FOR AGENDA

EBS/83/33

CONFIDENTIAL

February 11, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Brazil - Staff Report for the 1982 Article IV Consultation, Request for Extended Arrangement, and Use of Fund Resources - First Credit Tranche

Attached for consideration by the Executive Directors is the staff report for the 1982 Article IV consultation with Brazil and Brazil's requests for an extended arrangement equivalent to SDR 4,239.375 million and a purchase in the first credit tranche equivalent to SDR 249.375 million. The letter of intent, the technical memorandum of understanding, and the text of the extended arrangement, previously circulated as EBS/83/4 (1/6/83), and Correction 1 (1/17/83), are also attached. Draft decisions appear on pages 36 and 37.

This subject and Brazil's request for a purchase under the compensatory financing facility (document to be issued shortly) will be brought to the agenda for discussion on a date to be announced.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

BRAZIL

Staff Report for the 1982 Article IV Consultation, Request for Extended Arrangement, and Use of Fund Resources - First Credit Tranche

Prepared by the Western Hemisphere and Exchange and Trade Relations Departments

(In consultation with the Fiscal, Legal, and Treasurer's Departments)

Approved by Eduardo Wiesner and W.A. Beveridge

February 10, 1983

I. Introduction

The 1982 Article IV consultation discussions with Brazil were held in Rio de Janeiro and Brasilia during November 29-December 16, 1982.1/ At the same time the mission also negotiated an economic program in support of which Brazil requests access to Fund resources. The representatives of the Brazilian Government included the Ministers of Planning, Finance, and Industry and Commerce; the President and several Directors of the Central Bank; and other senior officials of various ministries, agencies, banks, and corporations of the public sector. The staff mission consisted of Horst Struckmeyer (Head-WHD), Thomas Reichmann (WHD), Hans Flickenschild (ETR), Jose Fajgenbaum (WHD), Ana Maria Jul (WHD), and Moira Sucharov (Secretary-WHD). Mr. Alexandre Kafka, Executive Director for Brazil, participated in the discussions.

In the attached letter dated January 6, 1983, signed by the Minister of Finance and the President of the Central Bank, the Government of Brazil requested access to Fund resources for the equivalent of SDR 4,488.75 million (450 per cent of Brazil's quota), of which SDR 249.375 million under the first credit tranche, and SDR 4,239.375 million in the framework of an extended arrangement for a period of three years. Of the amount requested under the extended arrangement, SDR 1,396.5 million would come from ordinary resources and SDR 2,842.875 million from borrowed resources. The Brazilian authorities are also expected to request a further purchase under the Fund's compensatory financing facility, which will be dealt with in a separate document.

Brazil's request for an extended arrangement is in support of a program described in the attached letter and Technical Memorandum of Understanding, and which is analyzed below. A copy of these documents

1/ The last consultation discussions were concluded by the Executive Board on November 13, 1981. Brazil continues to avail itself of the transitional arrangements of Article XIV.

and of the text of the extended arrangement was circulated to Executive Directors on January 6, 1983 (EBS/83/4, plus Cor. 1). The report on recent economic developments, which will be issued shortly, provides background and statistical information.

Under the requested extended arrangement, up to SDR 1,246.875 million would be available to Brazil in the first year of this arrangement, and up to SDR 1,496.25 million the second year. Purchases during the first year would not exceed SDR 124.875 million until May 31, 1983, SDR 498.875 million until August 31, 1983, and SDR 872.875 million until November 30, 1983. The first credit tranche purchase of SDR 249.375 million would be effected following Board approval of the arrangement.

As of February 1, 1983, Fund holdings of Brazilian cruzeiros stood at 100 per cent of Brazil's quota of SDR 997.5 million. Brazil has had ten stand-by arrangements with the Fund; the last one expired in March 1973 and no purchases were made thereunder. Full use of the requested extended arrangement, together with the requested purchase under the first credit tranche, would raise the Fund's holdings of Brazilian cruzeiros under tranche policy to 550 per cent of quota upon the expiration of the arrangement (Table 1).

II. Background and Recent Economic Developments

Since the mid-1960s the Brazilian authorities have made the attainment of high levels of economic growth and employment, and significant increases in the standard of living, their primary objectives (Chart 1). By matching ample domestic resources with sizable imports of capital and technology, they were highly successful in achieving these objectives until the late 1970s. In the process, important structural changes in the Brazilian economy were effected, resulting in extensive industrialization and a substantial increase in the size and role of the public sector as both investor and regulator.

However, the second oil shock in 1979 forced the authorities to shift attention from economic growth to the need to strengthen the external situation. The adjustment measures taken in late 1979 and early 1980 included fiscal and monetary restraint, a major devaluation of the cruzeiro, and a liberalization of the foreign trade system so as to improve economic efficiency.1/ Rises in foreign interest rates and a weakening of external demand compelled the authorities to adopt additional measures in late 1980 and in 1981 that related to monetary, fiscal, and exchange rate policies. These initiatives met with some success. The current account deficit, which had exceeded US$12 billion (or about 4-1/2 per cent of GDP) in 1980, decreased to US$11 billion (or 3-1/2 per cent of GDP) in 1981.2/ This reduction reflected an

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1/ See SM/80/67 (3/24/80).

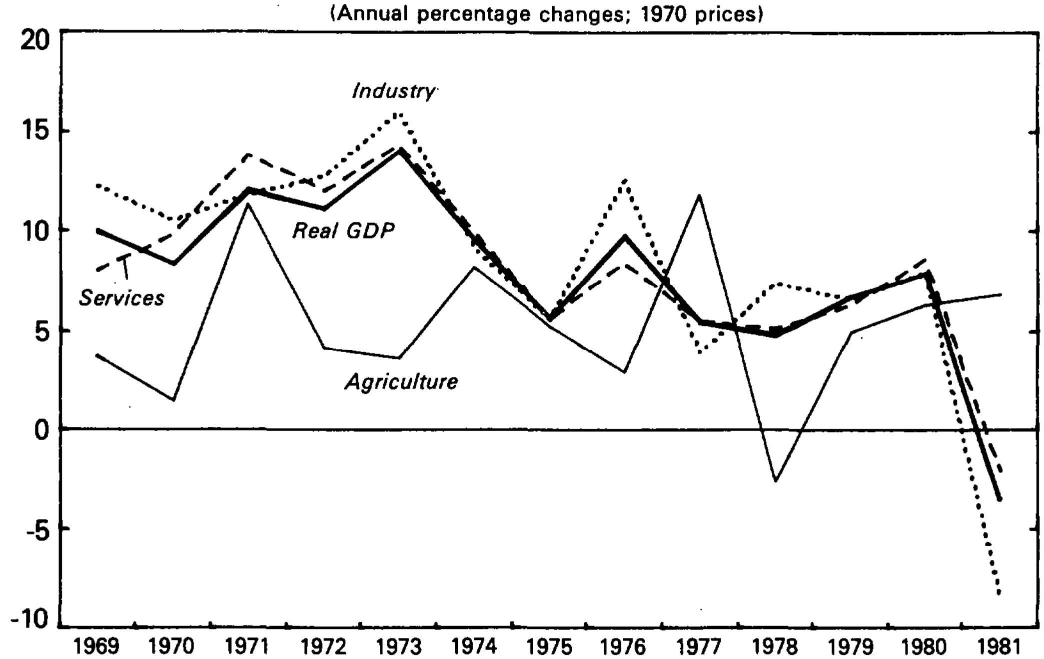
2/ Throughout this paper balance of payments data will exclude reinvested earnings because of the volatility of these transactions and the delay with which reliable information on such earnings becomes available.

CHART 1

BRAZIL

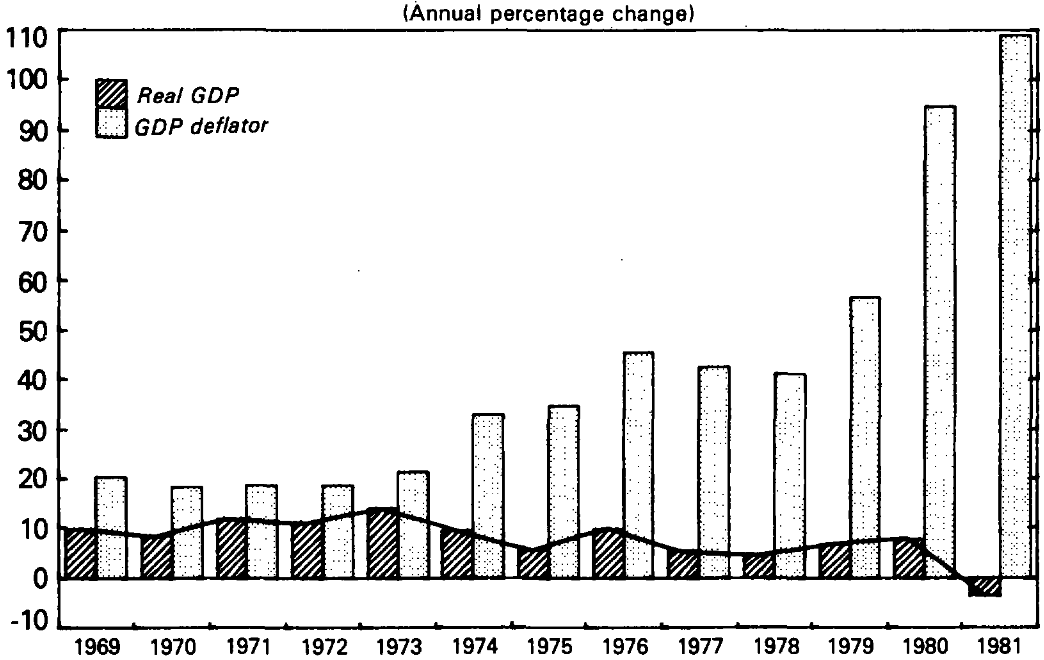
REAL GDP BY MAJOR SECTORS

(Annual percentage changes; 1970 prices)



REAL GDP AND GDP DEFLATOR

(Annual percentage change)



Source: Getulio Vargas Foundation.

Table 1. Brazil: Projection of the IMF Position 1/

	Outstanding Dec. 31, 1982	Operations in March 1983–February 1984: Mar.-May	June-Aug.	Sept.-Nov.	Dec.-Feb.	Total	Operations Mar. 1984–Feb. 1985	Operations Mar. 1985–Feb. 1986
			(In millions of SDRs)					
Purchases	498.8	840.6	374.0	438.5	374.0	2,027.1	1,496.3	1,496.3
EFF	--	124.9	374.0	374.0	374.0	1,246.9	1,496.3	1,496.3
Ordinary resources	(--)	(62.4)	(187.0)	(187.0)	(187.0)	(623.4)	(748.2)	(25.0)
Enlarged access	(--)	(62.4)	(187.0)	(187.0)	(187.0)	(623.4)	(748.2)	(1,471.3)
First credit tranche (ordinary resources)	--	249.4	--	--	--	249.4	--	--
Compensatory financing	498.8	466.3	--	--	--	466.3	--	--
Buffer stock financing	--	--	--	64.5 2/	--	64.5 2/	--	--
Repurchases	--	--	--	--	--	--	--	--
Total holdings (end of period) 3/	1,236.5	2,336.9	2,710.9	3,149.4	3,523.4		5,019.7	6,516.0
Excluding CFF and buffer stock	737.7	1,371.8	1,745.8	2,119.8	2,493.8		3,990.1	5,486.4
			(In per cent of quota)					
Purchases	--	84.3	37.5	44.0	37.5	203.2	150.0	150.0
EFF	--	12.5	37.5	37.5	37.5	125.0	150.0	150.0
First credit tranche	--	25.0	--	--	--	25.0	--	--
CFF and buffer stock	--	46.8	--	6.5	--	53.2	--	--
Total holdings (end of period) 3/	124.0	234.3	271.8	315.7	353.2		503.2	653.2
Excluding CFF and buffer stock	74.0	137.5	175.0	212.5	250.0		400.0	550.0

Source: International Monetary Fund.

1/ Partials may not add up to totals because of rounding.

2/ Estimated on the basis of Brazil fulfilling a maximum stocking obligation of 402,000 metric tons of sugar.

3/ After full use of reserve position of SDR 259.8 million on February 1, 1983.

improvement of US$4 billion in the trade account (the U.S. dollar value of exports grew by 16 per cent while imports declined by 3-1/2 per cent), which more than offset an increase in net interest payments of almost US$3 billion, to over US$9 billion.

Brazil experienced no major difficulties in 1981 in obtaining sufficient foreign credit to finance such a deficit on current account and in rolling over maturing foreign debt. Confidence of foreign lenders in Brazil's economic policy and the acceptance of higher spreads by the authorities enabled Brazil to continue to have access to foreign capital markets on the scale required. Net international reserves increased by well over US$1/2 billion during 1981, and gross official reserves reached US$7-1/2 billion at the end of that year. Brazil's external debt (including short-term) grew from US$63 billion at the end of 1980 to US$72 billion a year later, reaching the equivalent of 24 per cent of GDP. It should be stressed that Brazilian foreign debt statistics include both public and private debt.

The tightening of demand policy in 1980-81 slowed economic growth. Real GDP, which had expanded by 8 per cent in 1980, decreased by 3-1/2 per cent in 1981,1/ mainly because of a decline in industrial production. Rigidities in the official wage formula, as well as the widespread indexation in the economy, prevented substantial progress toward reducing the rate of inflation in 1981; by year-end, the 12-month rate of price increases was 95 per cent, compared with 110 per cent in December 1980 and a peak of 121 per cent in March 1981.

Brazil's economic performance suffered another serious setback in 1982. Output is likely to have stagnated, the rate of inflation has remained at nearly 100 per cent, and the external situation weakened considerably. The latter reflected the decline in international commodity prices, weak foreign demand, growing international protectionism, and economic difficulties in countries that had recently become important buyers of Brazilian industrial products. Moreover, because 1982 was an election year,2/ domestic demand policies had also become somewhat looser in the earlier part of 1982; public sector spending rose at practically all levels, and there were delays in implementing planned increases in prices and reductions in subsidies.

As it became increasingly clear during the second half of 1982 that the trade surplus of US$3 billion forecast at the beginning of the year would not be achieved and, as the access to international capital

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1/ At a later stage, industrial output was re-estimated, and this had the effect of reducing the decline in real GDP to 1.9 per cent; however, no breakdown of the expenditure components exists for this new set of data.

2/ These were the first nationwide elections since 1964 and determined the composition of Congress, the leadership at the state and local levels, and the electoral college that will elect the next President of the Republic in 1985.

markets was reduced sharply, the Brazilian authorities proceeded to tighten domestic demand management and exchange and trade restrictions. In the monetary area, reserve requirements were raised on demand deposits and imposed for the first time on term deposits; also, access to consumer credit was curtailed. In the fiscal area, central government spending was tightened, which enabled the Central Administration to make larger transfers to the monetary authorities as partial reimbursement for transactions carried out on account of the Government.

With respect to the external sector, the authorities extended the tax on exchange purchases to all travel expenses abroad and introduced a long list of import prohibitions. They accelerated the pace of the minidevaluations of the cruzeiro, thereby producing for the year as a whole a small real depreciation against the U.S. dollar and reversing most of the real appreciation that the cruzeiro had registered against the currencies of Brazil's major international competitors during the first eight months of 1982.

Preliminary information on Brazil's balance of payments performance (Chart 2) reveals that the U.S. dollar value of exports fell by over 13 per cent, to US$20.2 billion in 1982, mostly because of a decline in volume; last year's decrease in the nominal value of exports was the first since 1967. The value of imports fell by more than 12 per cent in 1982, to US$19.4 billion, with the oil bill decreasing by more than 6 per cent, to US$10.3 billion. The trade surplus amounted to US$0.8 billion in 1982, compared with a surplus of US$1.2 billion in 1981 and a deficit of US$2.8 billion in 1980. Net service payments rose by US$3 billion, to US$15.2 billion, mainly reflecting higher payments for interest and travel. In all, the current account deficit rose by almost US$3-1/2 billion in 1982 to US$14.4 billion, equivalent to 4.5 per cent of GDP.

