

# 4 Brazil

Edson Shinya Suzuki

## 4.1 Introduction

### A) Geography and Environment

#### A.1) Situation

With a total area of 8,547,403.5 sq.km, Brazil is the fifth largest country in the world, after Russia, Canada, China and the United States. The country is located in South America's central eastern area, encompassing about 47 percent of the continental area.

The country is situated between the 05°16'20" parallel of latitude north and the 33°44'32" parallel of latitude south, and the 34°47'30" and 73°59'32" meridians west of Greenwich (England).

Its boundaries run through 23,086 km, of which 7,367 on the east shape the shore of the Atlantic Ocean. To the north, west and south Brazil has boundaries with almost all South American countries except for Chile, Ecuador and Trinidad and Tobago.

The extreme points are: to the north, the source of the Ailã river, on the Caburáí mount (State of Roraima, bordered by Guyana); to the south, one of the bends of the Chuí brook (State of Rio Grande do Sul, bordered by Uruguay); to the east, the point of Seixas (State of Paraíba); and to the west, the source of the Moa river on the Contamana or Divisor Range (State of Acre, bordered by Peru).

The national language is Portuguese and the currency is the Real (R\$).

#### A.2) Standard Time

Due to the distance separating its east-west extreme points (4,319.4 km) the country has four time zones. In most of the Brazilian territory, the time is three hours earlier than the standard Greenwich meridian time (GMT), England. When it is 12 p. m. in Greenwich, it is 12 - 3 = 9 a. m. in Brasília, the capital of Brazil.

Between the months of October and February, when the summer occurs, the country adopts the day-light savings time, setting the clock forward by one hour, in the Southeast, Central West and South Regions, and the States of Bahia (Northeast Region) and Tocantins (North Region).

#### A.3) Administrative Division

Brazil is a Federative Republic, with 5,548 municipalities combined into 26 states and a Federal District. The Federal District, where Brasília - the Republic's capital - is located, is the seat of government, housing the Executive, Legislative and Judiciary powers.

The states form five major regions: the North Region is the country's largest, covering 45.2 percent of the national territory and including the States of Rondônia, Acre, Amazonas, Roraima, Pará, Amapá and Tocantins; the Northeast Region occupies 18.2 percent of the national territory and is formed by the States of Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe and Bahia; the Southeast Region comprises 10.8 percent of the national territory and includes the States of Minas Gerais, Espírito Santo, Rio de Janeiro and São Paulo; the South Region is the smallest, occupying 6.7 percent of the territory and including the States of Paraná, Santa Catarina and Rio Grande do Sul; and the Central West Region, with 18.8 percent of the territory, is formed by the States of Mato Grosso do Sul, Mato Grosso, Goiás and the Federal District.

#### **A.4) Relief**

The Brazilian relief developed over an old geological base that for a long time was subject to the action of erosion without the occurrence of recent tectonic movements that would have created high mountain ranges. Therefore predominant altitudes are no higher than 500 m (78.03 percent of the territory), while a small area presents elevations over 1,200 m (0.54 percent).

#### **A.5) Climate**

The Brazilian geographic configuration, bordered by the ocean from north to south, continentality and relief features, associated to atmospheric systems dynamics, conditioned a vast climatic diversity, with sharp regional differences.

With regards to the thermal features, the higher annual measurements (26° to 28°C) occur in the Northeast Region's interior and the mid and lower Amazon river. The lowest values (under 18°C) occur in the hilly areas of the Southeast and the largest part of the South Region.

The highest absolute values, over 40°C, are recorded in the Northeast Region's low interior lands; in the Southeast Region's depressions, valleys and lowlands; in the Central West's Pantanal and lower areas; and in the South Region's central depressions and the Uruguay river valley. The lowest absolute temperatures, on the other hand, often show negatives values, occurring on the highest peaks of the Southeast and most of the South Region, where frosts and snow are usual.

Concerning the hydric aspects, rainy areas correspond to Pará's coastal lands and western Amazonas, where annual pluviometric values go beyond 3,000 mm. In the Southeast Region, on Serra do Mar (São Paulo), recorded annual values are over 3,500 mm. The less rainy areas are located in the Northeast Region, where annual values are under 500 mm.

Maximum precipitation occurs during summer-autumn in the most part of the Country, except for Roraima and north Amazonas where the rainy season occurs during the winter because these two states are located on the Northern Hemisphere.

#### **A.6) Hydric Resources**

Brazil has a vast and dense hydrographic network. Due to relief features, there is a predominance of highlands rivers that, among other characteristics, present a great potential for hydroelectric power production.

In Brazil, the hydropower generating potential, according to data from ELETROBRAS (1994) is estimated to be 127,867.6 MW/year, of which 24.42 percent are in operation and/or under construction, 35.80 percent inventoried and 39.78 percent estimated.

#### **B) Population**

Brazil had its first demographic enumeration in 1872. The Brazilian population was, at the time, 9.9 million inhabitants.

