteed a minimum price of 87 cents a pound for coffee processed in Brazil. SUMOC Instruction No. 99 of August 14, 1954 modified this decree to put the minimum at 20.32 cruzeiros per pound, which was the same as the previous cruzeiro equivalent of 87 U.S. cents per pound. However, Instruction No. 99 changed the effective exchange rate so that the present cruzeiro minimum price, converted into dollars at a time when the free market rate for dollars is 70 cruzeiros per dollar, gives an equivalent in U.S. cents per pound at 62.1 cents per pound, f.o.b. Santos, for Santos type 4 coffee. Allowing about 2.5¢ per pound for shipping costs, this works out at a New York price of a little less than 65 cents per pound.*

issued

Article 1 (b) of Decree 35,612 authorized a program of financing by the government of 80% of the ~~value of the coffee~~ on the basis of the minimum price, and article 3 of the same decree authorizes the Production Financing Commission of the Ministry of Finance to buy coffee, preferably from growers, at prices equivalent to the minimum price.

On July 22, 1954, the Bank of Brazil announced another program un der which special loans would be extended to exporters who agreed to purchase from producers on the basis of the minimum price. Details have not been

* The New York Times of Nov. 13, 1954 reported that on Nov. 12 the SUMOC again changed the coffee exchange rate, fixing it at 31.50 cruzeiros per dollar. This makes the minimum price equivalent to approximately 67 cents per pound, in New York.

b up to July 1, 1955

published regarding the operation of this program, but it is understood that it has been put into effect with several of the leading exporters under terms which permit the exporter to surrender b his coffee to the Bank in payment of the loan and the costs involved, or, at his option, to pay the loan and have the coffee available for sale abroad.

A further factor in making effective the minimum price is the requirement of an export permit to be issued by the Brazilian Coffee Institute. Although nominally this is simply to assure that the exporter is registering the full value of his coffee, in practice it means that any applications for licenses to export coffee at less than the minimum price are rejected by the Institute. We are informed that there is some small margin of flexibility in these matters. In practice most coffee is declared at a grade inferior to its true grade, which permits a sale at slightly less than the minimum price or permits the exporter to retain part of the dollar proceeds for disposal through the free market at an exchange ratemore than double the regular effective exchange rate for coffee.

In practice the minimum price program has become effective largely through the special credits extended by the Bank of Brazil to exporters. The purchases of coffee by the Production Financing Commission were small at the beginning but are understood to have picked up in recent weeks. Information on the exact purchases is kept confidential.

In addition to the financing of coffee by special loans, the regular loan program of the General Credit Department of the Bank of Brazil is in operation and had financed approximately 2.2 million bags as of July 31, 1954 -- an amount which we were told has increased substantially since that date. Loans on the pledge of this coffee by the General Credit Department of the Bank of Brazil totalled 3.4 billion cruzeiros as of that date. We were informed that the private banks also finance a large amount of coffee, perhaps equal in amount to the coffee stocks financed by the Bank of Brazil. Exact figures are not available on this part of coffee financing, but it may be noted that Finance Minister Gudin, in a press interview on October 26 estimated that 7 million bags of coffee were being financed by the banking system, such loans aggregating about 14 billion cruzeiros. Undoubtedly the large amount of loans on coffee represents the major reason for the continued expansion of bank loans in Brazil in the last two months.

For my files

Confidential.
One copy given to me.

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by Knoke and deBeers on their visit to Rio
in October - November, 1954

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Annexes: Part of the report dealing with coffee prices and dollar receipts 1950-54.

IR:dlr
Jan. 17 '55

CONFIDENTIAL

October 5, 1954 Annex A.

If Brazil should ask for a credit, I would like to have a statement along e.g. the following lines:

It is the decision of the President

a) Not to change his Government even if the results of the election should be that there is a majority against him.

b) That until the next President begins his term of office, he will carry on the following policies:

1. The Government's aim is to stop inflation. To obtain this:-

a) The deficits will eventually be eliminated in the budgets of the Government and those Government branches that have separate budgets, such as the railways, the ports, the shipping, and packing houses. The changes in the personel set-up necessary to reach this goal, will be made, ~~this year~~.

Inflation will be gradually reduced.

Increased income will be achieved by new taxes and better tax collections.

