IMMEDIATE ATTENTION

EB/CGATT/83/3

November 29, 1983

To: Members of the Committee on Liaison with the CONTRACTING PARTIES to the GATT

From: The Committee Secretary

Subject: Relations with GATT - Consultations with the CONTRACTING PARTIES

The attached memorandum from the staff concerning preparation for forthcoming consultations with the CONTRACTING PARTIES on their consultations with Brazil, Ghana, Peru, Tunisia, and Turkey is herewith submitted for consideration by the Committee.

In view of the time constraint, early action by the Committee is requested. In the absence of objection from a member of the Committee by noon on Thursday, December 1, 1983, the memorandum will be deemed approved by the Committee for submission to the Executive Board for consideration on a lapse-of-time basis.

Att: (1)

Other Distribution:
Members of the Executive Board

November 29, 1983

To : The Chairman of the Committee on Liaison with the CONTRACTING PARTIES to the GATT

From : The Director
Exchange and Trade Relations Department

Subject: Consultations with the CONTRACTING PARTIES to the GATT

The Fund has been invited to consult with the CONTRACTING PARTIES in connection with their consultations with Brazil, Ghana, Peru, Tunisia, and Turkey. The Managing Director has recommended that this invitation be accepted, and that Mr. Shailendra J. Anjaria, Chief, Trade and Payments Division, be designated to represent the Fund during the consultations to be held in Geneva during December 5-9, 1983. This recommendation was approved by the Executive Board on November 8, 1983 (EBD/83/282).

In accordance with the procedures set out in EBD/56/102 (8/29/56), the latest Recent Economic Developments papers on Brazil, Ghana, Peru, Tunisia, and Turkey have been transmitted to the CONTRACTING PARTIES. In addition, a paper containing supplementary background material on Brazil has been transmitted (SM/83/239, 11/18/83). It is expected that the CONTRACTING PARTIES will request the Fund's view with respect to Brazil and Ghana. It is recommended that, in reply to such request, the Fund representative should be guided by the statement set forth below.

Brazil

In 1981, the current account deficit 1/ of Brazil's balance of payments amounted to 5.6 percent of GDP. Brazil experienced no major difficulties in obtaining sufficient foreign credit to finance such a deficit, and in rolling over maturing foreign debt. Net international reserves increased by US$0.8 billion during the year, and gross official reserves reached US$7 1/2 billion at the end of 1981. However, real GDP declined by 3 1/2 percent, and only limited progress was made in reducing the 12-month rate of inflation--to 95 percent by end-1981, compared with 110 percent in December 1980.

Brazil's economic performance suffered a setback in 1982. Output was stagnant, inflation continued at nearly 100 percent, and the external situation weakened considerably. The effects of the deepening recession in industrial countries, a further deterioration of commodity prices, and financial difficulties in countries that had recently become important markets for Brazilian manufactures, were compounded in the second half of 1982 by the change in the attitude of international financial markets toward Brazil. For the year as a whole, both exports

1/ The current account deficit includes reinvested profits.

and imports declined by 12-13 percent, and the trade surplus fell to US$0.8 billion, from US$1.2 billion in 1981. Mainly due to higher interest and travel payments, the net deficit on services and transfers rose from US$12.9 billion in 1981 to US$17.2 billion. The current account deficit rose by more than US$4 1/2 billion to US$16.4 billion, equivalent to 7.6 percent of GDP, and gross official reserves declined by more than one half, to US$2.8 billion at the end of 1982.

Brazil maintains a complex trade and payments system, featuring many distortions and restrictions. In September 1982, in order to stem the rapidly deteriorating balance of payments situation, the authorities prohibited a substantial number of imports, tightened regulations on certain payments, and subjected tourist expenditures abroad to the financial transactions tax. In October 1982, the requirements for the minimum financing terms for imports of machinery and equipment and of industrial durable consumer goods with exchange cover were tightened.

In December 1982, Brazil announced an economic program for 1983-85. In the short run, the program aimed at reducing external and internal imbalances and, in the medium term, at bringing about structural changes to permit a return to high and sustainable rates of growth of output and employment. The basic objectives of the program were to raise domestic savings, especially in the public sector, to reduce dependence on external resources, and to make the economy more efficient by allowing relative prices to adjust, eliminating subsidies, and cutting back exchange and trade restrictions. The external targets of the program--which envisaged a sharp reduction in the current account deficit in 1983, followed by further reductions in 1984 and 1985--were a substantial reduction in the growth of external debt, and moderate surpluses in the overall balance of payments that would help rebuild foreign exchange reserves. Most of the improvement in the external position in 1983 was to come from a reduction in imports of goods and services. From 1985 on, however, a steady increase was expected in the U.S. dollar value of imports. Also, starting in 1984, increased conservation and domestic output was to reduce the oil bill, and thus to permit a significant recovery of non-oil imports, in line with the expected domestic economic recovery and the need to replenish inventories. The program called for a reduction in the public sector's financing requirement, which would be instrumental in scaling down foreign borrowing and reducing inflation. The program foresaw reductions in credit subsidies to agriculture, a substantial strengthening of domestic pricing policies, in particular with respect to prices of fuel products, and a tightening of incomes policies.