The 1940 Population Census showed that this figure had increased to 41.2 million inhabitants. Half a century later, data from the 1991 Census gave a count of 146,825,475 inhabitants, representing a 23.4 percent increase as compared to the population enumerated in 1980. Estimates for the year 2000 made by IBGE show that the Brazilian population would be around 167.7 million inhabitants. This year the annual population growth rate is expected to be 1.1%, indicating the large decline of the demographic increment in the last decades, induced by the behavior of the fertility.

The fertility rate of 2.4 children per woman, observed in 1998, expresses a reversion of the expectation of an explosive population growth, based on the growth rates of the fifties and sixties, which were close to 3%, considering the fertility level of the time, which was of 6 children per woman.

Although the fertility rate is different for each region, with 3.2 children in the North, 2.6 in the Northeast and between 2.1 and 2.2 in the Central West, the only Brazilian state with rates below the level of replacement (2 children per woman) is Rio de Janeiro, with 1.94 children per woman.

The aged population (persons sixty years old and over) has increased from 6.1 percent in 1980 to 7.3 percent in 1991 and now represents 8.8 percent of the total population. The life expectancy is estimated in 67.8 years (1999). In absolute figures, the aged population includes 14 million people. The Demographic Yearbook of 1997 shows that Brazil, whose process of population aging is recent, has one of the largest aged populations in the world, greater than that of countries such as France, Italy and United Kingdom.

On the other hand, the child and adolescent population (persons 0 to 17 years old) has fallen from a 45.3 percent share in the total 1980 population to 41 percent in 1991, and to 36.6 percent in 1998. This decrease was basically due to the Brazilian lower fertility rates and higher life expectancies, phenomena that have been occurring throughout the last decades.

### **C) Social Indicators**

Since the 1980's Brazil has been going through a particularly serious period in relation to its social situation: a very large number of Brazilians are living in a state of poverty and destitution whilst inequality in terms of wealth and income has reached a very high proportion. This poverty and inequality have their roots in the country's past but their more immediate causes can be found in the process of development based on the replacement of imports carried out by the state between the 1940's and the 1970's; in the crisis of that development pattern; in the failed attempts at economic adjustment; and in the consequences of the economic restructuring process imposed by globalization.

A study conducted by the IBGE – Instituto Brasileiro de Geografia e Estatística (Brazilian Institute of Geography and Statistics Foundation) in 1999 shows a little of this social condition. Here are some of the results of this study.

16.7% of the families are headed by women with no husband and with children. Among the poorest population this proportion is higher: 25.7% in Belém and 23.2% in Salvador.

Among a total 45.2 million of Brazilian families, 19.6% may be considered poor because they have a per capita income below one minimum wage. Maranhão has the highest percentage on this level of gains.

88.6% of the urban housing units in Brazil is served by public water supply. The proportion of urban housing units connected to public sewer systems is of 51.1% and 83.2% have their garbage collected.

In 1998, the country had 41.8 million households with 3.8 residents on average in each housing unit. The state of Amazonas had the highest average of residents per housing unit, 4.7, while Rio de Janeiro presented the lowest average, 3.3.

About two thirds of deaths among youngsters aged 15 to 19 is due to violent causes. The highest death rate due to external causes (homicides, traffic accidents, suicides, etc.) among young people 15 to 19 years old is observed in Roraima (82.5%), followed by the Federal District (77.6%) and Rio de Janeiro (77.2%). Even in childhood (5 to 9 years old) and adolescence (10 to 14 years old) the proportions are high. In the Central West Region, among all deaths in the group aged 5 to 9, 49.3% of them are violence-related.

About 30% of the families with children up to 6 years live with a per capita monthly income of half the minimum wage or less (the minimum wage is R\$ 151.00, about US\$ 77.50). The proportions of families with children in their first years that live with a per capita monthly income of half the minimum wage or less ranges from 67.8% in Maranhão to 9.8% in São Paulo.

The average income of the 40% poorest among the Brazilian population is R\$ 125.04 (about US\$ 64.10). Yet the average income of the 10% richest in the population is R\$ 2,477.61, adding up to 19 minimum wages. In this same comparison, we observe that among the 40% poorest in

the population, 31.1% live in housing units with basic sanitation, 2.8% are college students, 32.1% are employees without a formal contract, 25.7% are farm workers and only 8.8% work in manufactures. Regarding the 10% richest in the population, 80.5% live in housing units with basic sanitation, 25.5% are college students, only 6.8% are employees without a formal contract, 3.9% are farm workers and 14.6% are factory workers.

Income appropriation is very unequal as regards the composition of the skin color/ethnic group of the population, independently of the region considered. The figures show that the white population has better earnings than the black and the mulatto population. In Brazil, 12.1% of the families whose heads are white live with half a minimum wage per capita, while the proportions of families headed by blacks and mulattos range between 24.5% and 30.4%. At the other extreme, with income over five minimum wages, we have close to 15% of white families and only about 3% of black and mulatto families.

These data show that the Brazilian society has a tough task to promote and guarantee social rights and equality of opportunity to its population.