Because of the tightening of international capital markets, Brazil was able to cover only US$6.9 billion of the current account deficit through net capital inflows, leaving an overall balance of payments deficit of US$7.5 billion to be covered through a loss in net international reserves. Largely because of a decline in gross disbursements of financial loans and net repayments of suppliers' credits, net long-term capital inflows fell by US$3.3 billion. In addition, net short-term inflows recorded a negative swing of US$1.6 billion last year. At the end of 1982, net official international reserves were negative by a large amount, and Brazil's external debt outstanding (including short-term) had increased to over US$81 billion from US$72 billion a year earlier; in 1982, such debt was equivalent to 25 per cent of GDP. During 1982 external short-term liabilities rose by US$2.7 billion, including a US$2.2 billion increase in reserve liabilities.

III. The Adjustment Program

Brazil's present economic problems can be related not only to the external events of the immediate past but also to the conditions under which the country achieved rapid growth over the past 15 years or so. In the mid-1960s Brazil launched an impressive export-led growth process by relying increasingly on foreign borrowing to supplement domestic savings. Even the two oil shocks of the 1970s did little to change this growth-cum-debt strategy; however, in the process many distortions were introduced into the economy. The volume of investment effort and the size of individual projects led to an increase in the scope of the state enterprise sector. The activities that were being stimulated, such as exports and agriculture, received a wide range of incentives, especially through ample and subsidized bank credit. The external tariff mechanism has been distorted through widespread exemptions, a process that gave rise to protection through quantitative restrictions and exchange measures. The need to placate the labor force in the inflationary environment that has prevailed led to the enactment of wage legislation which, through its indexation provisions, became a key factor in the perpetuation of inflation. The wage law contained provisions that worked to raise real wages of certain groups faster than the growth of productivity; it also contributed to an increase in unemployment and a weakening of Brazil's external situation. The need to secure a constant net inflow of foreign funds and to manage a rapidly growing volume of external debt has constrained the authorities in their exchange and interest rate policies.

1. Strategy and objectives

The present state of international financial markets and prospects for the period ahead make it clear that the economic development path followed by Brazil in the past is no longer feasible, and that a fundamental change in the country's economic strategy is required. For the coming years Brazil will no longer be able to rely, to the extent it has in the past, on foreign resources to finance its development effort. Rather, future investment and growth will depend mainly on the generation of larger domestic savings.

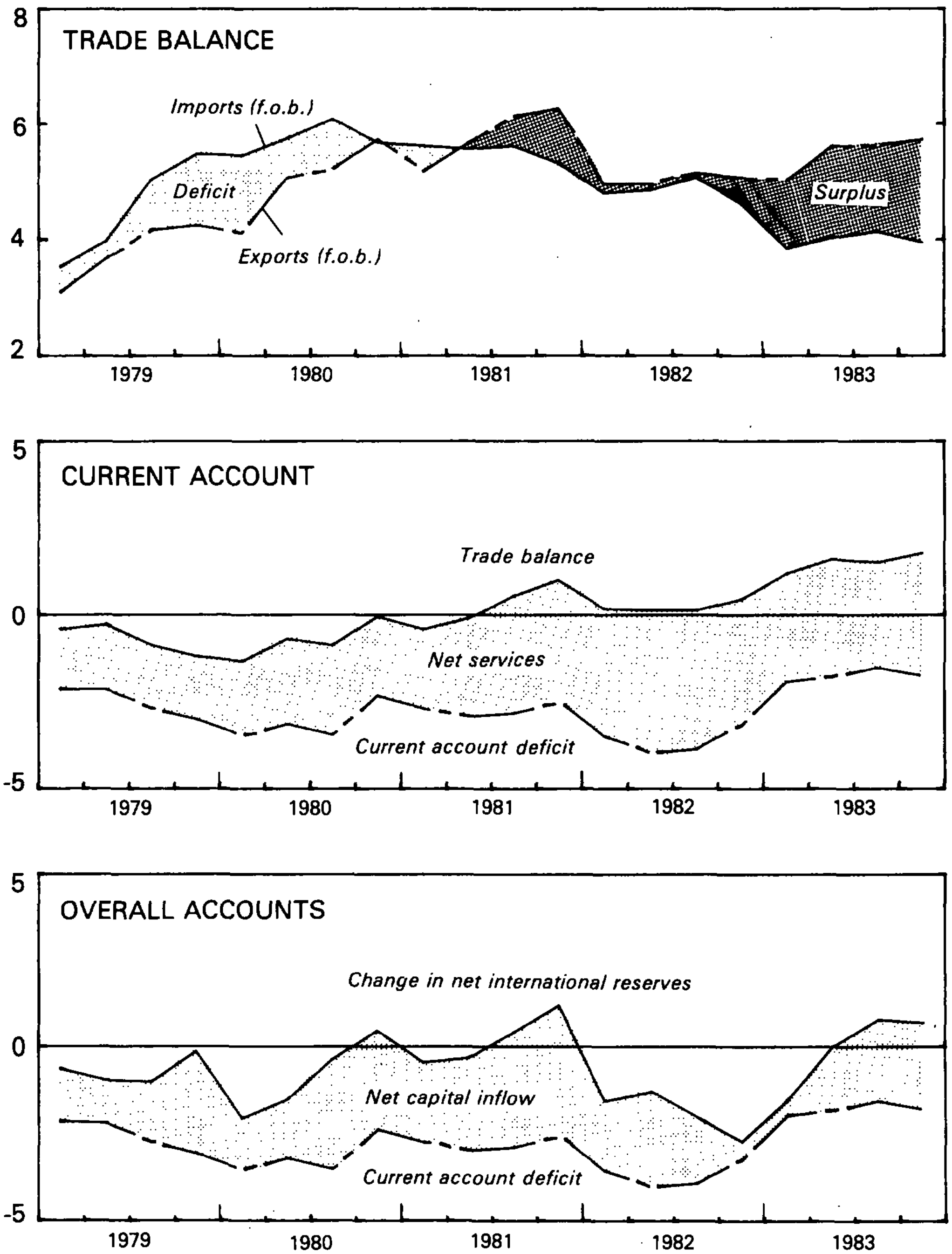
The economic program, which the Brazilian authorities have adopted, aims at a very substantial adjustment in the first year and more gradual ones in the second and third years. To effect the needed adjustment, the economic program entails a significant reduction in domestic spending, in particular in the public sector, and a substantial strengthening of domestic savings. In order to limit the negative effect on the standard of living, which is implied in such adjustment, the authorities intend to raise economic efficiency through a liberalization of the economy early in the program period. In the first year such liberalization will relate mainly to domestic price and administrative restrictions; the timing of the removal of external restrictions will depend on how quickly the foreign exchange constraint eases. During the second

CHART 2

BRAZIL

QUARTERLY BALANCE OF PAYMENTS

(In billions of U.S. dollars)



Source: Central Bank of Brazil; and Fund staff estimates.

and third years, the authorities intend to eliminate all remaining trade restrictions and exchange measures and to proceed with the liberalization of the domestic economy.

As will be evident from the description below, the economic program adopted by the Brazilian Government foresees most of the adjustment measures to be effective in the first year so as to bring about the substantial reduction in the external imbalance that is required in 1983. Reflecting the tightness of international financial markets and the low level of Brazil's international reserves, the deficit on current account of the balance of payments is to be reduced by almost US$7-1/2 billion in 1983, from nearly US$14-1/2 billion in 1982, to US$7 billion this year; in terms of GDP, the current account deficit would decline from 4.5 per cent to 2.2 per cent, respectively. Further reductions to 1-1/2 per cent of GDP in 1984 and about 1 per cent of GDP in 1985 are envisaged.

The anticipated strengthening of the current account should greatly reduce the need for foreign borrowing. Net disbursements of financial loans (almost exclusively from foreign banks), which declined by US$2 billion, to US$6.7 billion, in 1982, should fall further to US$3.6 billion in 1983 and, eventually, to US$3 billion in 1985. This development should reduce the ratio of debt service payments to exports of goods and services from 85 per cent in 1982 to 69 per cent in 1983 and 55 per cent in 1985. Gross official reserves are projected to increase moderately, and net international reserves to remain constant, in 1983; projected surpluses of US$1 billion in 1984 and US$2 billion in 1985 in the overall balance of payments should further strengthen Brazil's reserve position.

The key factor in achieving these external objectives is a significant reduction in the financial imbalance of the public sector. The program contains in its first year cumulative quarterly ceilings on the financing requirement of the nonfinancial public sector that limit it to 7.9 per cent of GDP in 1983 as a whole, compared with 13.8 per cent of GDP in 1982. The public sector financing requirement is slated to be reduced further to about 5 per cent of GDP in 1984 and some 4 per cent in 1985.

Monetary policy will reflect these changes in the stance of fiscal policy. The reduced need for recourse to the domestic financial system of the public sector will mitigate the crowding-out of the private sector that has occurred in previous years. Also, the major cutback in credit subsidies to agriculture in 1983, and the elimination of practically all credit subsidies over the program period, should enable the monetary authorities to strengthen the conduct of monetary policy by relying less on quantitative credit restrictions and more on instruments affecting the pricing of financial resources.

The authorities recognize that a continuation of the past high rates of domestic inflation would be harmful to investment and future economic growth. Therefore, the economic program aims at a reduction in the year-end rate of inflation from 100 per cent in 1982 to 70 per cent in 1983. The reduction in the rate of inflation will have to be slower at the beginning of the program period because of corrective price increases and the near-total indexation of the economy that can only be reduced over time. The rate of inflation is to be brought down further to about 40 per cent in 1984 and 20 per cent in 1985.

The economic program is designed to produce significant changes in the structure of domestic expenditure and in the financing of investment (Table 2). From 1977 to 1982, domestic consumption outlays grew from under 78 per cent of GDP to over 81 per cent; over this period gross domestic investment fell from 22.7 per cent of GDP to 19.1 per cent, and gross domestic savings fell from 20-1/2 per cent to 14-1/2 per cent. The result was that the recourse to foreign savings rose from 2.2 per cent of GDP in 1977 to 4.6 per cent in 1982. The reduction of 2.4 percentage points of GDP in the use of foreign savings programed for 1983 will bring the resource gap back to the level recorded in 1977; it will be achieved on the basis of an increase in the domestic savings ratio of 1.3 percentage points of GDP and a decline in the investment ratio of 1.1 percentage points.

Beginning in 1984, gross domestic investment is expected to grow again but, with domestic savings growing faster than investment, the current account deficit of Brazil's balance of payments should continue to fall. By 1985 consumption is anticipated to have fallen to 77 per cent of GDP, domestic investment to have increased to 21 per cent of GDP, and domestic savings to have advanced by 5-1/2 percentage points over the program period, to 20 per cent of GDP.

Growth prospects for 1983 are rather poor. The required cutback in domestic spending is likely to keep domestic output depressed, and real GDP might decline by some 3-1/2 per cent.1/ It is expected that the implementation of the program will allow a return to economic growth in 1984; real GDP is projected to increase by 2 per cent in that year and by 4 per cent in 1985.

2. Price and incomes policies

a. Price policy

The Brazilian representatives explained that during 1980-81 the authorities had largely dismantled the system of controls that had covered the prices of a wide range of goods and services produced by the private and public sectors. Only the prices of a limited number of goods and services, mostly produced by the public sector, had remained

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1/ The official forecast is for economic growth of 1 per cent in 1983.

Table 2. Brazil: National Accounts Statistics

	1977	1978	1979	1980	Prel. 1981	Projected 1982	1983	1984	1985
	(In billions of cruzeiros)								
GDP at market prices	2,523	3,730	6,239	13,104	26,441 1/	51,560	88,580	134,640	179,230
Rate of change in real GDP	5.4	4.8	6.7	7.9	-3.5 1/	--	-3.5	2.0	4.0
Rate of change in GDP deflator	42.4	41.1	56.8	94.6	109.1	95.0	78.0	49.0	28.0
Rate of change in nominal GDP	50.2	47.8	67.3	110.0	101.8	95.0	71.8	52.0	33.1
GDP in billions of US$	178.4	206.4	231.5	283.5	301.8	320.0	322.0	341.0	372.0
Net factor payments abroad	-40	-84	-163	-404	-1,017	-2,210	-3,320	-4,510	-5,320
GNP at market prices	2,483	3,646	6,076	12,700	25,424	49,350	85,260	130,130	173,890
Current account deficit on goods and services	56	127	287	686	1,107	2,350	1,920	1,970	1,900
Gross domestic expenditure	2,539	3,773	6,363	13,386	26,531	51,700	87,180	132,100	175,820
Consumption	1,965	2,996	5,129	10,617 2/	21,380 2/	41,870	71,220	105,150	138,000
Gross domestic investment	574	777	1,234	2,769 2/	5,151 2/	9,830	15,960	26,950	37,810
Gross domestic savings 3/	518	650	947	2,083	4,044	7,480	14,040	24,980	35,890
	(In per cent of GDP)								
Consumption	77.9	80.3	82.2	81.0	80.9	81.2	80.4	78.1	77.0
Gross domestic investment	22.7	20.8	19.8	21.1	19.5	19.1	18.0	20.0	21.0
Nonfactor current account	-0.6	-1.1	-2.0	-2.1	-0.4	-0.3	1.6	1.9	2.0
Net use of foreign savings 4/	2.2	3.4	4.6	5.2	4.2	4.6	2.2	1.5	1.0
Gross domestic savings 3/	20.5	17.4	15.2	15.9	15.3	14.5	15.8	18.5	20.0

Sources: Getulio Vargas Foundation; and Fund staff estimates.

1/ A special computation for 1981 estimates GDP for that year at Cr$26,863 billion, which corresponds to a rate of change with respect to 1980 of -1.9 per cent. No further breakdown of this revised estimate is available.
2/ Changes in stocks for 1980 and 1981 are included under consumption.
3/ Includes net transfers from abroad.
4/ Includes reinvested profits.

under control. At first, these prices had been adjusted in line with cost developments; during the election year of 1982, however, the rates of increase in the prices for some of these goods and services had fallen behind with respect to inflation. The result was that some implicit subsidies emerged, and, in the case of imported products (e.g., wheat), foreign purchases were stimulated. To redress this situation, the authorities have begun to implement the following measures:

(1) Fuel prices

The prices of gasoline, alcohol, and diesel were adjusted on December 29, 1982 by 16 per cent, 17 per cent, and 21 per cent, respectively; these price increases offset fully the decline in real fuel prices that had occurred during the earlier part of 1982. Since fuel imports account for over one half of total imports, the pricing of these products is of particular importance. One key factor of the economic program is the intention of the authorities to modify the prices of fuel products as a group during 1983, at intervals of about two months and rates that, on average, will be 1.5 percentage points a month above the rate of inflation. For 1983 as a whole, this policy will result in a real increase of almost 20 per cent. While the increase in the price of gasoline will be somewhat below average, price adjustments for diesel, fuel oil, and cooking gas will be above average.1/ This price policy is expected to lead to a reduction in domestic consumption of 9 per cent in 1983 which, together with a moderate (2 per cent) decline in the import unit price and a 22 per cent increase in domestic oil output,2/ is estimated to result in a reduction of almost 15 per cent in the oil bill. In the light of recent oil market developments, the projected decline in oil prices may be underestimated. It is interesting to note that a change in the oil price of US$1 per barrel has an impact of about US$250 million per year on the oil bill. It is also anticipated that this projected path of adjustments of fuel prices will result in a contraction of the oil account in the Central Bank; this account comprises the subsidies to oil consumption accumulated over the past years, and at the end of 1982 it amounted to Cr$145 billion.

With respect to the program period after 1983, it is expected that continued increases in domestic oil output as well as a continuation of price policies designed to encourage fuel conservation and substitution will reduce the oil bill further in absolute nominal terms in 1984 and 1985. It is interesting to note that domestic output is covering an ever-growing share of total fuel consumption, which is close to 30 per cent at present and will reach some 60 per cent in the last program year.

1/ At the end of 1982 gasoline sold at the equivalent of US$2.51 per gallon, and diesel at US$1.53 per gallon.

2/ During 1981 and 1982, domestic output rose by 17 per cent and 22 per cent, respectively.

(2) Nonagricultural goods and services

The prices for steel, public utilities, and transportation were raised recently, thereby improving the financial situation of the (mostly public) companies in those sectors. The prices of a number of other goods and services are being adjusted. The price of electricity was raised by almost 20 per cent in December 1982 (for a total of 103 per cent during 1982). With excess capacity already existing in the generation of electric energy and the huge hydroelectric project Itaipu coming on stream soon, the authorities are studying ways of granting preferential prices for electricity consumption in certain economic activities, such as production for export, and to those companies that convert from the use of fossil fuel to that of electricity.