This program formed the basis for a request by Brazil for the use of Fund resources. On February 28, 1983, the Fund approved the use of resources totaling the equivalent of SDR 4,955 million. Of this total, SDR 4,239 million (425 percent of Brazil's quota in the Fund), was made available for drawing over a three-year period under an extended arrangement; SDR 249.4 million, the equivalent of Brazil's first credit tranche, and a drawing of SDR 466.3 million under the compensatory financing facility were made available immediately. The drawing under the compensatory financing facility was in respect of a shortfall in Brazil's export earnings during the calendar year 1982, and followed an earlier drawing of SDR 498.8 million in December 1982.

To date, Brazil has made substantial progress toward meeting the external targets of the program for 1983, although its foreign exchange situation remains under severe pressure. In late February 1983, the cruzeiro was depreciated by 23 percent in terms of the U.S. dollar. This action reversed the appreciation of the cruzeiro in real effective terms which had occurred since 1980. The February devaluation and the policy of frequent adjustment of the exchange rate in line with domestic inflation have contributed to positive results in the trade account. The trade surplus reached US$4.9 billion in the first nine months of this year, an amount consistent with the targeted surplus of US$6.3 billion for the year as a whole. Exports in the period January-September were US$16.3 billion, about 8 percent higher than in the corresponding period of 1982. Partly as a result of being restrained by quantitative restrictions, especially by use of a comprehensive import budgeting scheme, imports declined by 23 percent. The current account deficit in the first half of 1983 was estimated at under US$4 billion, slightly larger than projected, mainly because international interest rates turned out to be higher than had been projected. Net capital inflows fell short of expectation, particularly as regards direct foreign investment and short-term financing provided by international banks. As a result, external payments arrears emerged during 1983, and reached US$2.8 billion by end-September 1983.

Progress in external adjustment was not matched on the domestic front. There were delays in implementing some adjustment measures, especially curbs over public sector expenditure and corrective price increases. Also, tax revenues fell short of projection, as export taxes were eliminated sooner than originally planned and tax receipts in general did not keep pace with accelerating inflation. Under these circumstances, inflation exceeded the assumptions underlying the program estimates, and inflationary expectations were exacerbated. The strong demand from the public sector for credit was accompanied by credit stringency to the private sector.

In June 1983, measures began to be implemented to re-establish the thrust of the adjustment effort. These included substantive action relating to price, wage, fiscal, and monetary policy, and a strengthening of the mechanisms of control and monitoring of public finances. Fuel prices were increased by 45 percent, thereby ending the subsidization of oil products. The prices of these products have subsequently been adjusted in line with currency depreciation. The price of wheat was raised by 100 percent in June, and by another 40 percent on September 1, 1983. Subsidization of wheat will be eliminated by June 1984. Prices of steel and electricity are being raised so as to achieve an increase of about 5 percent in real terms. Prices of other public services are being kept under review, with prices being adjusted to take account of market and efficiency considerations of the firms in this sector.

Inflation moved up sharply in June 1983, and has been high since that time. Supply limitations in the agricultural sector contributed to this acceleration, and policies to change relative prices had the effect of raising the general level of prices, in part because of the high degree of indexation of the Brazilian economy. The curtailment of imports added to the inflationary pressures. The continuation of much higher-than-projected inflation rates, in spite of the strengthening of demand management policies in the second half of 1983, convinced the authorities of the need for a further tightening of monetary control and the reinforcement of public finances.

On November 9, 1983, the Brazilian Congress adopted Decree Law No. 2065, which provides for an average rate of indexation of wages to inflation of 86 percent, which is significantly below the rate of indexation under legislation in force in 1982. Also, the growth of money supply (M_1) will be limited to only 50 percent in 1984, with credit policies designed to ensure positive real rates of interest. Adjustment of the public finances remains central to the overall economic program, and the public sector's overall financing requirement is expected to decline from 18.6 percent of GDP in 1983 to a range of 9-11 percent in 1984. To ensure these results, the authorities have adopted further revenue measures and additional expenditure cuts. Monthly targets for the borrowing needs of the Central Administration, states and municipal governments, and state enterprises have been set. Performance in respect of these targets will be monitored closely by a new organization, COMOR, which will signal whenever compensatory action is deemed necessary.