#### **D) Political Structure**

Discovered by Portugal in 1500, Brazil remained a colony for 322 years, having proclaimed its independence in 1822. Contrary to what happened in the rest of Latin America, it conserved the Monarchy as its form of government. In 1889 the Republic was proclaimed, and a constitutional model similar to the United States was established. The current Constitution was promulgated on October 5th, 1988. The unitarian State that have prevailed during the Monarchy (1822 – 1889) was transformed into a Federation, and the old provinces (now denominated states) began to exercise a decisive influence.

The official name of the country is Federative Republic of Brazil and it is composed by 26 states and the federal district where the capital Brasilia is located. The executive is headed by the president, who is elected for a term of four years. He chooses a cabinet of ministers which he heads and has a considerable residual power. The current president, Mr. Fernando Henrique Cardoso, was re-elected in the first round of the presidential election on October 4th 1998, with 53% of the votes.

The legislative power is exercised by a Bicameral National Congress with 81-seat Senate, composed of directly elected representatives of the 26 states plus the federal district of Brasilia, and 513-member directly elected Chamber of Deputies; elections for both houses are simultaneous.

Each state has its own judicial system; the country has a system of courts for dealing with disputes between states and those matters outside the jurisdiction of state courts.

### **4.2 Overview of Macroeconomic Activity and Fiscal Position**

The history of the Brazilian economy during the colonial period was characterized by its specialization in a variety of products which were of the interest to the Portuguese. When colonization began, production centred on the production of Brazil-wood; later, between the 16th and 17th centuries it concentrated on sugar-cane production whilst between the 17th and 19th centuries gold extraction was the main activity. As from the second half of the 19th century, Brazil became one of the major coffee producers.

The great depression of 1929 marked an important period in the Brazilian economy. The importance of coffee decreased perceptibly and the industrialization process which had started previously became more significant due to the exchange rate devaluation and the setting up of a variable exchange rates policy.

The post-war period was marked by a rapid process of import replacement which began in the sector producing consumer goods and then moved vertically backward as far as the production of capital goods and basic raw materials.

Today, Brazilian industry accounts for 20% of national production, agriculture for another 20% and the service sector, 60%. The next table show some of the economic indicators of Brazil.

**Table 4.1 National Accounts Indicators**

|  | R\$ thousand |              |              |              |              |                             |
|--|--------------|--------------|--------------|--------------|--------------|-----------------------------|
| Itemization  | 1994         | 1995         | 1996         | 1997         | 1998         | 1999                        |
| GDP at market prices                                 | 349 204 679  | 646 191 517  | 778 886 727  | 864 111 026  | 899 814 132  | 1 011 930 710 <sup>3/</sup> |
| Real GDP change rate (%)                             | 5.9          | 4.2          | 2.7          | 3.6          | - 0.1        | 1.0                         |
| Implicit GDP deflator (%)                            | 2 240.2      | 77.6         | 17.4         | 7.1          | 4.3          | 11.3 <sup>3/</sup>          |
| Nominal GDP change rate (%)                          | 2 377.1      | 85.0         | 20.5         | 10.9         | 4.1          | 12.5 <sup>3/</sup>          |
| Net income/payments abroad 1/                        | 5 912 805    | 10 153 742   | 12 227 761   | 17 110 252   | 22 362 173   | 33 149 160                  |
| GNP at market prices                                 | 343 291 874  | 636 037 775  | 766 658 966  | 847 000 774  | 877 451 959  | 978 781 550 <sup>3/</sup>   |
| Net unrequited transfers 2/                          | 1 478 647    | 3 324 649    | 2 598 250    | 2 022 936    | 1 759 437    | 2 035 265 <sup>*</sup>      |
| Gross national disposable Income 2/                  | 344 770 521  | 639 362 424  | 769 257 216  | 849 023 710  | 879 211 396  | 980 816 815 <sup>3/</sup>   |
| Balance of payments deficit in current account       | 3 207 077    | 18 226 492   | 24 509 968   | 37 883 110   | 44 573 739   | 24 383 018 <sup>*</sup>     |
| Consumption expenditures and Gross capital formation | 347 977 598  | 657 588 916  | 793 767 184  | 886 906 820  | 923 785 135  | 1 005 199 833 <sup>3/</sup> |
| Consumption  | 270 644 256  | 513 561 741  | 630 813 704  | 699 352 261  | 732 311 291  | ...                         |
| Gross capital formation                              | 77 333 342   | 144 027 175  | 162 953 480  | 187 554 559  | 191 473 844  | ...                         |
| Gross savings 2/                                     | 74 126 265   | 125 800 683  | 138 443 512  | 149 671 449  | 146 900 105  | ...                         |
| <b>GDP (US\$ billion)<sup>3/</sup></b>               | <b>543.1</b> | <b>705.4</b> | <b>775.5</b> | <b>801.7</b> | <b>775.5</b> | <b>557.5</b>                |

Source: Bacen, IBGE

1/ Nonresident employees earnings included.

2/ Capital transfers are included, due to fail in identifying them up to now.

3/ Banco Central do Brasil estimates.