(3) Wheat

Despite a reduction in real terms over the past three years or so, a sizable subsidy (equivalent to about US$1-1/2 billion) still remains on wheat consumption. This subsidy will be reduced by over 40 per cent during 1983 and eliminated altogether during the program period. As most of the wheat consumed in Brazil is imported, such a price policy should have a positive impact on the balance of payments.1/

(4) Sugar

In the first year of the program the authorities intend to reduce by some 15 per cent the producer subsidy for sugar, which amounted to the equivalent of about US$1 billion in 1982, reflecting the low international prices that prevail; there will be substantial further reductions in the second and third years. Any subsidy that might still be in existence by the end of 1985 will be paid through the fiscal budget and not, as at present, directly by the monetary authorities. The Brazilian representatives stressed that the removal of this subsidy had to be gradual because a large part of the sugar was produced in the economically depressed Northeast region of the country and often constituted the only agricultural activity that climate and soil in that area would tolerate.

In general over the period of the extended arrangement, the authorities intend to follow pricing policies that will prevent the reemergence of subsidy payments and will eliminate practically all subsidies in the economy. The authorities also intend to reduce their role in the domestic marketing of agricultural products, which they now play through direct purchases and extension of credit.

b. Wage policy

The Government has played an important role in the process of wage determination. In order to protect real incomes in Brazil's inflationary environment, various kinds of automatic wage adjustment formulae

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1/ Wheat imports amounted to US$0.8 billion in 1981.

have been applied over the years. However, as all of them tie wage and salary adjustments overwhelmingly to past inflation, anti-inflation policies have been seriously hampered by this rigid indexation.

From November 1979 until late January 1983 the official wage formula applicable to workers and employees of the nonagricultural private sector and the state enterprises provided for semiannual wage adjustments of 110 per cent of past inflation on that portion of their remuneration that was equivalent to 3 minimum wages, 100 per cent for the part equivalent to 3-10 minimum wages, 80 per cent for the part equivalent to 10-15 minimum wages, and 50 per cent for the part equivalent to 15-20 minimum wages; increases in remuneration in excess of 20 minimum wages were left to free negotiation. Minimum wages have been adjusted generally in line with inflation over the years.

In addition to the automatic wage and salary adjustments, there were further annual adjustments for presumed increases in productivity. These increases, which were negotiated between employers and employees, typically were in the range of 3 to 5 per cent, irrespective of whether advances in productivity could be documented. Although workers and employees of the Central Administration were not subject to the official wage formula, they were granted comparable increases.

The result of this wage policy was an upward pressure on labor costs, which aggravated unemployment and increased the practice of labor rotation in the private sector whereby workers are dismissed prior to their annual wage adjustment date and rehired elsewhere at lower real wages. While the latter practice has tended to lower labor costs, it has also reduced labor productivity because of the inefficiencies inherent in such a system of high labor turnover. Labor rotation was not practiced in the state enterprises; as a result, the wage bill of these enterprises has shown real increases over the past years.

In late January 1983, the Brazilian Government issued a decree-law 1/ modifying the wage formula. The new formula contains the following new rates and brackets: an adjustment of 100 per cent of past inflation on that portion of labor remuneration that is equivalent to 3 minimum wages; an adjustment of 95 per cent to the part equivalent to 3-7 minimum wages; an adjustment of 80 per cent to the part equivalent to 7-15 minimum wages; an adjustment of 50 per cent to the part equivalent to 15-20 minimum wages; and no adjustment to the portion above 20 minimum wages.2/ The authorities consider the latest change in wage legislation as a first step toward the eventual introduction of a system of collective bargaining.

1/ This decree-law could theoretically be repealed by the new Congress after it convenes in March 1983.

2/ The latter provision is interpreted as a floor, allowing higher adjustments on incomes above 20 minimum wages through free bargaining.

The new formula is superior to the old one in that it abolishes the principle of adjusting incomes up to 3 minimum wages by 110 per cent of inflation; over two thirds of the labor force covered by this wage formula receives remunerations of 3 minimum wages or less. Even though the new formula will reduce significantly the rate of increase in wage adjustments that would have resulted from an application of the old one, real wages will still increase by some 2-5 per cent in 1983, depending on what path of deceleration is assumed to arrive at the targeted rate of price increase of 70 per cent at the end of 1983. However, more important than what happens to the calculated wage is how the real wage bill of the economy develops. The average general wage increase (i.e., exclusive of individual promotions) in the Central Administration has been limited to 65 per cent in 1983, which would imply a reduction of 7-1/2 per cent in real terms. The Brazilian representatives contend that the wage bill of the state enterprises and the private sector will also decline in real terms this year because: (1) a directive has been issued to the state enterprises, limiting the annual growth rates of their wage and salary outlays in each month to the rate of inflation during the previous 12 months; this implies that any real increases in individual remunerations resulting from promotions, etc., will have to be offset by a reduction in the payroll; (2) the Ministry of Labor would be issuing guidelines shortly to the labor courts tying productivity adjustments in 1983 to the change in per capita income during 1982, which would result in no adjustment for productivity this year; (3) compliance with the monetary policy as agreed in the economic program will induce enterprises to increase labor rotation and reduce the payroll; and (4) the national consumer price index, which is used for wage adjustments, will be modified to exclude the effects of the acceleration of the currency depreciation and of corrective price increases, so as to facilitate changes in relative prices at home and in international transactions.

3. Fiscal policies

The largest contribution to the adjustment process will be made by the public sector. The borrowing requirement of the public sector 1/ has been made subject to quarterly ceilings under the requested extended arrangement. That requirement had grown from the equivalent of 7.1 per cent of GDP in 1980 to 13.8 per cent in 1982, but it is to be reduced to 7.9 per cent in 1983; this corresponds to a reduction of 45 per cent in real terms. As can be seen from Table 3, over half (3.3 per cent of GDP) of the targeted improvement of 5.9 per cent of GDP in the finances of the public sector is to come from the Central Administration. Wide-ranging revenue measures, almost all of which are already in place, should produce additional receipts equivalent to

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1/ This requirement covers (1) net credit from the domestic banking system; (2) changes in private sector holdings of public debt; (3) changes in the floating debt of the state enterprises; and (4) net foreign financing of the Central Administration, state enterprises, and state and local governments.

1.9 per cent of GDP. Reductions in expenditures are to yield a financial improvement of 1.4 per cent of GDP; these reductions refer mainly to outlays that the monetary authorities make on behalf of the Central Administration and reflect the policy of eliminating subsidies.

Table 3. Brazil: Public Sector Adjustment Effort

(As per cent of GDP)

	Est. 1982	Proj. 1983	Change
Central Administration	6.4	3.1	3.3
Revenues	9.1	11.0	1.9
Expenditures	15.5	14.1	1.4
State and municipal governments	2.7	1.9	0.8
Debt	0.7	0.5	0.2
Banking system credit	2.0	1.4	0.6
State enterprises	5.0	3.2	1.8
Revenues	15.5	16.6	1.1
Treasury transfers	3.1	2.9	-0.2
Expenditures	23.6	22.7	0.9
Wages	(3.3)	(3.4)	(-0.1)
Interest payments	(2.2)	(2.6)	(-0.4)
Capital and other	(18.1)	(16.7)	(1.4)
Other institutions	-0.3	-0.3	--
Total	13.8	7.9	5.9

Sources: Ministry of Finance; Ministry of Planning; Central Bank of Brazil; and Fund staff estimates.

The adjustment effort in the state enterprises is targeted to yield an equivalent of 1.8 per cent of GDP on the strength of improved pricing policies and a cutback in investment outlays. The financial position of the state and local governments, which had become particularly expansionary during 1982, is to improve by the equivalent of 0.8 per cent of GDP, mainly through a curtailment of their access to domestic bank financing.

a. Central Administration

The improvement in the finances of the Central Administration that is expected can be traced in Table 4. On the strength of an increase in revenues of 16 per cent in real terms, transfers of the Central

Administration to the monetary authorities are expected to more than double in real terms in 1983; these transfers compensate for expenditures made on behalf of the Government. Transfers to the rest of the public sector are expected to show a moderate increase in real terms, as existing legislation will give the state and local governments a share of the new revenues that will result from recent tax measures. However, wage and salary outlays and other expenditures will decline in real terms, reflecting mainly tight control over personnel outlays.

Table 4. Brazil: Central Administration Accounts

(In billions of cruzeiros; and in per cent)

	1981		Est. 1982		Proj. 1983	
	Value	Real Percentage Change	Value	Real Percentage Change	Value	Real Percentage Change
Revenues	2,334	-8.9	4,719	3.7	9,735	15.9
Expenditures 1/	2,009	8.0	4,084	4.3	7,365	1.3
Wages and salaries	256	-0.9	550	10.2	920	-6.0
Transfers	1,407	12.0	2,722	-0.8	4,985	2.9
To state enterprises	(975)	(21.5)	(1,802)	(-5.2)	(3,085)	(-3.8)
To state and municipal governments	(432)	(-4.8)	(920)	(9.2)	(1,900)	(16.0)
Other expenditures	346	0.5	812	20.3	1,460	1.0
Transfers to monetary authorities	325	-53.6	635	0.2	2,370	109.7

Sources: Ministry of Finance; Ministry of Planning; and Fund staff estimates.

1/ Excludes expenditures made by the monetary authorities on behalf of the Central Administration.

The strong increase in Treasury revenues, after allowance for inflation, is based on a number of measures whose yield is estimated to be equivalent to almost 2 per cent of GDP in 1983 (Table 5). The most important of these new tax measures is a modification of the income tax law approved in November 1982, which provides for the indexation for inflation of tax liabilities as well as a reduction (from 20 months to 12 months) in the period during which corporate tax obligations have to be paid. There were also other modifications to the income tax legislation. These measures are to be strengthened further by specific action to reduce tax evasion and broaden the tax base; such action is to include an increase in personnel and in funds for the appropriate administrative units of the Ministry of Finance. This year's projected fiscal revenues will reflect also a surcharge of 5 percentage points on the sales tax and an increase in the tax on diesel. Furthermore, there has been an increase in the taxation of tobacco and some alcoholic beverages, and a rise in the tax on sugar and alcohol consumption from 20 per cent to 30 per cent. Also, tax exemptions on imports into the free trade zone of Manaus have been eliminated, and certain fiscal incentives have already been reduced substantially, with the remainder being slated for complete elimination in the near future. The authorities are considering further tax action, such as an increase in taxation on non-alcoholic beverages and beer, and they also intend to submit to Congress a tax reform bill later this year.

Table 5. Brazil: Estimated Yield of New Tax Measures

(In per cent of GDP)

	Est. 1982	Proj. 1983	Change
Central Administration	9.1	11.0	1.9
Tax revenues	8.6	10.5	1.9
Income tax	(3.0)	(3.8)	(0.8)
Taxes on goods and services	(4.7)	(5.7)	(1.0)
IPI (value-added tax)	/2.2/	/2.3/	/0.1/
Energy	/0.8/	/1.0/	/0.2/
Services	/1.4/	/2.1/	/0.7/
Other	/0.3/	/0.3/	/--/
International trade	(0.6)	(0.5)	(-0.1)
Other	(0.3)	(0.5)	(0.2)
Nontax revenues	0.5	0.5	--

Sources: Ministry of Finance; Ministry of Planning; and Fund staff estimates.

The authorities also intend to maintain the social security system financially self-sustainable. The finances of the system had suffered a serious deterioration in 1981. However, an increase in the rate of contributions and some reduction in benefits have improved significantly the financial position of that system. Moreover, the indexation for inflation of benefits was scaled down recently in line with the new wage formula.

b. State enterprises

The budgets that were recently approved for the state enterprises point to a dramatic improvement in their finances, as can be seen in Table 6; the projected reduction in the overall deficit for 1983 is equivalent to more than one third in real terms.

Table 6. Brazil: State Enterprises' Accounts

(In billions of cruzeiros; and in per cent)

	1981		1982		Proj. 1983	
	Value	Real Percentage Change	Value	Real Percentage Change	Value	Real Percentage Change
Revenues	4,081	-0.8	8,051	1.2	14,755	3.0
Transfers from Central Administration	823	17.0	1,585	-1.2	2,570	-8.9
Expenditures	6,027	8.2	12,204	3.8	20,200	-7.0
Current	3,649	2.5	7,904	11.1	14,060	-0.1
Wages and salaries	(811)	(4.5)	(1,707)	(7.9)	(3,040)	(--)
Interest	(366)	(36.2)	(1,122)	(57.2)	(2,320)	(16.2)
Other	(2,472)	(-1.7)	(5,075)	(5.3)	(8,700)	(-3.7)
Capital	1,856	0.4	3,866	6.8	6,000	-12.8
Other	522	...	434	...	140	...
Overall deficit	-1,123	21.1	-2,568	17.3	-2,875	-37.1
Financing	1,123	21.1	2,568	17.3	2,875	-37.1
Foreign (net)	111		570		1,565	
Domestic (net)1/	996		1,600		1,425	
Floating debt and other	16		398		--	
Bonds	--		--		-115	

Sources: Ministry of Planning; Central Bank of Brazil; and Fund staff estimates.

1/ Mostly from banking system.

Revenues of the state enterprises are projected to increase by 3 per cent in real terms in 1983, compared with 1 per cent in 1982 and a decline of nearly 1 per cent in 1981. The improvement in revenues anticipated for 1983 reflects mainly the changes in pricing policies referred to above.

The volume of expenditures of the state enterprises is expected to decline by 7 per cent this year, as against rates of increase of 4 per cent in 1982 and 8 per cent in 1981. Current outlays are estimated to decline marginally in real terms this year, despite a 16 per cent real increase in interest payments on foreign debt. Wage outlays are not expected to grow in real terms this year. The volume of investment spending is projected to decline by almost 13 per cent. As was indicated above, investment outlays of the state enterprises have grown rapidly over the past years; the decline anticipated in 1983 reflects the winding down of some big projects, such as the hydroelectric project "Itaipu", and a deliberate slowing of the execution of ongoing projects. The largest reductions are programed for investments in steel (-57 per cent), roads (-28 per cent), hydroelectricity (-23 per cent), and nuclear electricity (-22 per cent). Also, no major new investment projects 1/ will be initiated during 1983.

Despite the significant improvement projected in the finances of the state enterprises, their recourse to foreign financing in 1983 is to nearly triple over last year's level. It is assumed that Brazil's limited access to international capital markets will affect mostly private borrowers; state enterprises, on the other hand, will be using their advantage of being able to offer a better (often government) guarantee and to tie their borrowing closer to the execution of a specific project, to pick up the slack of the private sector. In this way, domestic resources will be freed for use by the private sector.

The investment policy with respect to the state enterprises will be reviewed for 1984 and beyond in the light of the progress made this year in adjusting Brazil's external accounts. In general, the authorities intend to scale down the size of the public sector and reduce the number of state enterprises. Except for those that have a special social or development function to fulfill, all other state enterprises will be treated like private companies and, therefore, will need to become financially self-sustaining.

4. Monetary policies

The Brazilian representatives said that, despite significant improvements in some areas over the past few years, monetary policy had continued to be affected unfavorably by the existence of substantial subsidies to interest rates (among others) and special credit programs that were largely dependent upon funds from the monetary authorities.

1/ With the exception of parts of the Carajas complex (mining and forestry), which are fully financed from abroad.

In order to strengthen the conduct of monetary policy, the National Monetary Council had adopted in late 1982 a tight monetary budget for 1983, together with several other monetary measures.

Foremost among these measures was the program of gradual increase in interest rates on loans to agriculture, which breaks with a long tradition of such rates having been negative (at times heavily negative) in real terms in Brazil. The substantial subsidization of agricultural credit has been a serious impediment to the conduct of monetary policy. The volume of credit to that sector has been very difficult to control and funds destined for agriculture have been diverted to other sectors. Also, the portfolio requirements for lending to agriculture and for other purposes at subsidized rates forced banks to charge higher rates on loans to other sectors of the economy.

The new program of reducing the subsidization of agricultural loans involves a detailed set of prescriptions differentiating the rate of interest according to the type of loan (e.g., planting, investment or commercialization), according to the region (Center-South or North-Northeast), and according to the economic size of the recipient (small, medium, large); a detailed description of these regulations can be found in Section II of the recent economic developments report. Interest rates to be applied to new agricultural credits will be determined every six months. Those in effect for the first half of 1983 imply an annual rate of 65 per cent for planting and investment loans; this compares with a rate of 45 per cent in effect previously. The rate of interest on loans for the commercialization of agricultural products will remain unchanged at 45 per cent; somewhat lower rates of interest for all three types of loans apply in the North and Northeast regions of the country. However, the actual rate paid will be higher because agricultural borrowers, depending on their size, can obtain only between 40 per cent and 90 per cent of their credit needs at subsidized rates, the remainder having to be procured at market rates.