Rates for railways, etc. will also be increased.

b) The Government will also try to obtain external balance.

c) The demand for credit will be curtailed and credit will in various ways be restricted. The Banco de Bresil will be permitted to give only temporary credits to the Government, its organizations, the States, and the municipalities.

2. When that price increase which is a consequence of the higher minimum wage decided by the last Government has taken place, the Government will aim at stability of prices and ~~wages~~.

3. The foreign exchange system will be simplified step by step.

4. Arrears will be avoided.

5. The oil policy will be changed in order to have internal oil production increased as soon and as much as is politically and economically possible.

6. The Government will aim at having the export goods sold regularly in order to avoid such crises as have been experienced several times during the last few years when cotton, coffee, and other products have been withheld.

7/ Present rules for minimum prices for coffee and other products will be changed.

8. The bottlenecks in the economic situation such as lack of electricity, deficiencies of the railways, etc. will be gradually eased partly by foreign loans.

9. The Government is interested in creating a central bank.

In order to give the Fund the true picture of the economic situation, the Government, the Banco do Bresil, and/or Sumoc will give the Fund information:

a) On the present situation:

Copies of the information given to the U.S. Government, the Exim Bank, and the IBRD. Statements of Brazil's present foreign indebtedness, the amounts of interest and amortization - separately. The amounts of dollars (and other currencies if any) sold by the Banco do Bresil to be delivered after a certain period -- 4 to 6 months, with the amount given separately for each month. The swaps with foreign banks and exporters and short term credits by Petrobras and other Gov't agencies.

We understand that during September the Banco do Bresil had to pay out $86 million previously sold by the Banco do Bresil for delivery in September. A corresponding figure for October is said to be about $57 million. So far it is not yet known how much is sold for delivery during the following months.

The amount issued in bonds payable in dollars or cruzeiros of the consolidation loan authorized during the Aranha régime.[x] Are holders of the old internal loans still authorized to exchange them for the new loans?

x) This law was not passed. Cr 3 bill of short Gov't papers sold with 6% int. payable (interest only) in $.

b) Regular information along the lines indicated in the memorandum given by Mr. Rooth to Mr. Gudin ~~on October~~ 1st.

Reduced amounts offered at the auctions may lead to a change in the categories that are imported and will lead to higher prices

R

Confidential October 5, 1954

Notes for further talks about the Brazilian drawing.

Brazil's quota is $150 million. At present Brazil has drawn:

March 1953	$ 18.75 million
August 1953	18.75 "
December 1953	28. "
	$ 65.5 "

Repayment should take place as follows:

7/1/57	$ 10 million
12/30/57	15 "
7/1/58	20.25 "
12/31/58	20.25 "
	$ 65.5 "

Brazil has probably a repurchase obligation to the Fund, as of April 30, 1953 of $34 million. There may also be a repurchase obligation on April 30, 1954

Brazil needs more foreign help than they have got through the new loan of $80 million from the Federal Reserve Bank. We should have up to date figures about their situation.

On Annex A, I have laid down some conditions for new credits by the Fund or by the Americans.

I think the Brazilian Government should try to have a postponement of certain of its indebtedness during 1954 and 1955. The amount due in 1955 seems to be about $55 million. I am not sure if the interest on its foreign loans is included in that amount.

Brazil should also fix its repurchase obligation or obligations with the Fund at the same time as it discusses the new drawing.

Brazil should first negotiate with the New York bankers about credits before approaching us.

The maximum amount of total credits that the Fund could give to Brazil would be ~~the quota of~~ $150 million. Brazil ought to propose dates for the repayments of the new credits, if it is not repaid previously by repurchases.

In its loan contracts with the IBRD, Brazil has given the usual negative pledge. Therefore the Fund cannot consider a credit to Brazil with collateral without the approval of the Bank.

over and above the gold tranche

150
28
122

| 20
10

5/10 54

F.S. and J.H. MC R

Fund Should not compete with private banks
Get advice from FRB NY. Appointment with Exter
Find out what resources that are available
Will the FRB give more
Whole 90 m. with private banks drawn.
Only in rare conditions gold loans from Fund
only a firm 3 year commitment

Had asked f $300 to repay FRB 80 and new money

Friday ev: Waugh, Andy, Woodword

Befor Rio meeting if necessary sit down with him

J.H. Should have defaulted
R. They can't default on everything, e.g. not on cash contracts
F.S. agrees with R

Negative pledge Brazil 5/10/54 [illegible]

Relations with Arg.
Need to buy wheat with $

Income from coffee For each budget $76 a month = 304 for 4 mo.
May to August only $112 = -$192 m.
New budget $160 a month
Sept 60-70 m.