Inflation has been the most distinctive feature of the Brazilian and the most of the other Latin American economies. Since 1948, when Getulio Vargas Foundation began to calculate the general price indexes, Brazilian inflation has always been very high, always on the increase and most of time reaching over two figures annually. In 1964 the military government that deposed the previously established civil government imposed a rigid wages policy that brought down the inflation rate and created a legislation that enabled the price-level replacement of taxes and of financial assets and finally, after 1967, mini devaluations of the exchange rate. The Brazilian economy became highly indexed with falling inflation rates thanks to wages and labor union control.

With the 1974 oil crisis, inflation rose once again and the military government announced the start of the open policy process. The second oil shock in 1979 and the foreign debt crisis in 1982 marked the beginning of a very difficult period for the Brazilian economy, with the interruption of foreign loans and with an increase in the inflation rate to unheard of levels, even in Brazil.

In 1985, with the end of the military government and of the wages law, workers began to demand ever more frequent wage adjustments, with immediate repercussions on the inflation rate. After 1986, Brazil tried various economic stabilization programmes. The first of these, the Cruzado Plan (1986), abolished the price-level restatement and indexation, freezing prices. The Plan failed and the other attempts followed: the Bresser Plan in 1987; the Summer Plan in 1988, and the Collor Plan in 1990. The latter differed from the others in terms of the seizure of 80% of financial assets, including demand deposits, leading the country to a recession process, as well as beginning a process to reduce import tariffs.

In March 1994 Brazil's foreign debt was renegotiated within the renegotiation framework used for other Latin American countries. July of the same year saw the launch of the Real Plan which with the freeing up of prices, brought down the inflation rate and reduced the trade tariffs still further. The exchange rates was fixed at constant nominal values and there was a definite drop in

inflation. After many years of clear trade surpluses, the Brazilian economy began to move into deficit.

In terms of inflation, the Brazilian economy underwent a radical change after the Real Plan. In terms of growth, the strategy adopted by the Real Plan and the actual growth rate of the world economies are less promising.

In January 1999, after losing a large volume of exchange reserves since the Russian crisis of October, 1998, the Central Bank abandoned the fixed exchange rate system that could vary within the bands, which represented a serious threat to the country's stability. The rate of exchange devaluated in the first two months in nearly 60% and then retracted to a devaluation of approximately 30% with relation to the 1998 final fixed exchange rates. Now it is in a rate approximately 55% higher in relation to the 1998 final exchange rates.

Now the expectations concerning the Brazilian economy began to take on a more optimistic tone. For 1999, real GDP growth is estimated to have increased for about 1% and from this year to 2002, the government is projecting GDP growth at an average of 4.5% a year.

In terms of inflation, in July 1999, the government has instituted a formal inflation targeting framework for monetary policy. A broad-based consumer price index was chosen (the IPCA – IBGE), with the annual targets for consumer price inflation through the year being set at 6 percent this year, 4 percent in 2001 and 3.5 percent in 2002. In 1999, despite significant depreciation of the Real and some supply shocks, the annual inflation rate was 8.94 percent, within the tolerance range of the established inflation target for the year (8 percent plus or minus 2% points). The target mechanism was designed to play a dual role: a permanent one of nominal anchor and a temporary one of disinflation guideline. This is not unlike what happened in other countries that adopted inflation targeting immediately after letting their currencies float. A band of 2 percentage points around the target levels was introduced. This band is wider than that of most other countries because there is no a core inflation index in Brazil yet, and also because there is more intrinsic uncertainty in Brazil at this stage than elsewhere.

## **4.2.1 Macroeconomic Activity**

### **A. International Environment**

#### **A.1) Trade Balance**

The historical trend in relation to export and import in Brazil largely reflects the guidelines adopted along the years by trade policy and exchange rate policies as well as by other economic policy mechanisms affecting overseas trade. During most of the 1980's, trade surpluses took precedence as a result of the problems with the foreign debt, leading to efforts to ensure that exchange rates did not lag behind in relation to inflation. At the same time, protectionist policies – both tariff and non-tariff – were retained for the industrialisation period.

During the 1990's, the opening up of the economy resulted in increased imports. The renegotiation of the foreign debt and a new and intense inflow of short-term capital removed the trade mega-surpluses from the agenda of priorities of those formulating economic policy. As from mid 1994, the exchange rate base instituted by the Real Plan played an important part, forcing down the price of tradable goods.

Many economists considers that an important exchange rate valuation, in real terms, has taken place at the beginning of the exchange rate base operation. The consequent explosion in Brazilian imports in 1995, as well as the exchange rate crisis in Mexico at the end of 1994 provoked a debate on the sustainability of the exchange rate and trade policy in the force at the time. After this Mexican crisis the exchange rate regime had become partially flexible with the introduction of exchange bands and with the previous announcement of gradual exchange rate devaluation. The Asiatic financial crisis in 1997, followed by Russia's moratorium in mid 1998 and by

contaminating effects of the later, altered the exchange rate regime more rapidly until it became completely flexible, by provoking an important capital exodus between August and December, 1998.