The authorities said that this change in policy would result in an average nominal rate of interest on new bank loans to agriculture as a whole equal to--or slightly above--the rate of inflation expected by the end of 1983. During the second and third years of the program period, the authorities intend to subject lending to agriculture more and more to market conditions, with special treatment continuing to be given, however, to the economically depressed areas of the North and Northeast of Brazil. The cost of whatever preferential treatment might be left at the end of the program period will be covered for the most part by the fiscal budget.

Another important element in the strengthening of monetary policy in 1983 was to be the increase of up to 10 percentage points, to a maximum of 45 per cent, of the legal reserve requirement on sight deposits as well as the introduction for the first time of a reserve requirement (5 per cent) on term deposits. Also, the discount rates charged by the Central Bank were increased from a range of 47-58 per cent to one of 105-130 per cent; the rates of the Bank of Brazil for commercial loans were raised from a range of 60-64 per cent to one of 80-95 per cent.

However, in early January 1983 the monetary authorities decided to reduce the legal reserve requirement on sight deposits to the former maximum of 35 per cent. Around the turn of the year, they also lowered the discount rate of the Central Bank to a range of 70-93 per cent and the commercial loan rate of the Bank of Brazil to one of 72-78 per cent. In addition, they reduced by one third the tax on bank loans (previously at 6.9 per cent per annum). These measures were taken to reduce the very high real rates of interest (30 per cent and more) that apply to industrial and commercial loans 1/ and to ease the credit squeeze created by the near absence of foreign funds for on-lending.

The tightening of monetary policy entailed in the economic program is evident in Table 7 which gives a projection for 1983 of the summary accounts of the monetary authorities. It should be pointed out that the data for the end of 1982 are estimates based on actuals for September 1982, and that they are subject to various elements of uncertainty, including those stemming from the unusual external events of the last quarter.

Table 7. Brazil: Summary Accounts of Monetary Authorities

(In billions of cruzeiros; and in per cent)

	1981		Est. 1982		Proj. 1983	
	Value	Real Rate of Change	Value	Real Rate of Change	Value	Real Rate of Change
Net foreign assets	1,100	-9.1	832	-62.1	1,490	5.3
Net domestic assets	1,283	39.9	3,500	36.6	5,800	-2.5
Net claims on public sector	-133	...	201	...	-759	...
Credit to private sector	1,966	-14.7	3,305	-15.8	5,467	-2.7
Official capital and surplus	102	...	899	341.5	2,918	90.9
Medium- and long-term foreign liabilities	-641	3.6	-1,218	-4.8	-2,753	33.0
Other	-11	...	313	...	927	74.2
Liabilities to private sector	2,383	12.0	4,332	-9.0	7,290	-1.0

Sources: Central Bank of Brazil; and Fund staff estimates.

1/ See Appendix to the recent economic developments report.

The projection of net foreign assets is consistent with the balance of payments target of equilibrium in 1983 of the economic program. The net domestic assets, which are subject to quarterly ceilings, are projected to decline by 2-1/2 per cent in real terms during 1983; this compares with a rate of increase of 37 per cent in real terms during 1982. In reflection of the tightening of fiscal policy referred to above, the financial position of the public sector is expected to swing from that of a debtor at the end of 1982 to one of a creditor at the end of this year. Credit to the private sector, which had been declining by about 15 per cent in real terms in both 1981 and 1982, is projected to develop in line with net domestic assets and the pace of economic activity.

After increasing by 12 per cent in real terms in 1981, liabilities to the private sector declined by 9 per cent in 1982; they are projected to fall by 1 per cent in real terms this year. The effect of the anticipated decrease in real GDP is expected to be partly offset by a further slowdown of income velocity of money because of improved confidence and the projected reduction in the rate of inflation. Also, the equivalent of over US$1 billion in deposits on foreign borrowing, which form part of these liabilities to the private sector, is expected to be withdrawn in the course of this year.

A projection of monetary and credit aggregates for the entire banking system is presented in Table 8. Net bank credit to the public sector is expected to decline by some 17 per cent in real terms in 1983, leading to a substantial reduction in the crowding out of the private sector. The rate of credit expansion to the private sector is estimated at over 10 per cent in real terms during 1983 as a consequence of the deliberate support to the export sector, and--as mentioned above--higher recourse to domestic funds for lack of foreign funds. The projected growth in net domestic assets and liabilities to the private sector in 1983 reflects the effect of the intended real depreciation of the exchange rate on the valuation of loans, other domestic assets, and deposits denominated in foreign currency. Excluding this effect, the real value of net domestic assets is estimated to remain constant, and that of liabilities to the private sector to increase by some 2 per cent in 1983.

Table 8. Brazil: Summary Accounts of the Banking System; End of Period

(In billions of cruzeiros; and in per cent)

	1981		Est. 1982		Proj. 1983	
	Value	Real Rate of Change	Value	Real Rate of Change	Value	Real Rate of Change
Net foreign assets	532	...	-291	...	-74	...
Net domestic assets	8,326	62.8	18,340	10.3	31,964	2.5
Public sector (net)	3,216	23.1	7,351	14.5	10,401	-16.8
Social security funds (net)	-2,549	7.1	-5,368	5.5	-9,125	--
Private sector	10,230	-3.1	21,233	3.9	40,233	11.5
Long-term foreign liabilities	-2,682	8.5	-5,935	10.8	-11,900	17.9
Other	111	...	1,059	377.7	2,355	30.8
Liabilities to private sector	8,858	6.8	18,049	2.0	31,890	3.9

Sources: Central Bank of Brazil; and Fund staff estimates.

5. External policies

While most of the improvement in Brazil's external position projected for 1983 is expected to come from a reduction in imports of goods and services, the further decline in the current account deficit targeted for 1984 and 1985 is based mainly on the assumption of a growth rate of exports, which is modest by past Brazilian standards (Table 9).

The U.S. dollar value of exports is projected to increase by less than 9 per cent in 1983 on the strength of an estimated 4 per cent rise in export prices and a 5 per cent advance in volume. Among the products whose foreign prices are expected to register increases are coffee, meat, orange juice, paper pulp, and various types of manufactures. The programed real effective depreciation of the cruzeiro, slack domestic demand conditions, and particular attention to exports (e.g., special domestic credit facilities) should help increase export volume. A continuation of appropriate exchange rate policies and some recovery of the world economy are the principal factors behind the projected average growth rate of about 14 per cent a year in the value of exports in 1984 and 1985.

Table 9. Brazil: Balance of Payments

(In billions of U.S. dollars)

	Actual		Prel.	Projected		
	1980	1981	1982	1983	1984	1985
Trade balance	-2.8	1.2	0.8	6.0	8.0	9.2
Exports	20.1	23.3	20.2	22.0	25.7	28.8
Oil	(0.4)	(1.3)	(1.7)	(1.8)	(2.0)	(2.3)
Other	(19.7)	(22.0)	(18.5)	(20.2)	(23.7)	(26.5)
Imports	-22.9	-22.1	-19.4	-16.0	-17.7	-19.6
Oil	(-9.8)	(-11.0)	(-10.3)	(-8.8)	(-7.9)	(-7.3)
Other	(-13.1)	(-11.1)	(-9.1)	(-7.2)	(-9.8)	(-12.3)
Services and transfers	-9.6	-12.2	-15.2	-13.0	-13.0	-13.2
Interest (net)	-6.3	-9.2	-11.0	-9.5	-9.0	-8.7
Other	-3.3	-3.0	-4.2	-3.5	-4.0	-4.5
Current account 1/	-12.4	-11.0	-14.4	-7.0	-5.0	-4.0
(In per cent of GDP)	(4.4)	(3.6)	(4.5)	(2.2)	(1.5)	(1.1)
Capital account	9.0	11.8	6.9	7.0	6.0	6.0
Direct investment	1.1	1.6	1.1	1.5	1.6	1.8
Financial loans	4.1	8.7	6.7	3.6	3.4	3.0
Disbursements	(8.6)	(14.0)	(11.5)	(8.4)	(8.8)	(9.7)
Amortization	(-4.5)	(-5.3)	(-4.8)	(-4.8)	(-5.4)	(-6.7)
Other long-term (net)	0.6	1.2	0.1	2.1	1.5	1.7
Brazilian lending abroad (net)	0.4	-0.9	-0.6	-1.1	-0.5	-0.5
Short-term and errors and omissions (net)	2.8	1.2	-0.4	0.9	--	--
Overall balance	-3.4	0.8	-7.5	--	1.0	2.0
Change in net official reserves (increase -)	3.4	-0.8	7.5	--	-1.0	-2.0
Assets 2/	3.2	-0.9	4.8	-0.8	-2.6	-3.6
Liabilities	0.2	0.1	2.7	0.8	1.6	1.6
IMF	(--)	(--)	(0.5)	(2.2)	(1.6)	(1.6)
Other	(0.2)	(0.1)	(2.2)	(-1.4)	(--)	(--)

Sources: Central Bank of Brazil; and Fund staff estimates.

1/ Excludes reinvested earnings.
2/ Adjusted for valuation changes and gold monetization.

The U.S. dollar value of merchandise imports is estimated to decline by 17-1/2 per cent in 1983. The value of oil imports should fall by 14-1/2 per cent as a result of a 2 per cent reduction in prices and an almost 13 per cent reduction in volume. The latter reflects the change in the pricing policy for petroleum products referred to above, and a continued increase in domestic oil output. The value of non-oil imports is projected to decline by 21 per cent this year on the basis of the tightening of demand management that is programed, the modification of the exchange rate policy, and the substantial quantitative import restrictions that were introduced in late 1982. However, it is assumed that imports will begin to grow again toward the end of this year, as an easing of the foreign exchange situation should make it possible to start to loosen the controls over imports.

The U.S. dollar value of total imports is projected to grow by 11 per cent a year in 1984 and 1985. Increased conservation and domestic output should reduce the oil bill by 10 per cent in 1984 and 7-1/2 per cent in 1985, despite estimated increases of 5 per cent and 4.5 per cent, respectively, in the price of imported oil. On this basis, there could be a significant recovery of non-oil imports in 1984 and 1985, in line with the expected domestic economic recovery and the need to replenish inventories. Reflecting the new pricing policy for fuels and the increase in domestic oil output, the net oil bill (imports less exports) is estimated to decline from nearly US$10 billion in 1981 to US$7 billion in 1983; a further reduction to US$5 billion is foreseen by 1985.

The deficit on service and transfer account, which amounted to over US$15 billion in 1982, is expected to decline to US$13 billion in 1983 and to remain at that level in 1984 and 1985. Net interest payments are projected to decrease by US$1-1/2 billion, to US$9-1/2 billion, in 1983. With over 80 per cent of Brazil's external debt estimated to carry flexible interest rates, a change in LIBOR of 1 percentage point results in a change in interest payments of more than US$1/2 billion a year in interest payments, with a time lag of about one-half year. The effective LIBOR applicable to the variable rate element of Brazil's external debt, which amounted to 16 per cent in 1982, is estimated at 11 per cent for the first and 10 per cent for the second semester of 1983. For 1984 these rates were estimated at 10 per cent and 9 per cent, and for 1985 at 9 per cent and 7-1/2 per cent, respectively. These anticipated declines in international interest rates as well as receipts from a buildup in gross official reserves explain the continuing decline in net interest payments projected for 1983-85. Other service payments are heavily influenced by the payments of freight and insurance on imports.

In all, the current account deficit is expected to be reduced from about US$14-1/2 billion in 1982 to US$7 billion in 1983, US$5 billion in 1984, and US$4 billion in 1985.

Capital account projections involve various elements of uncertainty. Direct investment, which is estimated to have declined to just over US$1 billion in 1982, is expected to receive a boost in 1983 from a recent measure which provides special tax advantages for conversions of foreign financial loans into direct investment. It is expected that the level of foreign direct investment can be increased moderately in 1984 and 1985 as foreign confidence in Brazil is strengthened and export competitiveness is improved.

The item "financial loans" of Table 9 refers mostly to credits from international banks and to a minor extent to lending by Brazilian banks abroad and intercompany loans. The projected net disbursement of US$3.6 billion, which is about one half the amount recorded in 1982, assumes--among other transactions--bank disbursements of US$1.2 billion on loans committed in 1982 and of US$4.4 billion on loans to be committed in 1983, as well as rolling over US$4 billion of amortizations that become due in the course of 1983.1/ Brazil is working closely with several large international banks to secure the required new loans, roll over of amortizations (both short- and long-term), and maintain the access to the international money markets that Brazilian banks abroad had in mid-1982. In 1984 and 1985 it is expected that, with the anticipated improvement in the current account, there will be further reductions in the reliance on loans from the international banking community.

Other long-term capital inflows comprise those from international development organizations, foreign governments, and suppliers. The projected increase in net disbursements from an exceptionally low US$0.1 billion in 1982 to US$2.1 billion in 1983 reflects mainly accelerated disbursements under existing loans and new quick-disbursing facilities in support of the Brazilian economic program by foreign governments and the World Bank. During 1984 and 1985 such capital flows are expected to return to the more normal levels recorded in previous years.

The more than doubling to US$1.1 billion that is anticipated in net Brazilian lending abroad during 1983 is directly connected with the increased export effort this year. Net short-term capital inflows are estimated at just under US$1 billion in 1983, mainly on the strength of a lengthening of the financing terms of oil imports from the present 30-40 days to 70-80 days. This projection of short-term capital movements in 1983 is heavily predicated on the assumption that short-term, trade-related credits to Brazilian banks and enterprises will show little or no change from 1982.

1/ To facilitate the orderly and equitable implementation of the requested rollover of amortization payments, the Brazilian monetary authorities required debtors in Brazil to make amortization payments falling due from the start of 1983 into an account maintained at the Central Bank.

b. Exchange and trade policies

The Brazilian representatives noted the real appreciation of the cruzeiro that had taken place during part of 1982 (Chart 3). Staff calculations show that this real appreciation amounted to over 6 per cent with respect to the U.S. dollar during the first six months of 1982 and to 18-1/2 per cent with respect to the currencies of Brazil's principal export markets 1/ during the first eight months of last year. However, an acceleration of the rate of nominal depreciation of the cruzeiro during the second half of 1982 has not only fully offset the earlier appreciation vis-a-vis the U.S. dollar but has resulted in a real depreciation of 3 per cent for all of 1982. Also, in view of the decline in the external value of the U.S. dollar in late 1982, most of the real appreciation of the cruzeiro with respect to the currencies of major export markets had been erased by the end of 1982.

For 1983 the Brazilian authorities have adopted a policy that calls for a rate of depreciation of the cruzeiro with respect to the U.S. dollar that--on average--will be the equivalent of 1 percentage point above the rate of domestic inflation. This commitment is a minimum quarterly performance criterion under the requested extended arrangement. For 1983 as a whole, this exchange rate policy will result in a real depreciation of the cruzeiro in terms of the U.S. dollar of almost 13 per cent, exclusive of any allowance for U.S. inflation. The real effective depreciation of the cruzeiro against the currencies of other countries, of course, will depend on the behavior of the U.S. dollar in international currency markets.

Brazil's trade and payments system is highly complex and features many distortions and restrictions. As exemptions and reductions have weakened the tariff mechanism, protection has been effected by quantitative and exchange restrictions. To stem the rapidly deteriorating balance of payments situation, in September 1982 the authorities prohibited a substantial number of imports, tightened regulations on certain invisible payments, and subjected tourist expenditures abroad to the financial transactions tax. In October 1982 these measures were supplemented by a tightening of the requirement that import payments be made on improved financing terms. Moreover, the practice of negotiating import programs between the Government 2/ and importers, which has been in effect with varying degrees of stringency since 1981, has been tightened since late 1982.

Changes in exchange practices subject to Fund approval under Article VIII since the last consultation include: (1) the extension of the scope and duration of the export tax credit system (credito premio),

1/ These countries absorbed two thirds of Brazilian exports in 1981. For more details, see Section VII of the recent economic developments report.