Sept 60-70 m.

Sisal and cotton stocks

Find out what is available in New York

all information given to

Certain standards
Loan with collateral

Any risk for a new Govt.
Neg pledge

Quota 150

Am 450 P 600

BdaB 2nd 262

Imp. lic 75

337 + Exim B 300

37.

Diff 113 450

836
896
774
790

In Dec ~~150~~ 110

15/9 398

80 + 80 – Oct 1955

13.300 each month

Negative pledge.

321 – 160

150 in Dec + 13.3 each
3 year

1st rep to FRB Nov.

Full Oct 1958

Repay from Oct 1955 36 inst of 310

Ceiling 310 Credit of 150 in Dec 1954 rest gradually during 1955

40 m. excl. oil (27 a month) Started with 6 then 10

Reduce to 10 m,

Has discussed with $.

1½ to Federal

What is 272 in August 1955

Confidential

October 4, 1954

Brazil

The Gudins dined with us Saturday evening, October 2, 1954. When talking about the Brazilian situation, I said that I understood that the Foreign Exchange budget had a figure of $76 million as the average proceeds of coffee sales to the U.S. Almost $200 million less had been obtained during May to August. Gudin agreed that they had got much less than expected. In the present foreign exchange budget, the monthly dollar figures for coffee was only $60, not $76 as before.

The Banco de Bresil was expected, during September, to obtain between $60 and $70 million from exports. He hoped that they would be able to continue to increase the proceeds from coffee sales during the coming months. However, there was no reason to try to push the sales too much and thereby press the price of coffee. That would not give them more dollars. He was, however, fully aware of the importance of selling coffee regularly.

I asked him about cotton and sisal stocks. I asked the question because Kafka had said on Friday that the Banco de Bresil still held cotton and sisal which they had purchased at the price of about 1.5 billion cruzeiros. Kafka said that the quality of the cotton was not good and that the value of these goods was probably not much more than 1/2 billion cruzeiros. Gudin said he thought that the cotton was practically sold and that he knew that there was some sisal left but that he did not know its value. He agreed that they should try to sell it.

Gudin was very worried about the dollars to be delivered at future dates that the Banco de Bresil had been selling. During September for instance, they had such maturities of $86 million that had been met. The maturities for October were slightly below $60 million. I did not get any more figures from him.

On Friday he had spoken to General Edgerton of the EXIM Bank. He also got the official American reply through Messrs. Waugh and Overby to the effect that the U.S. could not do anything more than ask the Federal Reserve to give them a new loan of $80 million against gold collateral. He had asked for about $200 million new money from the U.S. but thought that he could have managed fairly well even if he only got $100 million from the Exim Bank. Postponement for some months of the monthly repayments of $4.2 to the Eximbank would also have been of some help to him.

The World Bank had not promised him any loan but was willing to study the situation. However, Black had declared himself willing to try to do something for him.

Gudin stressed the bottleneck that they still had because of the shortage of electricity. Many factories in Sau Paulo could not get power for more than four days a week. It was a must to solve this problem. The railway problem had also to be solved. They could not do either without some financial assistance from abroad.

On Friday, he had given the order to Brazil to cut down the sales of dollars offered at auctions from $20 to $10 million a month. I asked him if this would not affect the raw material supply for the Brazilian industry and thus stop part of the industrial machine. He believed, however, that for a short period, there would be enough new materials for keeping the industry going.