After this adjustment it was expected that the recent commercial deficits cycle had come to an end. But the developments so far in the external trade balance have been less favorable than expected. The accumulated trade surplus in the period between January and September 2000 came to US\$ 717 million, as compared to a deficit of US\$ 776 million in the same 1999 period, but the expectations of the government were of a surplus of US\$ 3.5 billion for the year. This relatively modest size of improvement reflects a substantial unanticipated loss in Brazil's terms of trade, due to the sharp increase of international oil prices, the declines in the prices of some major export commodities and weakness of manufacturing export prices.

An interesting point to comment is that the performance of the import sector was also marked by growth in the purchase of raw materials and intermediate products reflecting the good performance of the economy during this year.

**Table 4.2 Trade Balance – FOB**

**US\$ million**

| Period    | Exports |             |           | Imports |             |           | Balance |             |           |
|-----------|---------|-------------|-----------|---------|-------------|-----------|---------|-------------|-----------|
|           | Monthly | Accumulated | 12 Months | Monthly | Accumulated | 12 Months | Monthly | Accumulated | 12 Months |
| 1987      | -       | 26 224      | 26 224    | -       | 15 051      | 15 051    | -       | 11 173      | 11 173    |
| 1988      | -       | 33 789      | 33 789    | -       | 14 605      | 14 605    | -       | 19 184      | 19 184    |
| 1989      | -       | 34 383      | 34 383    | -       | 18 263      | 18 263    | -       | 16 120      | 16 120    |
| 1990      | -       | 31 414      | 31 414    | -       | 20 661      | 20 661    | -       | 10 752      | 10 752    |
| 1991      | -       | 31 620      | 31 620    | -       | 21 041      | 21 041    | -       | 10 579      | 10 579    |
| 1992      | -       | 35 793      | 35 793    | -       | 20 554      | 20 554    | -       | 15 239      | 15 239    |
| 1993      | -       | 38 555      | 38 555    | -       | 25 256      | 25 256    | -       | 13 299      | 13 299    |
| 1994      | -       | 43 545      | 43 545    | -       | 33 079      | 33 079    | -       | 10 466      | 10 466    |
| 1995      | -       | 46 506      | 46 506    | -       | 49 972      | 49 972    | -       | - 3 466     | -3 466    |
| 1996*     | -       | 47 747      | 47 747    | -       | 53 346      | 53 346    | -       | - 5 599     | -5 599    |
| 1997*     | -       | 52 994      | 52 994    | -       | 59 837      | 59 837    | -       | - 6 843     | -6 843    |
| 1998*     | -       | 51 140      | 51 140    | -       | 57 734      | 57 734    | -       | -6 594      | -6 594    |
| 1999* Jan | 2 949   | 2 949       | 50 172    | 3 645   | 3 645       | 56 731    | - 696   | - 696       | -6 559    |
| Feb       | 3 267   | 6 216       | 49 723    | 3 165   | 6 811       | 55 954    | 101     | - 595       | -6 230    |
| Mar       | 3 829   | 10 045      | 49 279    | 4 052   | 10 863      | 54 840    | - 222   | - 817       | -5 561    |
| Apr       | 3 707   | 13 752      | 48 409    | 3 672   | 14 535      | 53 882    | 35      | - 782       | -5 473    |
| May       | 4 386   | 18 139      | 48 183    | 4 079   | 18 614      | 53 227    | 307     | - 475       | -5 044    |
| Jun       | 4 313   | 22 451      | 47 609    | 4 458   | 23 072      | 52 984    | - 145   | - 620       | -5 374    |
| Jul       | 4 117   | 26 568      | 46 756    | 4 027   | 27 099      | 51 616    | 90      | - 530       | -4 859    |
| Aug       | 4 277   | 30 845      | 47 048    | 4 464   | 31 562      | 51 926    | - 187   | - 717       | -4 878    |
| Sep       | 4 187   | 35 033      | 46 697    | 4 244   | 35 806      | 50 444    | - 57    | - 774       | -3 747    |
| Oct       | 4 304   | 39 337      | 46 984    | 4 459   | 40 265      | 49 450    | - 155   | - 929       | -2 466    |
| Nov       | 4 002   | 43 338      | 47 282    | 4 530   | 44 796      | 49 254    | - 528   | -1 457      | -1 972    |
| Dec       | 4 673   | 48 011      | 48 011    | 4 426   | 49 222      | 49 222    | 247     | -1 210      | -1 210    |
| 2000* Jan | 3 453   | 3 453       | 48 515    | 3 548   | 3 548       | 49 124    | - 95    | - 95        | - 609     |
| Feb       | 4 123   | 7 576       | 49 372    | 4 047   | 7 595       | 50 006    | 76      | - 18        | - 634     |
| Mar       | 4 472   | 12 048      | 50 014    | 4 436   | 12 031      | 50 390    | 35      | 17          | - 376     |
| Apr       | 4 181   | 16 230      | 50 489    | 3 998   | 16 029      | 50 716    | 183     | 200         | - 228     |
| May       | 5 063   | 21 292      | 51 165    | 4 702   | 20 731      | 51 339    | 361     | 561         | - 174     |
| Jun       | 4 861   | 26 153      | 51 713    | 4 603   | 25 334      | 51 484    | 258     | 819         | 229       |
| Jul       | 5 003   | 31 156      | 52 599    | 4 885   | 30 219      | 52 342    | 118     | 937         | 257       |
| Aug       | 5 519   | 36 675      | 53 841    | 5 424   | 35 643      | 53 302    | 95      | 1 032       | 539       |
| Sep       | 4 724   | 41 399      | 54 378    | 5 044   | 40 682      | 54 102    | - 320   | 712         | 276       |