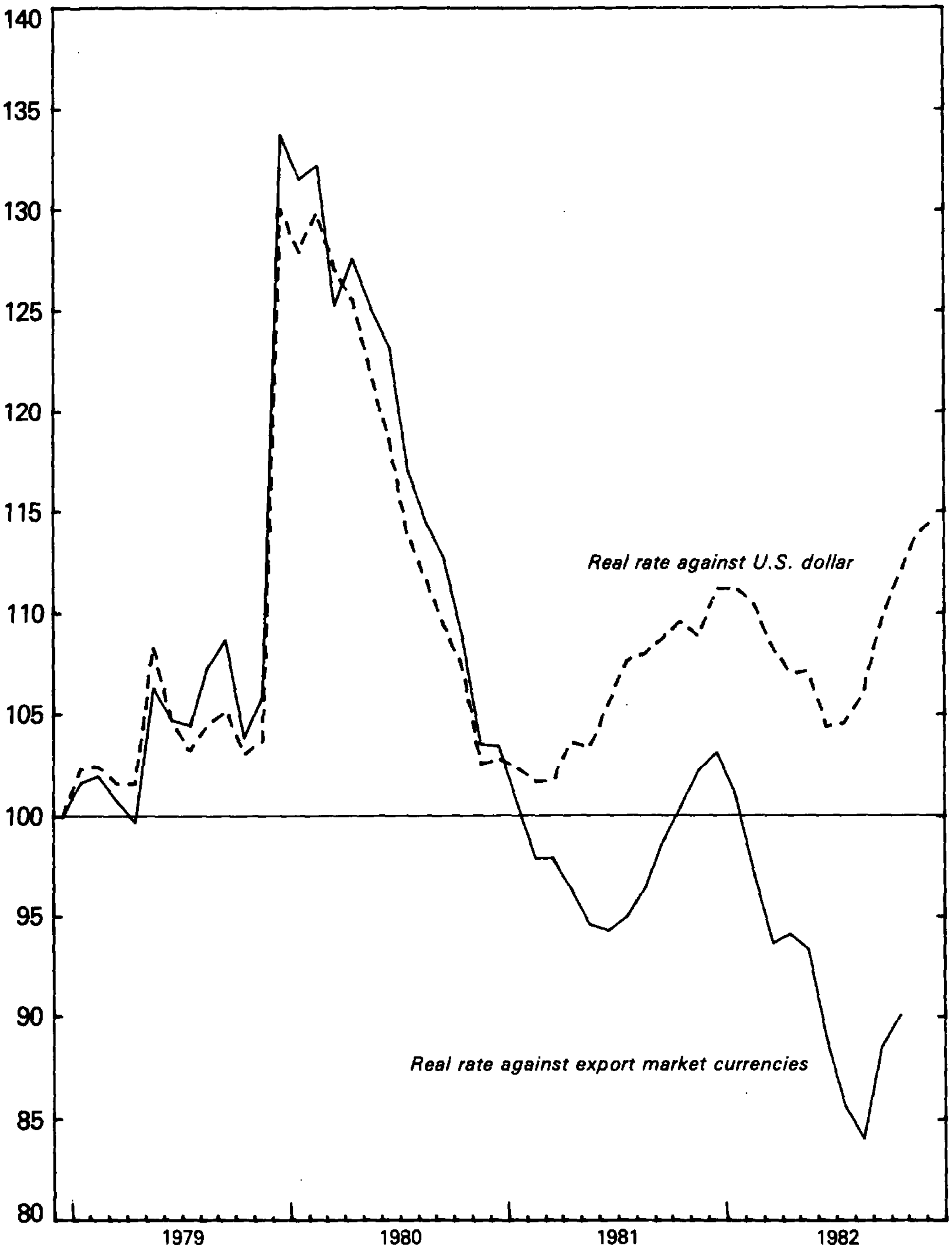
2/ Through the foreign department of the state-owned Bank of Brazil, CACEX.

CHART 3

BRAZIL

EFFECTIVE EXCHANGE RATE INDICES

(December 1978=100)



Source: IMF data Fund and Fund staff estimates.

along with the imposition of offsetting export taxes on selected exports receiving such tax credits if shipped to the United States; (2) the extension of the financial transactions tax to exchange purchases for travel abroad; (3) the reduction of the export taxes on beef cattle hides and, on a temporary basis, on orange and tangerine juice; and (4) the reclassification of Brazil's bilateral payments agreement with Hungary as requiring Fund approval under Article VIII following Hungary's accession to Fund membership in May 1982.

In view of the tight payments situation and the large adjustment required in the external current account in 1983, the authorities stated that they needed to retain temporarily the system of export tax credits and the financial transactions tax on certain current payments (hereafter called "major exchange measures"). As Brazil's external situation improves, the authorities intend to give priority to a relaxation of the quantitative import restrictions in order to stimulate growth and economic efficiency. Consequently, it is possible that little progress will be made in 1983 to reduce reliance on the major exchange measures. However, in the letter of intent the authorities have stated that, should there be a significant decline in the external value of the U.S. dollar during 1983, the resulting real effective depreciation of the cruzeiro with respect to the currencies of Brazil's major trading partners will be used to reduce the scope of these exchange measures after review with the Fund. In addition, the authorities intend to eliminate during the first year of the arrangement a number of minor exchange restrictions and multiple currency practices (items 1-3c below), and--as a first step--they recently abolished the supplementary graduated income tax on remittances of dividends of investment companies. In any case, they have stated that all exchange measures will be eliminated by the end of the program period.

The following exchange practices remain subject to Fund approval under Article VIII: (1) limits on the availability of foreign exchange for outward remittances in respect of technical assistance fees and royalty payments; (2) bilateral payments agreements with Hungary and Romania; (3) multiple currency practices arising from (a) the application of contribution quotas to exports of coffee, cocoa, and wild animal hides, (b) the export taxes on cornmeal, beef cattle hides, and--after expiry of the temporary exemption--orange and tangerine juice, (c) the imposition of a graduated supplementary tax on outward remittances of profits and dividends on direct investment when such remittances average more than 12 per cent of nonresident capital over a three-year period, (d) the imposition of the financial transactions tax on specified imports of goods and services, and (e) the tax credits given to exporters of manufactured goods; and (4) a discriminating multiple currency practice arising from the taxes on the export of certain manufactured goods to the United States.

c. External debt policies

In order to honor Brazil's external debt obligations, given the extreme tightness of foreign financial markets, the authorities had to use a substantial part of their official international reserves in the second half of 1982. The Brazilian representatives pointed to the good maturity structure of Brazil's external debt, which includes also private foreign debt, and underscored that only a relatively small portion of total disbursed debt was contracted at short-term maturities (Table 10).

The Brazilian representatives stated that Brazil intends to continue to service the country's external debt as scheduled. In line with this objective, the economic program for 1983-85 has as its principal objective the substantial reduction in the deficit on current account of the balance of payments. However, even a reduction of this magnitude would not be sufficient to allow an orderly discharge of the scheduled debt service, in light of the conditions in international financial markets. Therefore, the Brazilian authorities requested from the international banking community collaboration on four separate projects; achievement of the targets of these projects is indispensable for the success of the economic program: (1) provision of new long-term financial loans of US$4.4 billion in 1983; (2) rollover of US$4 billion of amortizations falling due in 1983; (3) rollover of some US$9 billion in trade-related short-term lines of credit; and (4) maintenance of money market facilities to Brazilian banks abroad at the level recorded in mid-1982 or end of 1982, whichever is higher (estimated at about US$10 billion).

As of this writing, the response to the Brazilian request has been generally positive. Practically all of the required new long-term funds have been pledged and agreement on the rollover of short- and long-term debt falling due is near. It has been more difficult to reestablish access by Brazilian bank agencies abroad to money markets; however, a satisfactory solution to this problem, consistent with the objectives of the economic program, is expected to be found soon.

Implementation of the economic program should result in much lower growth rates in Brazil's external debt during 1983-85. Specifically, bank exposure, which had grown by 20-1/2 per cent in 1981 and almost 15 per cent in 1982, should increase by less than 6 per cent in 1983, less than 5 per cent in 1984, and about 4 per cent in 1985. The debt servicing is expected to decline from 85 per cent of exports of goods and services in 1982 to 69 per cent in 1983, 59 per cent in 1984, and 55 per cent in 1985.

6. Cooperation with the World Bank

Prior to the recent negotiation of the economic program with Brazil, Fund staff requested and received information on the nature and scope of the present and prospective lending programs of the Bank vis-a-vis Brazil to ensure as much as possible the compatibility between Bank and

Table 10. Brazil: External Debt

(In billions of U.S. dollars)

	1980	1981	June 30 1982	Prel. 1982	Projected 1/ 1983	1984	1985	1986	1987
Total debt	62.8	72.0	75.3	81.3	85.6	90.5	95.2	99.7	104.1
(In per cent of GDP)	(22.1)	(23.8)	(23.5)	(25.4)	(26.6)	(26.5)	(25.6)	(24.6)	(23.5)
Bank loans	47.8	57.6	61.6	66.1	69.9	73.3	76.3	79.4	82.3
Other sources	15.0	14.4	13.7	15.2	15.7	17.2	18.9	20.3	21.8
Medium- and long-term debt	53.8	61.4	64.4	68.0	76.0	80.9	85.6	90.1	94.5
Bank loans	38.8	47.0	50.7	54.2	60.3	63.7	66.7	69.8	72.7
Foreign banks	(34.6)	(41.0)	(44.0)	(47.5)	(53.5)	(56.9)	(59.9)	(...)	(...)
Brazilian banks	(4.2)	(6.0)	(6.7)	(6.7)	(6.8)	(6.8)	(6.8)	(...)	(...)
Other sources	15.0	14.4	13.7	13.8	15.7	17.2	18.9	20.3	21.8
Short-term debt	9.0	10.6	10.9	13.3	9.6	9.6	9.6	9.6	9.6
Bank loans	9.0	10.6	10.9	11.9	9.6	9.6	9.6	9.6	9.6
Foreign banks	(...)	(9.8)	(10.0)	(11.7)	(9.4)	(9.4)	(9.4)	(...)	(...)
Brazilian banks	(...)	(0.8)	(0.9)	(0.2)	(0.2)	(0.2)	(0.2)	(...)	(...)
Other sources	--	--	--	1.4	--	--	--	--	--
Memorandum items									
Use of Fund resources	--	--	--	0.5	2.8	4.4	6.1	5.4	4.6
Interest payments 2/	7.5	10.3	6.1	12.2	10.7	10.6	10.2	10.2	10.5
Amortization 3/	6.7	7.5	3.8	7.9	7.2 4/	7.5	8.6	13.4	15.9
Debt service	14.2	17.8	9.9	20.1	17.9	18.1	18.8	23.6	26.4
(In per cent of exports of goods and services)	(60.9)	(66.2)	(86.0)	(85.4)	(68.8)	(59.7)	(55.1)	(61.5)	(61.1)
Increase in bank exposure 5/ (in per cent)	...	20.5	...	14.8	5.7	4.9	4.1	4.1	3.7
Of which: foreign banks	(...)	(...)	(...)	(16.5)	(6.3)	(5.4)	(4.5)	(...)	(...)

Sources: Central Bank of Brazil; and Fund staff estimates.

1/ Besides the assumptions specified in the text, the projections incorporate the following additional ones: (1) debt contracted in 1983 and beyond has a maturity of eight years, including a three-year grace period; (2) spreads over LIBOR are 2.25 per cent for 1983, 2.0 per cent for 1984-85, and 1.8 per cent for 1986 and 1987; (3) LIBOR remains at 7.5 per cent during 1986-87; (4) the interest rate on fixed-rate loans is 10 per cent for loans disbursed in 1983, 9 per cent for loans disbursed in 1984-85, and 8 per cent for loans disbursed in 1986-87; (5) GDP in terms of the U.S. dollar grows by 9 per cent in 1986 and 1987; and (6) exports of goods and services grow by 12.5 per cent in 1986 and 1987.

2/ Includes IMF charges and interest on short-term debt.

3/ Includes IMF repurchases in 1986 and 1987.

4/ Includes US$4.0 billion to be refinanced.

5/ In relation to bank loans to Brazil outstanding at the beginning of each year.

Fund supported programs, and to learn about the possible contribution of the Bank over the period of the requested extended arrangement. Upon return to headquarters, further staff contacts took place between the two institutions to discuss the Brazilian economic program and to review the need for additional financial support from the Bank to Brazil.

The Bank supports the economic program of the Brazilian Government and recently sent a mission to Brazil to determine, among other things, how it can best assist the Brazilian efforts of re-establishing external and domestic balance with adequate economic growth. As a short-term response, the Bank is considering operations that are quick disbursing and do not unduly increase claims on public sector resources. Discussions have been initiated on sector loans to industry and agriculture, and some other operations consistent with the above criteria are under consideration.

With respect to the medium and long term, the Bank intends to assist Brazil in the development of plans that take account of the prospects of lower economic growth rates and reduced availability of external resources.

7. Performance criteria and review clause 1/

The program, in support of which Brazil is requesting an extended arrangement, contains the following performance criteria: (1) a set of cumulative quarterly ceilings on the change of the net international reserve position of the monetary authorities, which requires equilibrium in the balance of payments for 1983 but allows for seasonal variations (paragraph 1 of the Technical Memorandum of Understanding attached to the letter of intent, Attachment III); (2) a set of cumulative quarterly limits on the global borrowing requirement of the nonfinancial public sector (paragraph 2 of the Technical Memorandum); (3) a set of cumulative quarterly ceilings on the net domestic assets of the monetary authorities, consistent with the balance of payments targets (paragraph 3 of the Technical Memorandum); (4) a set of cumulative quarterly limits on net disbursement of medium- and long-term external debt of both the public and private sectors, plus changes in the net position of certain types of short-term indebtedness (paragraph 4 of the Technical Memorandum); (5) a set of cumulative quarterly minimum requirements in respect of the rate of real depreciation of the cruzeiro with respect to the U.S. dollar (paragraph 5 of the Technical Memorandum); and (6) a special review clause requiring consultation with the Fund prior to August 30, 1983, i.e., before the third purchase can be effected, as well as annual reviews to reach understandings with the Fund before the beginning of the second and third years of the program on suitable performance clauses for those years of the extended arrangement (paragraph 29 of the letter of intent, Attachment II).

The program contains also the customary injunctions against the introduction and intensification of exchange and trade restrictions.

1/ Quantitative performance criteria are presented in Table 11.

Table 11. Brazil: Extended Arrangement, Quantitative Performance Criteria for the Period through December 1983

	Actual Sept. 1982	Est. Dec. 1982	Targets and Limits for 1983 Jan.-March	Apr.-June	July-Sept.	Oct.-Dec.
			(In billions of cruzeiros)			
Limit on borrowing requirement of nonfinancial public sector	...	7,140	1,200	3,200	5,000	7,000
Limit on expansion of net domestic assets of monetary authorities	2,415	3,500	4,050	4,650	5,150	5,800
			(In millions of U.S. dollars)			
Cumulative change in net international reserves of monetary authorities	...	...	-1,500	-1,500	-700	--
Limit on net disbursements of medium-, long-, and selected short-term external debt of the public and private sectors	...	...	2,000	3,000	4,000	6,000
			(In per cent)			
Cumulative minimum requirement for real depreciation of cruzeiro against the U.S. dollar	...	...	3.0	6.2	9.4	12.7

Source: Fund staff estimates.

IV. Staff Appraisal and Proposed Decision

After some 15 years of rapid economic growth, which was aided by sizable imports of capital and technology, it has become evident that there has to be a change in Brazil's economic strategy, including a reduction in the reliance on foreign borrowing and the need for more domestic saving. The substantial adjustment measures, which started to be taken in late 1979, produced by 1981 a moderate reduction in the rate of inflation and in the current account of Brazil's balance of payments, but at the same time they reduced the pace of economic growth. Because of the marked increase in international interest rates, the deterioration of the terms of trade, and the weakening of external demand, these adjustment measures were insufficient to bring the current account deficit down to a level that could be sustained over the medium term. When the attitude of international financial markets toward Brazil changed in the second half of 1982, the authorities had to use a substantial part of their international reserves in order to service the country's external debt on schedule.

The Brazilian authorities have adopted a comprehensive medium-term economic program, in support of which they have requested maximum access to Fund resources in the first credit tranche and under the extended Fund facility. The staff believes that this program fully warrants such support from the Fund.