He spoke about the necessity of stopping the inflation by a) cutting down Government expenditure and thus balancing the budget for the Government and for the government organizations with separate budgets,and b) by cutting down the demand for credit and by restricting credit. He was anxious that the banks should not give as much credits as was done previously. He was going to see to it that the Banco de Bresil did not any more extend big direct credits and that it was much more careful with rediscounting that it had been so far. I said that of course this was excellent. I asked, however, to what extent it would be possible to reduce credits and wondered if he could get the Brazilian banks to cooperate wholeheartedly in his new policy of not giving credits except for good reasons. I told him that I had already, when I was in Rio, discussed this problem among others with Maciel and that I had told Maciel that to me it was important to try to reduce the possibilities of the banks for giving credits; e.g. by increasing the 6% of their deposits that the commercial banks now had to deposit with the Banco de Bresil. However, this increase in reserve requirements would be of no help if the Banco de Bresil continued as hitherto to use the money for new credits either to the Government, to the States, or to the banks. Therefore, I asked him to try to find out if there was any possibility of really sterilizing this money. When discussing the matter with Maciel, I had asked if it was possible to sterilize the money until Brazil had a real central bank. Maciel had said that it was possible but that he did not tell me how it could be done. I suggested that he should look into the problem. He agreed that something ought to be done. My suggestion should be discussed. Another possibility was, of course, to relate the increased reserve requirements to the increased deposits that the banks may get. We discussed shortly the consolidation loan that had been issued payable in dollars. He said he regretted it. I told him I had tried to dissuade the authorities from doing it.

He was leaving Sunday morning to have lunch with Mr. Milton Eisenhower.

He told me that he was anxious to have the assistance of Bernstein for two or three weeks sometime during the autumn when they were working on some of their economic problems. He also renewed his request that we should see if we could do something for Kafka next year.

I. Rooth

Confidential

October 5, 1954

On October 5, 1954 at 10:45, Paranagua
Gouvea
Foz
came to see Cochran and me.

Foz had a chart of the payments to be made and the credits needed. Supposing that the $90 million drawn from the New York banks had to be repaid in December, if a new credit arrangement should be made with them, the conclusion was that a new credit of $110 million would be needed. He had reckoned with repayments of the ~~the~~ FRB credit until October, 1955, and repayments of the credit from the New York banks (secured by collateral in gold) to be repaid in 36 installments. This would lead to a maximum of the credit of ~~amount~~ $290 million in August 1955; that would leave $30 million of the present $320 million gold of the Banco de Bresil unpledged, in August, 1955. In reality, it would be slightly more as the Brazilian gold production which is bought by the Banco de Bresil is about $3 million a year.

I told Paranagua that I did not think that a gold collateral loan to Brazil from the Fund could be considered until he had got a reply from the New York banks about the amount of credit he could get from them against gold collateral. I also told him that I could not think of the Fund discussing a figure of the magnitude he had indicated. He said that he was going to New York today and should get in touch with me after his return.

I stressed that if the Fund, later on, should give Brazil a loan against gold collateral, we would have to get the clearance from the World Bank as the Bank in its loan contract with Brazil has ~~this~~ its usual negative pledge.

The negative pledge of the World Bank approves ordinary ~~business~~ banking transactions for no more than a year. If gold should be ~~is~~ pledged for a credit longer than a year then the ~~IBRD~~ has to give its approval before the gold can be pledged.

Confidential

October 5, 1954

Southard and Hooker saw Cochran and me on October 5th, 1954 at nine o'clock.
I mentioned my (and their) talk with Paranagua yesterday, suggesting a credit from the Fund of $310 m. against gold.

Southard said that the opinion on the American side was that the Fund should not compete with private banks as far as gold collateral loans were concerened. Paranagua ought therefore first to find out what resources may be available in the New York market, including a higher or a longer loan from the Federal Reserve Bank.

When Gudin first approached the Americans, he had asked for a loan of $300 million, of which $80 million should have been used for repaying the loan to the Federal Reserve Bank. On Friday evening last week, Waugh, Overby, and Woodward met with Gudin and told him that for the time being, the American Government could not do anything. However, they were willing, if necessary to sit down with the Brazilians before the Rio meeting in November to see if something could be done.

I told Southard and Hooker that I could not see any possibility of discussing a loan of the magnitude suggested by Paranagua. The total amount that the Fund could give to Brazil would be, according to my view, the quota.

I thought that Brazil ought to have started by trying to postpone some payments on its debts such as to the Exim Bank. I felt that it would be difficult to ask the Fund to put up money for these repayments. For the time being, Brazil also needed money to pay for American exports. I was thinking of the amount that the Banco de Bresil had sold to be delivered after from four to six months. During September, these payments had been in the magnitude of $85 million. Gudin had told me that in October they would probably be somewhat below $60 million. The money needed for these payments ought to come from the American market and not from the Fund.