Source: MDIC/Secex

The next table shows the results of the exports detailed by products. An analysis of exports by aggregate factor points that the importance of the industrialized products has been increasing on the total volume exported. The latest data reported that until September 2000 the participation of the primary products corresponded to 23.3% of the total volume exported while the participation of the industrialized products corresponded to 73.8%. Between the manufactured products exported the aircrafts and the passenger vehicles are important products to be noted.

**Table 4.3 Exports – FOB**

**US\$ million**

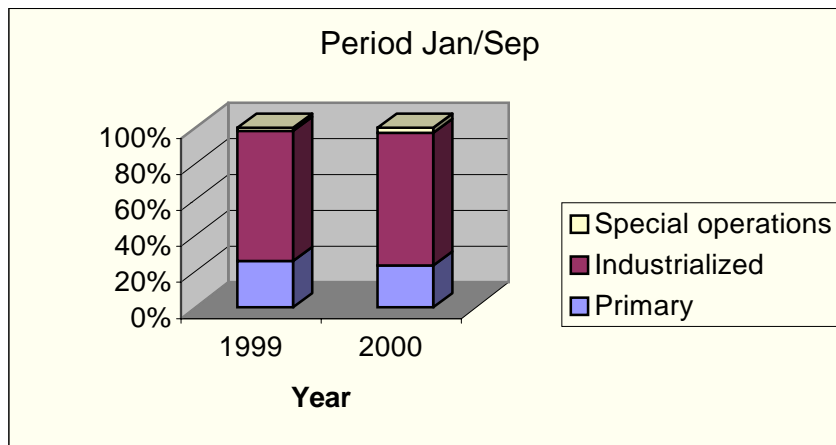
| Itemization  | 1995   | 1996*  | 1997*  | 1998*  | 1999   | 2000    |
|--|--------|--------|--------|--------|--------|---------|
|  |        |        |        |        |        | Jan-Sep |
| Total  | 46 506 | 47 747 | 52 994 | 51 140 | 48 011 | 41 399  |
| Primary products (value)   | 16 787 | 18 071 | 20 258 | 19 189 | 17 784 | 9 659   |
| Coffee (including instant coffee)  | 2 426  | 2 095  | 3 095  | 2 578  | 2 441  |         |
| Soybeans1/   | 3 820  | 4 462  | 5 729  | 4 761  | 3 784  |         |
| Cocoa (beans, butter, liqueur and cake)                                  | 117    | 162    | 116    | 140    | 95     |         |
| Sugar (raw and refined)  | 1 817  | 1 609  | 1 772  | 1 943  | 1 911  |         |
| Orange juice   | 1 105  | 1 393  | 1 003  | 1 262  | 1 235  |         |
| Meat2/   | 1 297  | 1 509  | 1 563  | 1 598  | 1 933  |         |
| Iron ore, manganese and other ores                                       | 2 746  | 2 933  | 3 061  | 3 468  | 2 943  |         |
| Tobacco in leaf  | 769    | 1 029  | 1 091  | 940    | 893    |         |
| Others (US\$ million)  | 2 690  | 2 880  | 2 827  | 2 498  | 2 550  |         |
| Industrialized products (US\$ million)                                   | 29 720 | 29 676 | 32 737 | 31 951 | 30 227 | 30 533  |
| Transport equipment and components<br>(parts, accessories and equipment) | 4 259  | 4 750  | 6 758  | 7 599  | 6 555  |         |
| Machines and mechanical instruments                                      | 3 050  | 3 150  | 3 393  | 3 197  | 2 907  |         |
| Electric and electronic equipment  | 1 505  | 1 584  | 1 783  | 1 712  | 1 813  |         |
| Metallurgical products   | 6 593  | 6 260  | 6 017  | 5 422  | 5 056  |         |
| Chemical products  | 3 348  | 3 486  | 3 828  | 3 671  | 3 462  |         |
| Wood and manufactured wood   | 1 135  | 1 110  | 1 218  | 1 127  | 1 391  |         |
| Footwear and leather products  | 1 550  | 1 712  | 1 663  | 1 454  | 1 409  |         |
| Oil derivatives3/  | 774    | 1 036  | 1 110  | 967    | 1 219  |         |
| Paper and pulp   | 2 705  | 1 935  | 1 991  | 1 979  | 2 144  |         |
| Textile products   | 1 328  | 1 272  | 1 250  | 1 093  | 995    |         |
| Others   | 3 473  | 3 381  | 3 725  | 3 727  | 3 277  | 1207    |

Source: MDIC/Secex

1/ Includes beans, bran, crude oil and refined oil.