In the external area, the principal objective of the program is a reduction in the deficit in the current account of Brazil's balance of payments, from 4.5 per cent of GDP in 1982 to 2.2 per cent in 1983 and, eventually, 1 per cent of GDP in 1985. This cutback in the use of foreign credits should lead to a decline in the debt service ratio over the program period. It also should permit a buildup in international reserves, following their substantial drop during 1982.

Domestically, the program calls for a reduction in inflation from 100 per cent during 1982 to 70 per cent during 1983, and it is expected that it will be brought down to 20 per cent by the end of 1985. Because of the magnitude of the adjustment required in the short term, the economy is unlikely to stage a recovery in 1983; however, a return to a more normal growth pattern is projected for 1984 and 1985.

The achievement of these external and internal objectives will require substantial structural changes in the economy. Consumption outlays are to be scaled down, and gross domestic savings are expected to rise by the equivalent of 5-1/2 percentage points of GDP during 1983-85. This should make it possible to raise the ratio of investment to GDP, despite a major reduction in the dependence on foreign savings. To help create the conditions for economic growth in 1984 and beyond, the authorities intend to complement the investment effort with measures aimed at making the economy more efficient. Such measures include a reduction in the size of the public sector, and the strengthening of the price mechanism through the elimination of subsidies and restrictions, including those applying to the external sector.

The economic program adopted by the Brazilian Government envisages a substantial reduction in the external imbalance right away. The staff notes with satisfaction that most of the measures that are needed have already been implemented and will therefore yield their full effect right from the beginning of the program. Foremost among these are measures to strengthen revenues and reduce expenditures of the public sector; as a result, the public sector borrowing requirement is to decline from 13.8 per cent of GDP in 1982 to 7.9 per cent in 1983. Of particular importance in this connection are the recently introduced indexation for inflation of income tax liabilities, the increases in tax rates on a number of goods and transactions, and the sizable cutback in expenditures of the Central Administration and in investment outlays of the state enterprises.

The staff welcomes the intention of the authorities to tighten monetary policy in 1983. The current high real rates of interest on commercial and industrial credit reflect--among other factors--the subsidies to agriculture and exports. The authorities are, therefore, to be commended for their recent action in reducing substantially the long-standing subsidies to agricultural bank credit. This measure should go a long way not only toward lowering interest rates on industrial credit but also toward improving the control of the monetary authorities over domestic bank credit expansion and its allocation. Also, the reduced borrowing requirement of the public sector should enhance access of the private sector to domestic credit.

However, in January 1983, legal reserve requirements and the cost of domestic bank borrowing were lowered. These actions run the risk of generating effects that might weaken the economic program. As long as substantial external and internal imbalances exist, domestic rates of interest need to be geared to the tasks of stimulating financial savings, controlling the demand for credit, and fostering continued capital inflows from abroad. In connection with the latter, the intended pace of real depreciation of the cruzeiro will have implications for domestic interest rate policy. It should be stressed that any measure that would keep interest rates artificially low will increase the difficulty of complying with the ceilings on the net domestic assets of the requested extended arrangement.

As a part of the economic program, the Brazilian authorities have made significant changes in pricing policies so as to strengthen the financial situation of the state enterprises and, more broadly, to improve the allocation of resources. Of particular importance in this respect are the various corrective price adjustments that were introduced recently and the plan of the authorities to raise the prices of fuels, taken together, by some 20 per cent in real terms during 1983. The staff welcomes the intention of the authorities to eliminate all subsidies in the economy during the program period, with the exception of special treatment that will continue to be required by economically depressed areas.

The recent modification of the official wage formula represented a particularly difficult policy decision on the part of the authorities. While this change in the formula is certain to reduce the pressures on costs as compared with the previous formula, the new formula, nonetheless, will continue to yield real wage increases in 1983 under the inflation assumptions of the economic program. How the wage bill of the economy develops will be of crucial importance to the program. The staff notes the measures taken to limit the growth of the wage bill in the public sector as well as the intention of the authorities to achieve a similar result in the private sector through adherence to tight credit and monetary policies. The result, in these circumstances, is likely to be the creation of additional slack in the economy and increased labor rotation. Therefore, the staff welcomes the intention of the authorities to work toward a return to a system in which wages are determined by collective bargaining.

The projected improvement in the trade and current accounts of Brazil's balance of payments during the first year is substantial and will depend on the pursuit of appropriate exchange rate and domestic demand policies; it is also assumed that several major trade and exchange restrictions and multiple currency practices will be maintained. In the second half of 1982, the authorities began to accelerate the rate of depreciation of the cruzeiro and they intend to continue this policy during 1983, by depreciating at a rate that on average will be the equivalent of at least 1 percentage point a month above the rate of domestic inflation. After allowing for inflation abroad, this policy may result in a real effective depreciation of the cruzeiro of some 20 per cent during 1983.

Brazil's trade and payments system is highly complex and involves many distortions and restrictions. As the external situation improves, the authorities intend--at first--to relax quantitative import restrictions in the interests of growth and economic efficiency. In any case, existing trade restrictions will not be intensified or new restrictions on imports introduced. The staff also notes that the authorities intend to eliminate a number of minor exchange restrictions and multiple currency practices during the first year of the arrangement and that one of these has already been abolished. Progress toward elimination of existing exchange measures will be reviewed before August 30, 1983.

The authorities have undertaken to eliminate the measures listed above under (1), (2), (3a), (3b), and (3c) in the course of 1983, and may begin eliminating the remaining ones in 1983. At any rate, all exchange restrictions and multiple currency practices will be eliminated by the end of the program. In these circumstances, the staff proposes to give temporary approval for measures (1) through (3e). Approval is not recommended for the discriminatory multiple currency practice arising from the taxation of certain manufactured exports to the United States.

Brazil is working closely with the international banking community to secure not only new loans and a rollover of amortizations on long- and short-term debt, but also to maintain adequate access to money markets by Brazilian banks abroad. Full success in these endeavors is required to make Brazil's economic program viable.

To conclude, the Brazilian authorities have begun to implement a medium-term program designed to reduce the external and internal imbalance which, together with important structural changes in the economy, should set the stage for a resumption of sustained growth of output and employment. Undoubtedly, the successful implementation of this ambitious program will be difficult and will require major efforts on the part of the authorities. The staff believes that the program is appropriate to achieve the objectives described above.

Accordingly, the following draft decisions are proposed for adoption by the Executive Board:

I. First Credit Tranche Purchase

1. Brazil has requested a purchase equivalent to SDR 249.375 million, which is the amount equivalent to its first credit tranche.

2. The Fund approves the requested purchase.

II. Extended Arrangement

1. The Government of Brazil has requested an extended arrangement for a period of three years from March 1, 1983 for an amount equivalent to SDR 4,239.375 million.

2. The Fund approves the extended arrangement attached to EBS/83/33.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

III. Article IV Consultation

1. The Fund takes this decision relating to Brazil's exchange measures subject to Article VIII, Sections 2 and 3, and, in concluding the 1982 Article XIV consultation with Brazil, in the light of the 1982 Article IV consultation with Brazil conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund urges Brazil to eliminate at the earliest possible date the tax on certain industrial exports to a Fund member. In view of the circumstances of Brazil, the Fund grants approval of the multiple currency practices and

exchange restrictions that are described under points 1, 2, and 3 on page 27 in EBS/83/33 (2/11/83) until August 30, 1983, or the completion of the first review under the extended arrangement, whichever is earlier.

Fund Relations with Brazil

Status:	Article XIV		
Quota:	SDR 997.5 million		
	As of February 1, 1983	Millions of SDRs	Per Cent of Quota
Fund holdings of Brazilian cruzeiros:	Total	1,496.3	150.0
	Of which: Compensatory financing	498.8	50.0
	As of February 1, 1983	Millions of SDRs	Per Cent of Allocation
SDR Department:	Net cumulative allocation	358.7	100.0
	Holdings	3.2	0.9
Gold distribution:	Brazil has acquired 376,565.569 ounces of fine gold in four distributions.		
Direct distribution of profits from gold sales:	US$69.9 million.		
Exchange rate (February 3,1983):	Cr$278.70 per U.S. dollar buying and Cr$280.09 per U.S. dollar selling.		
Last consultation (Article IV):	August-September 1981, completed by the Executive Board on November 13, 1981.		

Brazil--Basic Data

Area and population			
Area	8,512,000 sq. kilometers		
Population (mid-1982)	125 million		
Annual rate of population increase (1978-82)	2.5 per cent		
GNP per capita (1982)	SDR 2,220		

Origin of GNP	1980	1981	Proj. 1982
		(per cent)	
Agriculture	13.0	12.1	...
Industry	34.0	31.9	...
Commerce	16.1	...	...
Transport and communications	5.1	...	...
Other	31.8	...	...
Ratios to GDP			
Exports of goods and services	8.2	8.9	7.3
Imports of goods and services	13.5	13.2	12.0
Current account deficit 1/	5.1	4.0	4.5
Central Administration revenues	9.3	8.8	9.1
Central Administration expenditures 2/	6.8	7.6	7.9 3/
Registered external debt (end of year)	19.0	20.3	21.3
Total external debt service payments	5.0	5.9	6.3
Saving	15.9	15.3	14.5
Investment	21.1	19.5	19.1
Money and quasi-money 4/ (end of year)	21.3	22.5	24.5
Annual changes in selected economic indicators			
Real GDP per capita	5.3	-5.9	-2.4
Real GDP	7.9	-3.5	--
GDP at current prices	110.0	101.8	95.0
Domestic expenditures (at current prices)	110.4	98.2	94.9
Gross fixed investment	(118.2)	(86.0)	(90.8)
Consumption 5/	(108.4)	(101.4)	(95.8)
GDP deflator	94.6	109.1	95.0
Wholesale prices (annual averages)	109.2	113.0	94.0
Cost of living (annual averages)	82.8	105.6	98.0
Central Administration revenues	124.2	91.3	102.2
Central Administration expenditures 2/	86.8	126.7	103.3 3/
Money and quasi-money 4/	72.0	112.9	115.1
Money	(71.6)	(67.6)	(70.8)
Quasi-money	(72.9)	(149.1)	(133.9)
Net domestic bank assets 4/	85.9	128.9	116.6
Credit to public sector (net)	(...)	(299.9)	(176.4)
Credit to private sector	(72.7)	(103.9)	(107.6)
Merchandise exports (f.o.b., in U.S. dollars)	32.1	15.7	-13.4
Merchandise imports (f.o.b., in U.S. dollars)	27.0	-3.8	-12.2

Central Administration finances	1980	1981	1982
	(billions of cruzeiros)		
Revenues	1,220.1	2,334.2	4,719.3
Expenditures 2/	886.4	2,009.2	4,084.0 3/
Overall surplus or deficit (-)	333.7	325.0	635.3
Internal financing (net)	-333.7	-325.0	-635.3
Balance of payments	(millions of SDRs)		
Merchandise exports (f.o.b.)	15,459	19,784	18,283
Merchandise imports (f.o.b.)	-17,633	-18,765	-17,581
Investment income (net)	-5,087	-8,083	-10,441
Other services and transfers (net)	-2,325	-2,260	-3,300
Balance on current and transfer accounts	-9,586	-9,324	-13,039
Long-term capital (net)6/	4,905	9,040	6,567
Short-term capital (net)	2,392	1,357	-903
Errors and omissions	-313	-354	512
Change in net official international reserves (increase -)7/	-2,602	719	-6,863

International reserve position	Dec. 31 1980	Dec. 31 1981	Dec. 31 1982
	(millions of SDRs)		
Monetary authorities (gross)	5,419	6,450	2,992
Monetary authorities (net)	4,068	4,904	-1,360

1/ Excludes reinvested profits.
2/ Does not include interest and monetary correction on the public debt, nor transfers to the monetary authorities which amounted to Cr$331.3 billion in 1980, Cr$250 billion in 1981, and Cr$635 billion in 1982.
3/ Includes an unknown amount of unused appropriations.
4/ Banking system.
5/ Includes changes in stocks.
6/ Includes allocation of SDRs.
7/ Excludes changes in valuation of gold holdings and acquisition of gold.

Brazil: Selected Economic and Financial Indicators

	1981	Est. 1982	Program Period 1983	1984	1985
(Annual per cent changes, unless otherwise specified)					
National income and prices					
GDP at constant prices	-3.5	--	-3.5	2.0	4.0
GDP deflator	109.1	95.0	78.0	49.0	28.0
Consumer prices (end of period)	95.2	99.7	70.0	40.0	20.0
External sector					
Exports, f.o.b.	15.7	-13.4	8.9	16.8	12.1
Imports, f.o.b.	-3.8	-12.2	-18.5	10.6	10.7
Non-oil imports, f.o.b.	-15.3	-18.0	-20.9	36.1	25.5
Private and public external debt 1/	14.1	11.4	11.7	6.4	5.8
Central Administration					
Revenues	91.3	102.2	106.3	...	...
Expenditures 2/	126.7	103.3 3/	80.3	...	...
Money and credit					
Domestic credit 4/	128.9	116.6	74.3	...	...
Public sector	(299.9)	(176.4)	(-37.5)	(...)	(...)
Private sector	(103.9)	(107.6)	(89.5)	(...)	(...)
Money and quasi-money (M2)	112.9	115.1	76.7	...	...
Velocity (GDP relative to M2)	4.4	4.1	3.9	...	...
Interest rate 5/	97.2	114.7	...	...	...
(In per cent of GDP, unless otherwise specified)					
Public sector borrowing requirement	12.1	13.8	7.9	5.0	4.0
Domestic financing	(11.0)	(12.7)	(6.1)	(4.0)	(3.2)
Direct foreign financing	(1.1)	(1.1)	(1.8)	(1.0)	(0.8)
Current account deficit	4.0	4.5	2.2	1.5	1.1
Private and public external debt 6/	23.9	25.3	26.5	26.4	25.5
Debt service ratio 7/	66.2	84.5	69.2	59.4	54.8
Interest payments 7/	38.3	51.9	41.5	34.7	29.6
Overall balance of payments (billions of U.S. dollars)	0.8	-7.5	--	1.0	1.0
Usable gross official reserves (months of merchandise imports)	1.9	--	1.8	3.7	5.4

1/ Medium- and long-term debt.
2/ Excludes transfers to monetary aurthorities and interest and monetary correction on the public debt.
3/ Includes an unknown amount of unused appropriations.
4/ Net domestic assets of the banking system.
5/ End-of-period annual rate, 91-day Treasury bills.
6/ Includes short-term debt and use of Fund credit.
7/ In per cent of exports of goods and services.

Brazil: Summary of the Economic Program 1983-85

I. Targets

1. An improvement in domestic savings from 14-1/2 per cent of GDP in 1982 to almost 16 per cent in 1983, 18-1/2 per cent in 1984, and 20 per cent in 1985 is targeted. This would allow a reduction in the current account deficit from 4.5 per cent of GDP in 1982 to 2.2 per cent in 1983, 1-1/2 per cent in 1984, and 1 per cent in 1985.

2. The rate of inflation is expected to decline substantially over the program period. The 12-month rate of inflation at the end of the period is projected to fall from 100 per cent in 1982 to 70 per cent in 1983, 40 per cent in 1984, and 20 per cent in 1985. Average annual rates of inflation will be somewhat higher.

3. The overall balance of payments is programed to show a turnaround from a deficit of US$7.5 billion in 1982 to equilibrium in 1983 and surpluses of US$1 billion and US$2 billion in 1984 and 1985, respectively. Such an improvement would bring about a reduction in the debt service ratio from 85 per cent in 1982 to 55 per cent in 1985, a decline in the rate of increase of bank exposure from almost 15 per cent in 1982 to about 4 per cent in 1985, and an increase in net international reserves from a provisionally estimated negative US$1.5 billion at the end of 1982 to a positive US$1.5 billion at the end of 1985.

II. Assumptions

1. Real GDP is projected to decline by 3-1/2 per cent in 1983, reflecting mainly the scaling down of domestic consumption and public sector investment. A resumption of economic growth is expected in 1984 (2 per cent) and 1985 (4 per cent).

2. The U.S. dollar value of exports is projected to increase by 8.9 per cent in 1983, on the strength of a 4 per cent increase in export prices and a 5 per cent advance in volume. A stronger recovery of the world economy and the continuation of adequate domestic policies should produce an average annual growth rate of some 14 per cent in the value of exports in 1984 and 1985.