Hooker said that Brazil ought ~~to have~~ started the thing by defaulting on all its payments, both to the U.S. Government and the World Bank, and also on the payments from the Banco de Bresil. Frank Southard and I reacted and said that it is impossible for a country to have its central bank default on its contractual obligations.

I told them that I would give Paranagua the advice to try to get as much as possible from the New York market before approaching us.

I. Rooth

Draft. For my Braz. file 15/5 54

There is too much liquidity on the money and credit market in Brazil. This is a consequence of the credits given by (a) the Banco do Brasil, and (b) the commercial banks.

The Banco do Brasil is not a proper central bank, but the biggest commercial bank with some central banking functions. Part of the authority that is, as a rule, invested in the central bank is, in Brazil, invested in SUMOC.

The other commercial banks are obliged to pay to the Bank of Brazil the reserve requirements, at present   % of their deposits. This, of course, increases the liquidity of the Bank of Brazil. The Bank of Brazil is not itself obliged to ~~have~~ hold similar reserves against deposits.

The liquidity would be reduced if some means could be found whereby both the amount paid by the commercial banks and the reserve requirements for the Bank of Brazil could be sterilized.

The direct credits by the Bank of Brazil to ~~interstate~~ industry, commerce and agriculture seems to be fairly cautious. The increased money supply ~~due to the~~ because of Bank of Brazil credits are mainly those credits given to the federal governments, the states, the municipalities, and the actions taken ~~a couple of~~ years ago when the Bank of Brazil bought the cotton crop.

As a re-discounting authority the Bank of Brazil has to follow the lines laid down by SUMOC.

The representatives of the staff got the impression that the re-discount facilities could be reduced. The most important thing, in the credit field however, is that the credits to the Government authorities be reduced to a minimum.

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5/15/54

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March 15, 1954
[illegible]

1) Aranha was worried by the fact that the law prescribed a note cover in gold of 25% whereas the present cover was only 11%.

2) I feel strongly that something must be done to tighten the credit market. At present the banks had to pay 15 % of their sight and 10 % of their time deposits to the Banco de Bresil. The maximum limits laid down in the law were 20 % and 20 %. To raise the limits to the maximum will lead to difficulties for some of the banks.

The money paid to the Banco de Bresil is not sterilized. The Banco de Bresil is not only the central bank but also the biggest commercial bank.

Most of those in leading positions in the bank were not central bankers but good commercial bankers. The head of the rediscount department did not have any feeling of the necessity of curbing bank credit. I got the impression that either the general rules for rediscounting, laid down by the Superintendencia, were too liberal or they were not followed.

The rediscount limits seemed in reality to be fixed in relation to the capital and the reserves ~~of~~ a bank. Therefore at least one weak state bank had increased its capital and had the intention of increasing it again.

3) For these reasons, I wonder if it would not be better to try to restrict the credit by either:-

3) (continued)

a) having all the banks including the Bde B pay the amounts of the reserve requirements to someone else than the Bde B, and h ave them effectively sterilized and/or

b) let the bulk of the Government accounts be held in that way.

It may be that such a step or steps might have a too deflationary effect on the credit market for the time being. In such a case, to begin with, only part of the money should be sterilized.

The question is also: how can you sterilize it? Bulhoes said it had been done before. I do not know in which way it was done.

DECLASSIFIED Strictly confidential March 15. 1954

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Kissing   Draft for my Statement for the Board   Confidential

Brazil is still in the midst of an inflation. The most fundamental thing is to stop it. It is impossible, at least this year, to take effective measures to reduce Government expenditure and investments and to curtail credit as there will be elections for the Congress in 1954. The majority of the Governors will also be elected this year. The Presidential election takes place in October 1955. The Brazilian Constitution prevents the re-election of the President immediately after his four-year period.

The Budget deficit for 1953 was estimated at 4.5 billion cruzeiros. Over and above there were deficits in some of the states. The economic situation in the state of Sao Paulo was ~~especially~~ precarious; the Bank of Brazil had been forced to advance substantial amounts to help the state. I got the impression that some more financing of Sao Paulo ~~might~~ will have to be made during this year.