The balance of payments aims for 1983 under the program appear likely to be fulfilled: the current account deficit is now projected at about US$8.7 billion (4.0 percent of GDP), compared with US$16.4 billion in 1982 (7.6 percent of GDP). The overall balance of payments is projected to be in equilibrium, provided the external financing assumed in the program materializes. In addition, the program calls for the elimination of all external payments arrears by end-1983, and the authorities also intend to eliminate certain external payments restrictions. The current account deficit for 1984 is expected to be reduced to US$7.0 billion (3.0 percent of GNP). The authorities have affirmed their intention to introduce a trade system providing protection to domestic activity through tariffs rather than through quantitative restrictions. The authorities intend to present specific proposals for legislative action by mid-1984.

In summary, after a long period of rapid economic growth the need for a change in economic strategy became evident in mid-1982. Brazil faced an external environment fundamentally different from that prevailing over much of the previous two decades, and the measures that had been introduced to cope with the balance of payments problems that emerged in the wake of the two major oil price increases and the increase in real interest rates were shown to be insufficient to redress growing domestic and external imbalances. The comprehensive medium-term economic program that has been adopted by the authorities accordingly involves a shift in the strategy of growth based on foreign borrowing to one that emphasizes the efficiency of the economy and a strengthening of domestic savings. In the external sector, the adjustment calls for a reduction in the current account deficit of the balance of payments to levels that can be sustained over the medium term. Domestically, the program aims at reducing inflation and restoring economic growth. Maintenance of the competitiveness of Brazilian exports and improvement in resource allocation requires the continuation of the policy of small and frequent adjustments of the exchange rate in line with domestic inflation. The flexible exchange rate policy will help in the restoration of an orderly payments system through the elimination of external payments arrears, and it will facilitate the relaxation of exchange and trade restrictions.

The Fund welcomes the determination of the authorities to carry out the comprehensive adjustment efforts, whose success will also require the support and cooperation of the international financial community and Brazil's trading partners. The Fund believes that, with such efforts and support, conditions will have been created for the restoration of a liberal trade and payments system.

Ghana

During most of the 1970s, Ghana experienced serious economic and financial difficulties, resulting mainly from severe structural imbalances and expansionary policies. The cumulative impact of large budgetary deficits, rapid increases in domestic bank credit, and the pursuit of unrealistic domestic pricing, interest rate, and exchange rate policies, led to severe supply shortages, high inflation, a steady worsening of the balance of payments, and the accumulation of external payments arrears. These problems deepened during 1980-82, following a sharp deterioration in the terms of trade and prolonged drought conditions. As a result, real output, which had dropped steeply in the mid-1970s, declined at an annual average of about 2 percent during 1979-81, and fell again by an estimated 7 percent in 1982. Broadly in line with increased government controls and a tightening supply situation, parallel market activity for foreign exchange and goods flourished. Concurrently, the rate of inflation, as measured by the national consumer price index, accelerated sharply, peaking at 116 percent in 1981.

In the face of rising balance of payments pressures, imports were cut back to match declining exports, and the current account was thereby contained to an annual average deficit of US$90 million in 1981-82, following surpluses averaging about US$70 million in 1979-80. Although the value of trade fluctuated considerably during 1979-82, over the period as a whole both exports and imports declined in nominal U.S. dollar terms. Export earnings decreased at an annual average rate of 8.5 percent during 1979-82, from US$1,066 million to US$627 million. During the same period, nominal imports also registered an annual average decrease of about 9 percent, from US$803 million to US$529 million, but the decline was much greater in volume terms, amounting to 15 percent per annum. Net capital inflows were low relative to the requirements of the country. While net inflows of long- and medium-term government capital registered a broadly rising trend between 1979 and 1982, and direct private investment also increased, very large outflows on "errors and omissions," probably representing speculative capital flight, tended to depress the capital account balance. On a cumulative basis, the overall balance of payments was in virtual equilibrium during 1979-82, after taking into account changes in the stock of payments arrears. Gross international reserves amounted to US$224 million at end-1982, equivalent to five months' imports. This relatively high ratio of reserves to imports is misleading, because the level of imports in 1982 was unusually low and a large portion of reserves was pledged against past borrowings. Net foreign assets of the Bank of Ghana, excluding payments arrears, amounted to US$140 million at end-1982; if payments arrears are included, net foreign assets would be negative.