3. The U.S. dollar value of imports is projected to fall by 17-1/2 per cent in 1983. Oil imports (about one half of total imports) are expected to decline by 14-1/2 per cent in value as a result of a reduction of 2 per cent in prices and of 13 per cent in volume. In 1984 and 1985 the value of total imports should grow by about 11 per cent per year. The oil bill is projected to decline by 10 per cent in 1984 and 7-1/2 per cent in 1985, despite price increases of 5 per cent and 4-1/2 per cent, respectively. Over the program period, domestic oil output is expected to continue to expand at an average annual rate of more than 20 per cent.

4. The effective LIBOR applicable to the variable-rate element of Brazil's external debt is estimated at 11 per cent for the first half of 1983 and at 10 per cent for the second half. For 1984 these rates were assumed (by half years) to be 10 per cent and 9 per cent, and for 1985 to be 9 per cent and 7-1/2 per cent.

5. Net capital inflows during 1983 will depend crucially on foreign banks (1) disbursing US$1.2 billion of loans committed in 1982, and US$4.4 billion of loans to be committed in 1983; (2) fully rolling over debt repayments falling due in 1983; and (3) re-establishing deposits in Brazilian banks abroad to the levels prevailing in mid-1982.

III. Principal Elements of the Program

1. Public sector policies

a. Quarterly ceilings have been established on the financing requirement of the nonfinancial public sector, limiting it to Cr$7 trillion in 1983, the equivalent of 7.9 per cent of GDP; in contrast, this requirement had amounted to 13.8 per cent of GDP in 1982. The requirement is to decline to 5 per cent of GDP in 1984 and 4 per cent in 1985. The definition of the public sector includes the Central Administration, special funds and programs operated through the banking system, decentralized agencies, social security system, the state enterprises, and the state and municipal governments. The ceilings cover net credit from the domestic banking system, private sector holdings of public debt, floating debt of the state enterprises, and foreign financing.

b. Central Administration revenues are to increase by 16 per cent in real terms on the strength of new tax measures that are expected to yield the equivalent of almost 2 per cent of GDP. Together with utmost spending austerity, the improvement in revenue should produce a decrease in the Central Administration's borrowing requirement equivalent to 3.3 per cent of GDP.

c. Similarly, the overall deficit of the state enterprises is assumed to decline by 37 per cent in real terms, to Cr$2.9 trillion in 1983. Revenues of the enterprises are expected to rise by 3 per cent in real terms because of increases in the prices of goods and services provided by the state enterprises. Expenditures should decline by 7 per cent in real terms, mainly because of a cutback in investment outlays.

2. Money and credit

a. The net domestic assets of the monetary authorities are to be subject to quarterly ceilings as a performance criterion. These assets are expected to decline by almost 3 per cent in real terms in 1983.

b. The improved financial situation of the public sector should reduce substantially the crowding out of the private sector that has occurred in the past.

c. Despite a recent downward modification, subsidized interest rates were increased significantly since late 1982, and subsidies to agricultural credit are to be all but eliminated by the end of 1983. There were also reductions in other subsidies, such as to wheat and petroleum products. Subsidies to export credit will remain in effect for the time being. With minor exceptions, all subsidies are to be eliminated by the end of the program period.

3. Prices and wages

a. The prices for the relatively few goods and services that still remain subject to price control were increased substantially around the turn of the year. The prices of fuel products as a group will be adjusted during 1983 at a monthly rate that is 1.5 percentage points above the rate of domestic inflation. All explicit or implicit subsidies are to be eliminated over the program period.

b. The modifications to the official wage formula that were decreed recently will reduce the rate of increase in real wages, given the price projections of the program. The wage bill of the economy will not necessarily increase in real terms in 1983 because of rising labor rotation and unemployment.

4. External sector

a. The system of frequent and small devaluations of the cruzeiro will be continued. A quarterly performance criterion has been established that calls for a rate of depreciation of the cruzeiro against the U.S. dollar that on average will be the equivalent of at least 1 percentage point per month above the domestic rate of inflation.

b. The restrictiveness of the trade and exchange system will be reduced. Priority will be given to the removal of quantitative import restrictions so as to facilitate efficiency and economic growth. A number of multiple currency practices and minor exchange restrictions will be eliminated during the first year of the program. All exchange measures will be removed before the end of the program period.

5. Review

There will be a consultation on all aspects of the program with the Fund prior to August 30, 1983.

Brazil: Extended Arrangement

Attached hereto are a letter with attached memorandum dated January 6, 1983, from the Minister of Finance and the President of the Central Bank of Brazil, requesting an extended arrangement and setting forth:

(a) the objectives and policies that the authorities of Brazil intend to pursue for the period of this extended arrangement;

(b) the policies and measures that the authorities of Brazil intend to pursue during the first year of this extended arrangement; and

(c) understandings of Brazil with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Brazil will pursue for the second and third years of the extended arrangement.

To support these objectives and policies, the International Monetary Fund grants this extended arrangement in accordance with the following provisions:

1. For a period of three years from February , 1983, Brazil will have the right to make purchases from the Fund in an amount equivalent to SDR 4,239.375 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Until February , 1984, purchases under this extended arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 1,246.875 million, provided that purchases shall not exceed the equivalent of SDR 124.875 million until May 31, 1983, the equivalent of SDR 498.875 million until August 31, 1983, and the equivalent of SDR 872.875 million until November 30, 1983.

(b) Until February , 1985, purchases under this extended arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 2,743.125 million.

(c) The right of Brazil to make purchases during the second and third years of the extended arrangement shall be subject to such phasing as shall be determined.

3. Purchases under this extended arrangement shall be made from ordinary and borrowed resources in the ratio of one to one until purchases under this arrangement reach the equivalent of SDR 2,793.0 million and then each purchase shall be made from borrowed resources, provided that any modification by the Fund of the proportion of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Brazil will not make purchases under this arrangement:

(a) (i) during any period in which the data at the end of the preceding period indicate that the target for the net international reserves of the Brazilian Monetary Authorities, as specified in paragraph 1 of the attached Technical Memorandum, is not observed, or

(ii) during any period in which the limit on the public sector borrowing requirement, as specified in paragraph 2 of the attached Technical Memorandum, is not observed, or

(iii) during any period in which the limit on the net domestic assets of the Brazilian Monetary Authorities, as specified in paragraph 3 of the attached Technical Memorandum, is not observed, or

(iv) during any period in which the data at the end of the preceding period indicate that the limit on the use of external credit, as specified in paragraph 4 of the attached Technical Memorandum, is not observed, or

(v) if the cumulative quarterly target on the depreciation of the cruzeiro, as specified in paragraph 5 of the attached Technical Memorandum, is not observed or,

(b) if the review contemplated in paragraph 29 of the attached letter has not been completed before August 30, 1983, or if any performance clauses, having been established pursuant to that review, are not observed, or

(c) for the second and third year of this arrangement, if before February 15, 1984 and February 15, 1985, respectively, suitable performance clauses have not been established in consultation with the Fund as contemplated in paragraph 29 of the attached letter, or if such clauses, having been established, are not observed; or

(d) throughout the duration of the extended arrangement, if Brazil

(i) imposes new or intensifies existing restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes new or intensifies existing restrictions on imports for balance of payments reasons.

When Brazil is prevented from purchases under this extended arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Brazil and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Brazil's right to engage in the transactions covered by this extended arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director of the Managing Director, formally to suppress or to limit the eligibility of Brazil. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Brazil and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this extended arrangement will be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Brazil, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this extended arrangement involving borrowed resources will be normally either the 15th day or the last day of the month, or the next business day if the selected day is not a business day. Brazil will consult the Fund on the timing of purchases involving borrowed resources.

8. Brazil shall pay a charge for this extended arrangement in accordance with the decisions of the Fund.

9. (a) Brazil shall repurchase the amount of its currency that results from a purchase under this extended arrangement in accordance with the provisions of the Articles of Agreement and Decisions of the Fund including those relating to repurchase as Brazil's balance of payments and reserve position improves.

(b) Any reductions in Brazil's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this extended arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the extended arrangement Brazil shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Brazil or of representatives of Brazil to the Fund. Brazil shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Brazil in achieving the objectives and policies set forth in the attached letter and annexed memorandum.

11. In accordance with paragraph 29 of the attached letter, Brazil will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria under paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the extended arrangement and while Brazil has outstanding purchases under this extended arrangement, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Brazil's balance-of-payments policies.

Brasilia, January 6, 1982

Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. de Larosiere:

1. Over the past 15 years or so, Brazil has been following economic policies that aimed at high rates of domestic growth, the absorption of a rapidly growing labor force, and an appreciable increase in the standard of living of all Brazilians. Matching abundant domestic resources with sizable imports of capital and technology, the Brazilian economy was transformed during this period from a largely agricultural to a highly industrialized one. This transformation, which greatly expanded the size and role of the public sector, also affected the structure of Brazil's external trade. While formerly a few agricultural products like coffee and sugar dominated exports, today industrial products account for over one half of the total export value. Similarly the existence of a domestic market in excess of 100 million people has permitted a successful policy of import substitution; today, Brazil's imports consist overwhelmingly of oil, other raw materials, and investment goods.

2. Brazil's economic and financial policies since 1974 have been dominated by the need to adjust to the steep increase in the price of oil during the period. The substantial progress achieved in that effort suffered a severe setback with the second sharp oil price increase in 1979. The authorities responded by adopting, in late 1979 and early 1980, a comprehensive package of measures that included a major devaluation of the cruzeiro, fiscal and monetary restraint, and a liberalization of the foreign trade system. As the difficult external situation was further compounded by rising interest rates and weakening external demand, the authorities adopted additional measures in late 1980 and in 1981, including the partial freeing of interest rates, improved credit allocation, greater buoyancy of the tax system, tightened control over public spending, especially by state enterprises, and depreciation of the cruzeiro in line with the actual rather than projected rate of domestic inflation. Despite their scope, these measures did not restore domestic and external equilibrium. As a result, Brazil had to resort to considerable amounts of foreign borrowing.

3. The intention of the authorities of reducing the external and internal imbalances and of freeing the economy from restrictions in a gradual way suffered another setback in 1982, when Brazil's external situation weakened considerably. The decline in international commodity prices, the slowdown in the pace of world economic activity, an increase in protectionist policies, economic difficulties in countries that recently had become important buyers of Brazilian products, and the temporary appreciation of the cruzeiro, resulted in a decline in the value of exports that is estimated to reach 14 per cent in 1982. In contrast, the value of exports had grown by almost one third in 1980

and 16 per cent in 1981. Although imports have also declined appreciably this year, the 1982 trade surplus is expected to be no more than US$3/4 billion, compared with an original estimate of US$3 billion, and a surplus of over US$1 billion in 1981. Continued high international interest rates caused an increase of over US$1 billion in Brazil's net interest payments abroad; this factor, the decline in the trade surplus, and an increase in other service payments are likely to result in a sharp rise in the deficit on current account of the balance-of-payments (exclusive of reinvested earnings) from US$11 billion (equivalent to nearly 4 per cent of GDP) in 1981 to some US$15 billion (almost 5 per cent of GDP) in 1982.

4. In order to deal speedily and decisively with this situation, the Government has developed an economic program which, in the short run, will reduce substantially the external and internal imbalances and, in the medium term, will bring about structural changes in the economy that permit a return to high and sustainable rates of growth and employment. The basic strategy of this program is to raise significantly domestic savings, especially in the public sector, and to make the economy more efficient; the latter will be achieved through improvements in relative prices between the various sectors of the economy, an elimination of subsidies, and a reduction in restrictions and direct government intervention into the economic process.

5. In support of this economic policy program, which will be described in more detail below, the Government of Brazil hereby requests access to the financial resources of the International Monetary Fund for the equivalent of 450 per cent of Brazil's quota, under the first credit tranche and in the framework of an extended arrangement, for a period of three years. The Government of Brazil also intends to request the maximum amounts of assistance it can obtain under the Fund's compensatory financing facility for export shortfalls and the buffer stock financing facility.

6. To assure the success of this economic program, it will be essential that Brazil can continue to count on the financial support of foreign commercial banks, international organizations and governments. Such financial support will be of particular importance at the beginning of 1983 when the full adjustment effect of the measures has not yet materialized.

7. In October of 1982, the National Monetary Council approved the Foreign Sector Program for 1983 which aimed at a reduction in the deficit on current account of Brazil's balance of payments to about US$7 billion (some 2 per cent of GDP) and at equilibrium in the overall balance of payments. Such a significant improvement in Brazil's external accounts, together with the requested use of Fund resources, will strengthen considerably Brazil's international reserve position.

8. For the second and third year of the extended arrangement the Brazilian authorities will be aiming at a further strengthening of Brazil's external position. The deficit on current account is to be

reduced to about 1-1/2 per cent of GDP in 1984 and 1 per cent in 1985; the deficit in the latter year would be equivalent to some US$4 billion. Such an improvement would reduce substantially the growth of Brazil's external debt and allow for moderate surpluses in the overall balance of payments that would go to rebuilding Brazil's foreign exchange reserves even further.

9. The economic program also aims at a substantial reduction in the domestic imbalance. Because of the price effect of the intended reduction in restrictions and controls, the decline in the rate of inflation will necessarily have to be slower in 1983 than in the following two years. The average annual rate of inflation should decline from 95 per cent in 1982 to 78 per cent in 1983; the rate of price increases during the year is projected to decline from 99.7 per cent in 1982 to 70 per cent in 1983.

10. Recognizing the harmful effects that inflation has on investment and future economic growth, the authorities intend to formulate policies for 1984 and 1985 that will be directed toward major reductions in the annual rate of increase of domestic prices.

11. High foreign interest rates, the prolonged world recession, the tightness of foreign capital markets and other factors beyond the control of the authorities have made it increasingly difficult to follow policies geared to high rates of economic growth and employment. In order to ease the serious social hardships that the combination of high population growth with a stagnating pace of domestic economic activity has created, the authorities intend to stimulate economic activity and employment in 1983 and beyond by:

(1) an all-out effort to raise output for export through an appropriate exchange rate policy, and financial and technical assistance to the export sector;

(2) continued support to agriculture geared to raising investment and productivity in that sector;

(3) strengthening business confidence through this economic program which should stimulate industrial investment;

(4) a wage policy designed to increase employment; and

(5) price policies designed to stimulate output.

The authorities expect higher and sustainable growth during the second and third year of the extended arrangement, as the foreign constraint eases and the structural changes take hold.

12. Despite the wide-ranging price liberalization measures of 1980-81, the prices of some agricultural products and those of certain goods and services provided by the public sector have remained controlled and,

over the past year or so, were not adjusted in line with cost developments. To redress this situation, the authorities have adopted, or will be adopting, the following measures:

(1) the prices of fuel products will be increased shortly by substantial margins; in general, fuel products will be priced during 1983 in such a way as to lower fuel consumption and therefore oil imports (thus freeing foreign exchange for additional imports of other raw materials and investment goods); to stimulate oil substitution; and to reduce substantially the oil account, which reflects past and present subsidies to these products;

(2) the selling price of wheat will also be raised shortly; the remaining subsidy will be reduced significantly during 1983 and should be eliminated completely by the end of 1985;

(3) the subsidy to sugar producers, which is particularly large at this point in time because of the low international prices, will also be reduced during 1983 and the remainder of the program period; any subsidy that might still be in existence by the end of 1985, depending on the development of international prices for sugar, will be transferred from the accounts of the monetary authorities into those of the Central Government;

(4) the prices of nonagricultural goods and services provided by the public sector were also reviewed and increases were decreed for steel, public utilities and transportation. The prices of a number of other goods and services are being adjusted, taking into account not only the financial situation of the public sector but also supply and demand conditions as in the case of hydroelectricity for which excess capacity exists.

13. During the period of the extended arrangement, the authorities intend to follow a price policy that will prevent the re-emergence of subsidies that have been eliminated on the above-mentioned products and, in general, will be designed to reduce other explicit and implicit subsidies in the economy. In this regard, the authorities also intend to improve transport and storage facilities in agriculture so as to enable the Government to reduce its role in the domestic marketing of agricultural products.

14. Central government revenues will be strengthened considerably during 1983 because:

(1) the income tax law was modified recently providing for an indexation for inflation of tax liabilities and a reduction in the period during which tax obligations have to be paid; this measure alone is expected to yield additional revenues during 1983 equivalent to almost 1 per cent or GDP;

(2) the increase in the taxation of diesel, that was introduced around the middle of this year, will now produce a full year's effect on revenues;

(3) the authorities have taken steps to further improve tax administration that should begin to yield results already in 1983; and

(4) certain fiscal incentives have been reduced substantially and additional action will be taken to further reduce or even eliminate them altogether except in the North and Northeast; also, a number of tax rates and tariffs will be adjusted before the beginning of the requested arrangement.