Most of the coffee had been sold. Europe had taken greater quantities than previously. Part of it was now being shipped and the Bank of Brazil got substantial dollar amounts from coffee every day. The frost in Parana would substantially reduce next year's the crop in that state for the next few years.

All the cotton bought by the Bank of Brazil had been sold except 35,000 tons of long staple cotton from the north. The authorities hoped to be able to sell it fairly soon. Most of the other minor export goods that previously had been held by the Bank of Brazil have also been sold. All this had improved the situation considerably.

Brazil would need $270 million dollars for the import of petroleum during 1954. The authorities were still hopeful that there would be a possibility of making a contract with the foreign companies for the exploration of the oil fields. Whether this will be feasible is still an open question.

The northern part of Brazil is suffering from drought and underdevelopment. The sugar industry in that part of Brazil is losing money, whereas sugar in the southern part is a prosperous industry. I was told that the main reason for the distress of the northern sugar industry and the backwardness of the sugar districts was due to the fact that this sugar industry is in the hands of old families that have not understood the necessity for technical improvements and have done less for their workers than in other parts of the country. As a consequence of the distress of the north there was a migration of people to the southern and western states. Sao Paulo, Parana, Matto-Grosso MINAS GERAIS and some other states were therefore roughly in the same situation as the mid-west and west of the United States when the frontier was moving westward.

A great number of apartments and business houses and factories were being built in Rio and Sao Paulo. I was told that last year 624 new factories had been started in the city of Sao Paulo. My friends told me that similar developments took place also in other parts of the State of Sao Paulo and in other states in the middle and the south, among them Minas Gerais and Parana.

The aspects of the inflationary situation have been analyzed in various staff reports and will be brought up to date in the report that the staff mission to Rio will soon submit.

The super-abundance of money and credit is realized only by a few. Also these people consider it necessary to proceed with caution to avoid turning the boom into a crisis. A return to more normal financial and monetary conditions is overdue. Most of the savings, both voluntary and forced, and they are substantial, are invested in real estate, not for reasons of yield, but in order to protect the capital against progressive depreciation. An ordinary capital market is non-existent. People are not interested either in buying bonds or shares. Shares of a company, as a rule, are held by the family and a few friends and are not actively dealt in on the exchanges.

Credit controls have in some respects been tightened. Certain attempts are being made to curb speculation. The building boom has not yet come to an end, although the market in Rio seems to be reaching the saturation point. However, this does not mean that the situation is presently under control.

While I was there the Army took an initiative that led to the firing of the Minister of Labor who had proposed to double the minimum wage. An increase in the minimum wage was considered necessary. A raise from 1200 to 1500 or 1700 cruzeiros per month instead of 2400 as had been proposed by the former Minister was expected. When this happens it will react on prices and will have an impact on the budgets of the Government, the States and the Municipalities.

There are serious bottle necks in the economy, the most important of which are the great shortage of electricity and the lack of transportation. The urban development has been too rapid. Too little has previously been done to help agriculture. One of the advantages of the Aranha plan for imports and exports is the following:

Previously importers were the favoured ones. They made big profits that were invested mainly in buildings in the cities. Now the importers have to pay much higher prices and make less profit. The exporters make more money. Thereby money is being transferred from the cities to the interior of the country.

The old system of import licensing at the then over-valued import rate for the cruzeiro, gave rise to serious misuse. The present auction system has, as I said, reduced the profit of the importers. It yields considerable exchange profits which so far ~~has~~ have materially contributed towards curbing inflation. The auction technique is still complicated. The rates vary greatly for every currency, even in the course of the same auction for goods of the same category. This multiplicity needs to be reduced. We found certain interest for improving the rules.

At present Brazil is making a very serious effort to eliminate the backlog of import payments accumulated in the past. This means, however, that imports for the time being have ~~had~~ to be severely limited. No sterling or Belgian francs had been auctioned ~~when we were there~~ up to the end of our visit. The currency amounts that are auctioned are probably below the needs of the country. We were told that estimates in the budget for the incoming foreign exchange had been careful. The Bank of Brazil hoped after some time to be able to increase the US. $6 million that at present is offered weekly at the auctions. So far a substantial part of the incoming foreign exchange had been reserved for Government needs.