The restrictions on exchange and trade were progressively tightened throughout the 1970s and the early 1980s. All imports involving the use of official foreign exchange became subject to an increasingly restrictive specific import license requirement, within the framework of an annual import program. The list of products eligible for specific import licenses became progressively shorter; in 1982 licenses were issued only for a limited category of essential products. The number of prohibited imports also grew. As the restrictions on the issuance of specific import licenses intensified, the use of special import licenses not requiring transfers of foreign exchange through the banking system was encouraged and expanded. However, the utilization of these licenses was largely inadequate to compensate for the cutback of specific import licenses. As a result, severe shortages of imported goods developed. In addition, all invisible payments required specific approval of the Bank of Ghana. Foreign exchange for business travel and remittances of profits and dividends was granted only in exceptional cases, and foreign exchange for tourist travel was not granted. Foreign exchange for payment of approved imports was, in principle, granted without restriction. However, payments arrears emerged with respect to trade credits and other current payments, and, by end-April 1983, amounted to US$601 million, or the equivalent of one year's merchandise exports.

On April 21, 1983, the Government announced a major adjustment program which is being supported by a one-year stand-by arrangement with the Fund which became effective on August 3, 1983. The Government's policies focus on a major restructuring of relative prices, especially on correcting the substantial overvaluation of the cedi, on improving the financial position of the public sector, on increasing the volume of imports to promote economic activity, and on reducing external payments arrears. Substantive action has already been taken in a number of areas. The authorities initially adopted a multiple exchange rate system as a transitional arrangement, which resulted in an implicit average exchange rate of about ₵25 = US$1, compared with the rate of ₵2.75 = US$1 which had been in effect since August 1978. Action on the unification of the exchange rate was taken on October 10, 1983, well ahead of schedule, with the new unified exchange rate of ₵30 = US$1 representing a further depreciation in terms of local currency of about 20 percent. The Government is committed to continuing with a flexible exchange rate policy, so as to maintain Ghana's international competitive position.

Domestic price policy has been made more flexible. Producer prices for cocoa and other export crops are being adjusted to provide adequate incentives to farmers; the producer price for cocoa was raised by 67 percent in May 1983. Price controls on domestically produced food items have been lifted, and a flexible policy is being applied to other prices. The policy is to allow a full pass-through of the effects of the exchange rate adjustment on domestic prices of most imported and locally processed goods. The pass-through on petroleum products will be effected in stages; following a doubling, on average, of retail prices of petroleum products in April 1983, these were raised further by about 50 percent in October. To partially offset the erosion in real wages and salaries which, by early 1983, had dropped to 16 percent of the 1975 level, nominal wages and salaries were raised by 60 percent in the civil service and by 25 percent for other workers. Interest rate policy aims at attaining positive real rates over the medium term; toward this end, interest rates were raised by 35-40 percent (or by up to 5 percentage points) in October. Budget expenditure control has been strengthened, and additional discretionary revenue measures to strengthen the budget have also been taken. Cautious monetary and credit policies are being pursued, consistent with the needs of a reviving economy, at the same time as inflationary pressures are avoided.

The positive effects of the adjustment measures are expected to be felt progressively over 1983-84. Real growth is likely to be positive this year, and to accelerate to about 4 percent in 1984. In view of price decontrol measures, the rate of inflation, as measured by the national consumer price index, is expected to rise to 50 percent in 1983, but to be reduced by half in 1984. The overall budgetary deficit is expected to decline steadily through 1984 from the 1982 level of 4.6 percent of GDP. With regard to the balance of payments, a considerable increase in the current account deficit is expected, both in absolute terms and in relation to GDP (7-10 percent in 1983-84) because of the urgent need to expand import volumes to support investment and growth. Thus, import volumes are programmed to rise by around 50 percent in 1983-84. Already, a relatively more liberal import licensing policy has been adopted to enable the programmed increase in imports to take place. The impact of changes in the exchange rate, producer prices, and improved supply of imported inputs is expected to result in a strong expansion in export volumes in 1984. In addition, the Government intends to bring about a phased cash reduction of external payments arrears during the program period.

The Fund welcomes the adoption of the adjustment program as an important step toward rehabilitating the Ghanaian economy, and improving medium-term viability of the balance of payments. The authorities would clearly need to continue with their adjustment efforts beyond the current program period, and a significant increase in concessional external assistance from bilateral and multilateral sources would contribute to the success of such efforts. As the economic recovery takes hold, the authorities should be in a better position to ease exchange and trade restrictions.