15. The authorities intend to apply strict austerity in spending. This will apply in particular to personnel outlays and transfers to the state enterprises. Tight control over other outlays of the Central Government will result in economies with respect to budgetary appropriations.

16. Over the past years, it has become evident that the efficiency and equity of the Brazilian tax system could be further improved. Such improvements refer to revenue distribution between states, shifting the incidence of taxes from wage goods to luxury goods, and to the necessity to stimulate savings, investment and exports. The authorities are presently preparing a tax reform bill that will be submitted to Congress in the course of 1983.

17. A significant amount of government expenditures is currently being carried out directly by the monetary authorities without reimbursement from the Central Government. This practice will be all but eliminated by the end of the extended arrangement through a substantial reduction in the transactions involved and a gradual transfer of the remaining expenditures to the budget of the Central Government.

18. The finances of the social security system suffered a serious deterioration during 1981. However, an increase in the rate of contribution and some rationalization in benefits have improved significantly the financial position of the system. The authorities will continue to follow policies that ensure the financial viability of the social security system.

19. A substantial part of the adjustment burden will have to be borne by the state enterprises. Irrespective of the more adequate pricing policy that was referred to above, a substantial cutback in the volume of their expenditures will be required during 1983 and beyond. Capital outlays are to decline considerably in real terms, as no major new investment projects (with the exception of Carajas, which is fully financed from abroad) are to be undertaken in 1983 and the execution of ongoing projects is being slowed. The projected decline in the volume of current spending will be much less, as a sizable increase in the cruzeiro value of interest payments on foreign debt is likely to offset to a large extent the spending economies arising from utmost austerity and restrictive hiring practices.

20. Over the medium term, the authorities will continue to hold to their current policies of reducing the number of public sector enterprises and of subjecting the remaining enterprises to the same market conditions that apply to private sector companies. This implies that, except for those entities that have a special social or development function to fulfill, this sector will have to be financially self-sustaining before long.

21. As a result of the measures described above, the borrowing requirement of the nonfinancial public sector is projected to decline significantly. This borrowing requirement, which had risen from 12.2 per cent of GDP in 1981 to an estimated 13.8 per cent in 1982, is expected to decline to 7.9 per cent in 1983. The Government intends to follow public sector policies in 1984 and 1985 that are consistent with the external objectives.

22. Despite significant improvements in some areas during the past few years, monetary control continues to be unfavorably affected by the existence of interest rate subsidies, and special programs which are largely dependent upon access to Central Bank credit, among others. In order to reduce the present high real rates of interest applicable to nonsubsidized credit operations, the National Monetary Council approved on December 16, 1982 a program of gradual increases in interest rates on loans to agriculture; the average nominal interest rate on such loans should be equal to or slightly above the expected rate of inflation by the end of 1983. However, loans to farmers in the North and Northeast and to small farmers in other parts of the country will still retain some implicit subsidy, which will be covered overwhelmingly by the fiscal budget. These changes are reflected in the Monetary Budget (also approved by the National Monetary Council) which specifies targets for monetary and credit expansion that are consistent with the balance-of-payments and inflation objectives.

23. Over the program period the authorities intend to proceed with the liberalization of the financial system both in terms of interest rates and quantitative restrictions, regulating the amount of domestic liquidity through such instruments as reserve requirements, rediscounting, and open market operations.

24. It will be of utmost importance to achieve a substantial strengthening of Brazil's external position in 1983. In order to compensate for some real appreciation of the cruzeiro that occurred during 1982 with respect to the currencies of Brazil's major trading partners and to set the stage for a reduction in trade and payments restrictions, the Government has decided to continue to depreciate the exchange rate of the cruzeiro vis-a-vis the U.S. dollar at a monthly rate that on average will be one percentage point above the rate of domestic inflation.

25. The export subsidy (credito-premio) was recently extended through April 1985 at its current level of 11 per cent. Certain services and goods equivalent to less than one half of the total value of imports

are subject to an exchange tax of 25 per cent; also, a wide range of quantitative import restrictions and prohibitions were introduced recently to stem the rapidly widening balance-of-payments deficit. As the economy begins to adjust, the authorities intend to reduce substantially the quantitative import restrictions. In the present circumstances, it is impossible to foresee whether the significant exchange restrictions on exports and imports mentioned at the beginning of this paragraph can be reduced during the first year of the extended arrangement; however, should there be a significant decline in the external value of the U.S. dollar, the resulting real effective depreciation of the cruzeiro with respect to the currencies of Brazil's major trading partners will not lead to a modification of the exchange rate policy described in paragraph 24, but will be used to reduce these exchange restrictions.

26. During the first year of the requested arrangement, the authorities also intend to eliminate a number of minor exchange restrictions in an effort to facilitate international payments and transactions, and replace them, where necessary, with measures outside the exchange system.

27. During the second and third year of the arrangement the authorities intend to maintain the policy of minidevaluations of the cruzeiro in such a way that it will ensure the competitiveness of Brazilian exports and allow for the elimination of the remaining exchange restrictions. The authorities also intend to introduce during the period of the arrangement a trade system that would provide protection to domestic activity through tariffs rather than through quantitative restrictions.

28. Given the size of Brazil's public and private external debt, the authorities intend to limit new external net indebtedness, both short and long term to amounts that are consistent with the current account and the overall balance of payments targets.

29. The Brazilian authorities believe that the policies and measures described are adequate to achieve the objectives of the program, but will take any additional measures that may become appropriate for this purpose. During the period of the requested arrangement Brazil and the Fund will consult periodically, in accordance with the policies on such consultations, to examine progress being made in implementing the program and achieving its objectives. With respect to the program for the first year, the Brazilian authorities will consult with the Fund before August 30, 1983 on the progress made in implementing the program. Moreover, before February 15, 1984 and February 15, 1985 the Brazilian authorities will consult with the Fund on the policies, measures and performance criteria for the second and third year of the requested arrangement.

Sincerely yours,

/s/
Carlos Geraldo Langoni
President of the Central
Bank of Brazil

/s/
Ernane Galveas
Minister of Finance

Brasilia, January 6, 1983

Technical Memorandum of Understanding

This technical memorandum defines the concepts used in quantifying certain variables of the Economic Program described in the letter dated January 6, 1983, and sets out models for periodic reporting.

1. The overall balance-of-payments target for calendar year 1983 as described in paragraph 7 of that letter is at least equilibrium. The intermediate targets are a deficit of no more than US$1.5 billion for the three-month period ending March 31, 1983; a deficit of no more than US$1.5 billion for the six-month period ending June 30, 1983; and a deficit of no more than US$0.7 billion for the nine-month period ending September 30, 1983. For the purpose of these targets, the balance-of-payments performance will be measured by changes in the net international reserve position of the Monetary Authorities (the Central Bank of Brazil and the Banco do Brasil), that is shown in the attached Table 1. However, in order to measure balance-of-payments performance, the change in the net international reserve position will be adjusted for net gold monetization. Furthermore, gold, SDRs, and nondollar assets and liabilities will be valued at the prices and exchange rates in effect on December 31, 1982. In addition, any reduction in the short-term liabilities of the Monetary Authorities that results from the refinancing of bridge operations from the U.S. Treasury, the BIS and foreign banks obtained until December 31, 1982 will not be considered for purposes of these targets.

2. The borrowing requirement of the nonfinancial public sector referred to in paragraph 21 of the letter will be defined as the sum of the net increases in the items described in the attached Table 2 above their respective stocks on December 31, 1982. These cumulative financing needs will not exceed Cr$1,200 billion during the three-month period ending March 31, 1983; Cr$3,200 billion during the three-month period ending June 30, 1983; Cr$5,000 billion during the three-month period ending September 30, 1983; and Cr$7,000 billion during the three-month period ending December 31, 1983.

3. The monetary policy targets for 1983 mentioned in paragraph 22 of the letter translate for the purpose of this program into a set of limits on the net domestic assets of the Monetary Authorities; these assets are defined as the difference between the liabilities to the private sector and the net foreign assets of the Monetary Authorities as shown in the attached Table 3. For the purpose of this definition the U.S. dollar value of the net foreign assets position attained on December 31, 1982 will be converted at all times into cruzeiros at the exchange rate of December 31, 1982; and for each of the three-month periods ending March 31, 1983, June 30, 1983, September 30, 1983, and December 31, 1983, the U.S. dollar value of the changes in the net foreign assets position occurring during these three-month periods will be converted into cruzeiros at the average exchange rates corresponding to these periods. The net domestic assets so defined, which on September 30, 1982 amounted to Cr$2,415 billion, and are projected to amount

to Cr$3,500 billion by December 31, 1982 will not exceed Cr$4,050 billion during the three-month period ending March 31, 1983; Cr$4,650 billion during the three-month period ending June 30, 1983; Cr$5,150 billion during the three-month period ending September 30, 1983; and Cr$5,800 billion during the three-month period ending December 31, 1983.

4. The limits on new net external indebtedness referred to in paragraph 28 of the letter will be defined as the difference between disbursements and amortizations of medium- and long-term external debt of both the public and private sector, plus changes in the net position of certain types of short-term indebtedness, as described in the attached Table 4. The new net external indebtedness so defined will not exceed US$2 billion on March 31, 1983; US$3 billion on June 30, 1983; US$4 billion on September 30, 1983; and US$6 billion on December 31, 1983. Any loans obtained to refinance short-term liabilities of the monetary authorities resulting from bridge operations carried out before December 31, 1982 will not be counted against the net external indebtedness limits.

5. Allowing for the lag in publication of the relevant price index, the exchange rate policy described in paragraph 24 of the letter will be measured as follows: the percentage change in the cruzeiro value of the U.S. dollar on April 15, 1983 over its value on January 15, 1983 will be no less than the cumulative percentage change in the General Price Index--Domestic Supply (IGP-DI) during the three-month period ending March 31, 1983 plus 3 percentage points; the percentage change in the cruzeiro value of the U.S. dollar on July 15, 1983 over its value on January 15, 1983 will be no less than the cumulative percentage change in the IGP-DI during the six-month period ending June 30, 1983 plus 6.2 percentage points; the percentage change in the cruzeiro value of the U.S. dollar on October 15, 1983 over its value on January 15, 1983 will be no less than the cumulative percentage change in the IGP-DI in the nine-month period ending September 30, 1983 plus 9.4 percentage points; and the percentage change in the cruzeiro value of the U.S. dollar on January 15, 1984 over its value on January 15, 1983 will be no less than the cumulative percentage change of the IGP-DI in the 12-month period ending December 31, 1983 plus 12.7 percentage points.

6. The minor exchange restrictions referred to in paragraph 26 of the letter are (i) limits on outward remittances of technical assistance fees and royalties; (ii) contribution quotas on coffee, cocoa, and wild animal hides; (iii) exchange taxes on exports of orange and tangerine juice, corn bran, and hides of beef cattle; (iv) a graduated supplementary tax on outward remittances of profits and dividends; and (v) bilateral payments agreements with Hungary and Romania.

Attachments (4)

Table 1. Net International Reserves of the Monetary Authorities 1/

(In millions of U.S. dollars)

		Sept. 30 1982
I.	Assets	4,352.1
	A. Haveres prontos	1,386.1
	B. Haveres a curto prazo	2,617.4
	C. Haveres a medio e longo prazo	348.6
II.	Liabilities	3,303.7
	A. Obrigacoes prontas	--
	B. Obrigacoes a curto prazo	3,303.7
	C. Obrigacoes a medio prazo (FMI) 2/	--
III.	Net international reserves (I-II)	1,048.4

1/ Central Bank and Banco do Brasil.

2/ Includes all repurchase obligations arising from the use of Fund resources in the first credit tranche, under the extended arrangement, the compensatory financing facility, and the buffer stock financing facility.

Table 2. Public Sector Borrowing Requirements

(In billions of cruzeiros)

		1981 1/
1.	Net credit from banking system	1,923
	Monetary authorities	(-188)
	Commercial banks	(881)
	Rest of banking system	(1,230)
2.	Private sector holdings of public debt	867
3.	Private sector holdings of state and municipal debt	146
4.	Floating debt of state enterprises 2/	23
5.	Total domestic financing (1+2+3+4)	2,959
6.	Foreign financing	280
7.	Total public sector financing (5+6)	3,239
	(As per cent of GDP)	(12.2)

1/ Change in stocks between December 1980 and December 1981 as per annexed tables.
2/ To "enpreteiros e fornecedores".

Table 3. Net Domestic Assets of the Monetary Authorities as of September 30, 1982

(In billions of cruzeiros)

A.	Liabilities to private sector	3,419.05
	Monetary liabilities	1,002.57
	1. Papel moeda	(656.71)
	Papel moeda emitido	/772.30/
	Caixa das autoridades monetarias	/-15.37/
	Caixa dos bancos comerciais	/-100.21/
	2. Depositos a vista	(345.85)
	Depositos a vista do setor privado 1/	/345.85/
	Time and savings deposits	162.32
	Depositos a prazo no Banco do Brasil	(162.32)
	Other liabilities	2,254.15
	1. Depositos sobre importacoes	(7.20)
	Depositos diversos restit. s/import. (Res.331 e 443)	(0.08)
	Depositos diversos restit. s/import. (GECAM 31)	(7.12)
	2. Outros	(2,246.95)
	Depositos diversos setor privado 2/	/75.07/
	Depositos diversos restit. s/viagem exter. (Res. 380)	/0.16/
	Depositos diversos restit. s/oleo combust. (Res. 413)	
	Depositos diversos restit. s/empr. compuls. (DL 1782)	
	Depositos diversos restit. en moedas estrangeiras 3/	/2,171.66/
B.	Net foreign assets	1,078.80
	Net international reserves (see Table 1)	216.18
	Net other foreign assets	862.64
	1. Haveres	863.53
	BB cambiais em cobranca	256.41
	Saldo convenios ativos (inconv.)	(1.59)
	Exportacoes financiadas	(144.24)
	Outras contas inconversiveis	(0.60)
	Export financ. Finex	(280.12)
	Export financ. Convenios Bilat.-NP	(180.57)
	2. Obrigacoes	-0.89
	Saldo de convenios ativos	(--)
	Outras contas	(0.89)
C.	Net domestic assets (A-B)	2,340.25

1/ Conta 60.25.10 do Balancete consolidado das autoridades monetarias.
2/ Contas 70.10.10.50 a 70.10.10.75 do Balancete consolidado das autoridades monetarias.
3/ Contas 70.05.05.05 e 70.05.05.06 do Balancete consolidado das autoridades monetarias.

Table 4. Net Disbursements of External Debt

(In millions of U.S. dollars)

	Jan.-June 1982
I. Disbursements (medium- and long-term)1/	7,513.2
A. Emprestimos e financiamentos estrangeiros ao Brasil	7,511.6
1. Organismos internacionais e agencias governamentais	(737.3)
2. Linhas de credito de exportacao e importacao de medio e longo prazo (acima de 24 meses)	(-268.7)
3. Contratos de risco (petroleo)	(54.5)
4. Suppliers' and buyers credits	(937.3)
5. Lei No. 4131 (medio e longo prazos)	(3,576.8)
6. Resolucao 63 (medio e longo prazos)	(2,432.4)
7. Bonus	(42.0)
B. Financiamentos a residentes para exportacao (receita)	1.6
II. Amortization (medium and long term)	3,800.1
A. Emprestimos e financiamentos estrangeiros	3,800.1
1. Organismos internacionais e agencias governamentais	(375.6)
2. Suppliers' and buyers' credits	(756.5)
3. De governamentais	(283.7)
4. Lei No. 4131 (medio e longo prazos)	(1,434.0)
5. Resolucao 63 (medio e longo prazos)	(866.4)
6. Compensatorios	(3.1)
7. Conversao em investimentos	(71.1)
8. Divida publica externa consolidada	(0.2)
9. Emprestimos diversos (acervos)	(5.1)
10. Bonus	(4.4)
B. Financiamentos a residentes para exportacao (despesa)	--
III. Short-term capital	581.2
Bancos comerciais	581.2
IV. Net disbursements of external debt (I-II+III)	4,294.3

Source: DIBAP, Balanco de Pagamentos.

1/ Excludes disbursements of loans to refinance short-term bridge financing obtained by the monetary authorities until December 31, 1982.