2/ Includes meat and meat products. 3/ Includes on board consumption.

**Figure 4.1 Exports by Sector**



Source: IBGE



The next table shows the results of the imports detailed by products. We can notice the decrease in the volume of consumer goods imported and an increase in the volume of the raw materials and capital goods imported. According to the latest data available (September 2000) imports grew 13.6%, a performance that was impacted by an upswing in economic activity, particularly in the industrial sector. Since output of this sector was the highest since 1975, demand for raw materials and intermediate products heightened. Among the various sectors, outlays on fuels and lubricants registered the highest growth as a result of growth in international market oil prices.

**Table 4.4 Imports – FOB**

**US\$ million**

| Itemization         | 1995   | 1996*  | 1997*  | 1998*  | 1999   | 2000    |
|---------------------|--------|--------|--------|--------|--------|---------|
|                     |        |        |        |        |        | Jan-Sep |
| Total               | 49 972 | 53 346 | 59 837 | 57 734 | 49 222 | 40 682  |
| Consumer goods      | 8 631  | 9 010  | 9 241  | 8 825  | 6 283  | 5 326   |
| Raw materials       | 16 738 | 17 916 | 18 978 | 19 311 | 16 963 | 21 015  |
| Oil and derivatives | 4 712  | 6 142  | 6 018  | 4 313  | 4 816  | 4 538   |
| Capital goods       | 19 891 | 20 277 | 25 600 | 25 284 | 21 159 | 9 803   |

Source: MDIC/Secex

The next table relating to Brazilian overseas trade by area shows the development of overseas trade by region in 1999 and the period 2000 Jan-May. It can be noticed that the European Union is the largest regional partner, while the USA is individually the greatest one. In Asia, Japan is our major partner, while in the area of MERCOSUR (Common Market of the South) Argentina is our major partner.

**Table 4.5 Trade by area – FOB**

**US\$ million**

| Itemization          | 1999*   |         |         | 2000 (Jan-may)* |         |         |
|----------------------|---------|---------|---------|-----------------|---------|---------|
|                      | Exports | Imports | Balance | Exports         | Imports | Balance |
| Total                | 48 011  | 49 222  | -1 210  | 21 292          | 20 731  | 561     |
| Total excluding Opec | 45 742  | 45 477  | 266     | 20 509          | 18 894  | 1 614   |
| Laia                 | 10 024  | 8 483   | 1 541   | 4 773           | 3 824   | 949     |
| Mercosur             | 6 778   | 6 721   | 57      | 3 106           | 2 975   | 130     |
| Argentina            | 5 364   | 5 814   | - 450   | 2 357           | 2 581   | - 224   |
| Paraguay             | 744     | 260     | 484     | 309             | 150     | 159     |
| Uruguay              | 670     | 647     | 23      | 439             | 244     | 195     |
| Asia                 | 5 511   | 6 281   | - 769   | 2 186           | 2 886   | - 700   |
| China                | 676     | 865     | - 189   | 260             | 391     | - 131   |
| Korea, Republic of   | 628     | 1 019   | - 392   | 238             | 503     | - 265   |
| Japan                | 2 193   | 2 576   | - 383   | 920             | 1 055   | - 135   |
| Others               | 2 015   | 1 821   | 195     | 767             | 937     | - 170   |
| Canada               | 513     | 973     | - 460   | 205             | 342     | - 136   |
| European Union       | 13 736  | 14 984  | -1 248  | 6 182           | 5 594   | 587     |
| Eastern Europe       | 1 175   | 704     | 471     | 307             | 400     | - 93    |
| USA                  | 10 849  | 11 872  | -1 023  | 4 937           | 4 875   | 61      |
| Opec                 | 2 269   | 3 745   | -1 476  | 783             | 1 837   | -1 053  |
| Others               | 3 545   | 1 213   | 2 332   | 1 616           | 590     | 1 026   |

Source: MDIC/Secex

Note: Imports according to the country of origin, and not from the country of acquisition of the product.

## A.2) Current account balance

The balance of payments remains a problem because of the great deficit in the balance of services. As can be seen this figure has been the most important factor for the current transactions deficits in the period. The weight of the interest payments represents the lion's part in this deficit. Until the second quarter of 2000 the current transactions deficit shows a figure of US\$ 7.2 billion and for the year the deficit is expected to reach the total amount of US\$ 24.5 billion. This means that the Brazil remains vulnerable to external crisis because this current account deficit is still about 4% of GDP. The inflows of external investments and external loans are essential to cover this deficit. As can be observed the inflows of external investments during the last three years reached substantial figures (over US\$ 20 billion annually). The flow of foreign direct investments in 1999 reached US\$ 30 billion, hence covering entirely the the current account financing needs.