The inventories have been reduced. We were told that in a few industries there were stocks for perhaps a couple of years. On the whole new raw materials, etc. would probably have to be bought after half a year. The authorities hope that the auction system will help to keep the currency situation under control and, given time, allow them to return to a simplified rate structure reflecting the economic realities of the economy. This hope, as so many others, presupposes that inflation will be brought under control.

Brazil had, for the time being, no trade or payments agreement with Argentina. They had been trying to negotiate a new one for several months. Brazil had not bought wheat from Argentina as the price that Argentina wanted to charge was about $100, whereas they can buy from Canada for $73.

A lot of low cost houses were built. They were partly for people belonging to the pension schemes and partly aimed at taking care of the very great number of squatters (more than 300,000) that were living on the slopes and on the outskirts of Rio. It was considered a necessary thing in order to combat Communism.

It was felt strongly in certain quarters that the public service had to be reorganized. The President had ordered a study on the subject to be completed within six months.

Mr. Aranha told us that he was interested in reorganizing the ~~getting a new~~ balance sheet for the Bank of Brazil. [So as to produce a clearer picture of the monetary and financial situation] They had made some studies on the subject both in the Bank of Brazil and in the Superintendencia. He wanted advice on the matter. They should send us their proposals and if necessary we should send someone down to help them.

The Government has sent a bill to Congress proposing to authorize the executive to issue tax-exempted, 3½ percent bonds up to 60 billion cruzeiros. This new issue should be used for the consolidation of all the government (federal, and state, municipal) public debts~~)~~. At present the Federal internal issues amount only to ten billion cruzeiros. The old bond issues should be exchanged for the new ones. The states and municipalities will not be able to take part in the transaction unless they pass laws preventing them from contracting new debts during a ten-year period without the approval of the federal government.

There is no interest for the time being in Brazil for investing in new bonds. In order to make these bonds more attractive, it has been proposed that the interest on the bonds should be paid either in dollar checks on New York or in cruzeiros at the free market rate for dollars. To meet these dollar payments it is proposed that those who export goods to Brazil will have to pay a fee of 3% in foreign exchange before the consular invoice is issued. It was supposed that about 70% of the new bonds ~~were supposed to~~ would be held by the social insurance funds, insurance companies and other organizations, that would collect the interest in cruzeiros. The loss of dollars for Brazil was not expected to be more than, at the maximum, 30%.

I tried to point out to the Brazilian authorities that they were deluding themselves if they believed that these exporting goods to Brazil would take care of the foreign exchange part of the payment. One: all those exporters would not pay the 3% in dollars but also in other currencies. Two: when goods were shipped to Brazil, the cost of the goods would be increased by at least the 3% tax. Three: as the Brazilian importer does not have dollars, he will have to buy them from the Banco do Brazil. This means that he will pay cruzeiros to the Banco do Brazil for that part of the payment corresponding to the 3% paid for the consular invoice. That means a loss of exchange for the Banco do Brazil and will consequently reduce imports to Brazil to that extent. I found that only a few Brazilians were aware of this consequence. I told them that I doubted whether such a bond should be issued and that I felt strongly that it would be a mistake to do it as long as the inflation continues.

I was told that there was hardly any possibility that certain departments of the Banco do Brazil could in the near future be merged with the Superintendencia into a real central bank. A bill for introducing a central bank had also been sent to Parliament.

~~Rates~~
~~Free market~~
~~Supply & in the [illegible]~~
~~demand year.~~
~~Bor B[illegible]~~

K.) Prices

l) Wages

Need for foreign credits.
Brazilian attitude to oil
to electricity.

~~Losses as Govt buys at parity and sold~~

~~1) selling rate 1.73% above par~~
~~2) Tax~~
~~3) auction prices~~

~~$ sold forward - no contraction until paid.~~
~~Flight of capital~~
~~Are people forced to bring home money from abroad~~

INTERNATIONAL MONETARY FUND

TO :

FROM :

What are the reasons for the inflation? 1)
(give ~~examples~~ outline) ~~and~~ What can be done to stop it.
~~Take up each of them~~

a) Budget deficits, (prospects ~~Federal~~ Federal, State (see p. 2)
b) Credit policy
b) ~~Inflationary effect of~~ Auction system. Amounts bought (of) various currencies from beginning to Jan 1st
" sold " .
Continuous payments to exporters.
Much less sold to importers.

c) Bottlenecks of industrial production
Lack of raw-material in any industries?
" " machinery or spare parts?
Lack of electric power
Is anything done to increase electricity production?

d) Too much investments.
By the Govt?
By the States & municipalities — are these investments financed by BdoB
By Industry
For Housing including ~~business~~ office buildings
To what extent financed directly or indirectly by BdoB.

e) Can Govt. State and municipal deficits be met by selling bonds to market?
If not, to what extent has the BdoB to give credits, directly or indirectly?

f) How much is sold of the cotton (and other stocks) held by BdoB or the Govt.
How big were these stocks at end of 1953.
Are these commodities now being sold at world market prices?
Are they sold against for. exch? Which currencies?
To what extent ~~are~~ have they been sold for cruz.?
& when this is done, is the exchange obtained by

INTERNATIONAL MONETARY FUND

TO :

FROM :

the Braz. buyer, sold to BdoB if goods are exported

are there any Govt support prices? If so, then relation to world prices.

Are all Govt exp. in the Budget?

Does the Govt or the states have subsidies outside their budgets?

Balance of payment situation ~~1953 and~~ foreign exchange budget for 1954?

Is ~~this~~ it realistic?

Are the imports at too low a level?

comparison between 1953 exch. budget and factual results

To what extent are for. exch. sold spot? forward?

of buying and selling */

If exchange is sold spot, is the amount held at an a/c with the BdoB or with another bank?

When exchange is sold forward, has the buyer to pay the orig. amount or part of it at once?

Is there a risk for BdoB selling more forward than it has?

How much is ~~now~~ on Jan 1 '54 sold forward?

are BdoB own $ holdings reduced by that amount in the books of the Bank

Even if not more $ are sold forward than held by the Bank ~~there is~~ the risk that after selling forward not enough is available for spot sales after some months.

*) do not forget to ~~–~~ net forward transactions from holdings when computing reserves

to a)

to a)

b) see p. i)

INTERNATIONAL MONETARY FUND

TO :

FROM :

E.L. order to CB. Kafka Rio Feb 54

Gudin

Art 1 - 1947 Revision E.

Closed Feb,

National Council of Economics for 1953

now reducing its national debt

not collect income tax on income from L.A

Open Ex trade,

US company in Brazil 18% tax on profit in Brazil - 50% in USA

23 — 7 - 9 cent in the

1929 80 mil bags destroyed

Sept 51

Jan 52 Speech against for

Bulhoes

Only Govt buys from UK. No auction, ~~no auction of Bfrcs.~~

Bal sheet of B do B — Last annual report or bal sheet Bank of Br. To morrow

Who decides Exch Budget — Council of Superintendencia {Keeps Exp dept receipts Govt their needs

Rates decided by Council of Sup.

CB — Basic period last semester 1953

Effect — Stocks — Vested interests — by the M of F or the President of the Republ

Loans to S Paulo decided by President of Bank after order

Who decides what goods to be auctioned — will they get enough

any in Category II

Bank.

Boff. forecast

Dev. bank after the 5 years. How will they get the cruzeiros money for the Army + higher pay

Agricultural + Industrial credits of B do B

If part of ($42) of export receipts to Germany, this will reduce

Vargas almost resigned

Bolaz [illegible] for [illegible]

2/3

about 50; best negotiator Foreign trade of Br

José Nunes Guimarães Prof, Ec Bdo B Chemistry [illegible]

Roberto Campos, dipl, Los Angeles consul, former dir of Dev B

best economist several years at Econ (middle 30:ies) Braz's best economist

mayflower

25/1,54

Paranagua

1) Deterioration of the rate
Buckley about $30 said B. Not correct now 80 cr; paid promptly (previously 70)
2) Reduce dev. program
3) Way of financing 500 m. for fin.
4) Overimportation. Tighten credit
5) Need a show of strength to get a better rate. No need of it.
6) Mistake to begin with State Dept.
7) Go to Fund.
P. Prepared to go along with a big 30
President will back.

Local financing of development