**Table 4.6 - Balance of payments**

**US\$ million**

| Itemization                  | 1995    | 1996    | 1997*   | 1998*   | 1999*   | 2000*  |        |
|------------------------------|---------|---------|---------|---------|---------|--------|--------|
|                              |         |         |         |         |         | I Q    | II Q   |
| Trade balance – FOB          | -3 351  | -5 599  | -6 843  | -6 594  | -1 210  | 17     | 802    |
| Exports                      | 46 506  | 47 747  | 52 994  | 51 140  | 48 011  | 12 048 | 14 105 |
| Imports                      | 49 858  | 53 346  | 59 837  | 57 734  | 49 222  | 12 031 | 13 303 |
| Services (net)               | -18 595 | -20 443 | -26 279 | -28 800 | -25 884 | -4 570 | -8 497 |
| Interest                     | -8 158  | -9 173  | -10 388 | -11 947 | -15 270 | -2 628 | -5 366 |
| Other services <sup>1/</sup> | -10 437 | -11 271 | -15 890 | -16 853 | -10 614 | -1 942 | -3 130 |
| Unrequited transfers         | 3 974   | 2 900   | 2 216   | 1 778   | 2 032   | 422    | 462    |
| Current transactions         | -17 972 | -23 142 | -30 906 | -33 615 | -25 063 | -4 131 | -7 232 |
| Capital                      | 29 359  | 33 959  | 25 972  | 20 664  | 13 923  | 8 421  | 5 287  |
| Investment (net)             | 4 663   | 15 540  | 20 662  | 20 498  | 30 034  | 6 279  | 6 865  |
| Reinvestment                 | 384     | 531     | 151     | 124     | ...     | ...    | ...    |
| Financing                    | 2 834   | 4 307   | 19 621  | 22 153  | 15 974  | 1 993  | 4 377  |
| Foreign                      | 3 513   | 4 518   | 20 187  | 24 908  | 16 648  | 2 181  | 4 326  |
| Brazilian                    | - 679   | - 211   | - 566   | -2 755  | - 674   | - 188  | 51     |
| Amortizations                | -11 023 | -14 419 | -28 714 | -30 677 | -48 772 | -7 057 | -7 285 |
| Long and medium- term loans  | 14 736  | 22 886  | 28 964  | 41 596  | 28 022  | 7 581  | 3 520  |
| Short-term capital           | 18 834  | 5 403   | -18 936 | -31 170 | -8 765  | - 228  | -2 143 |
| Other capitals               | -1 069  | - 290   | 4 224   | -1 859  | -2 569  | - 146  | - 48   |
| Errors and omissions         | 2 093   | -1 800  | -2 911  | -4 335  | 400     | -1 142 | 1 351  |
| Surplus (+) or deficit (-)   | 13 480  | 9 017   | -7 845  | -17 285 | -10 740 | 3 148  | - 595  |
| Financing                    | -13 480 | -9 017  | 7 845   | 17 285  | 10 740  | -3 148 | 595    |

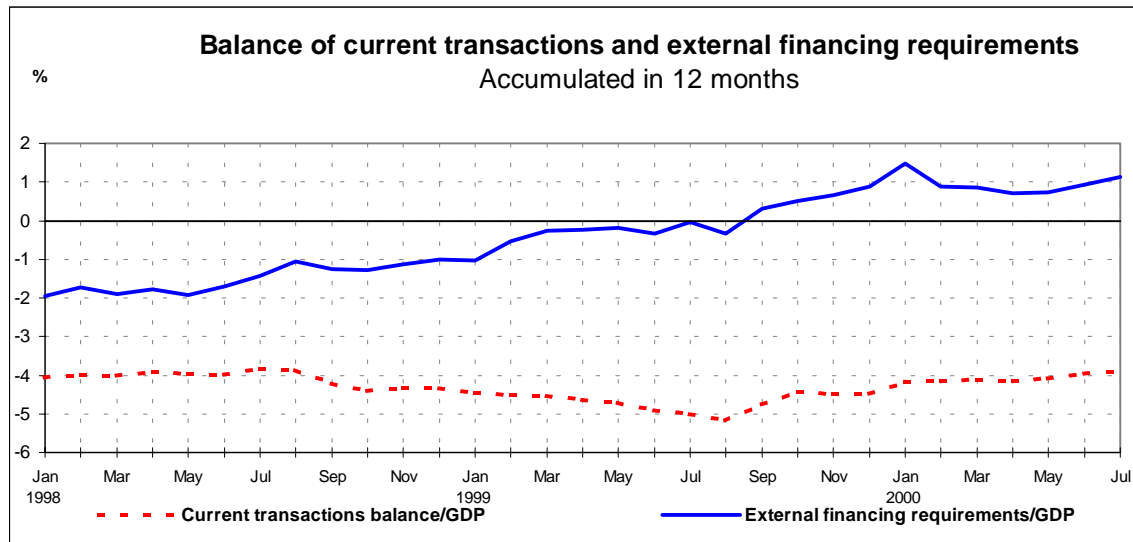
Source: Banco Central do Brasil/BACEN

<sup>1/</sup> Includes reinvested earnings.

<sup>2/</sup> Includes bonds, commercial papers, fixed/floating rate notes and securitization.

The next figure presents the behavior of the balance of current transactions and the external financing requirements as a percentage of the GDP. As can be noted the current account deficit still remains around 4% of the GDP.

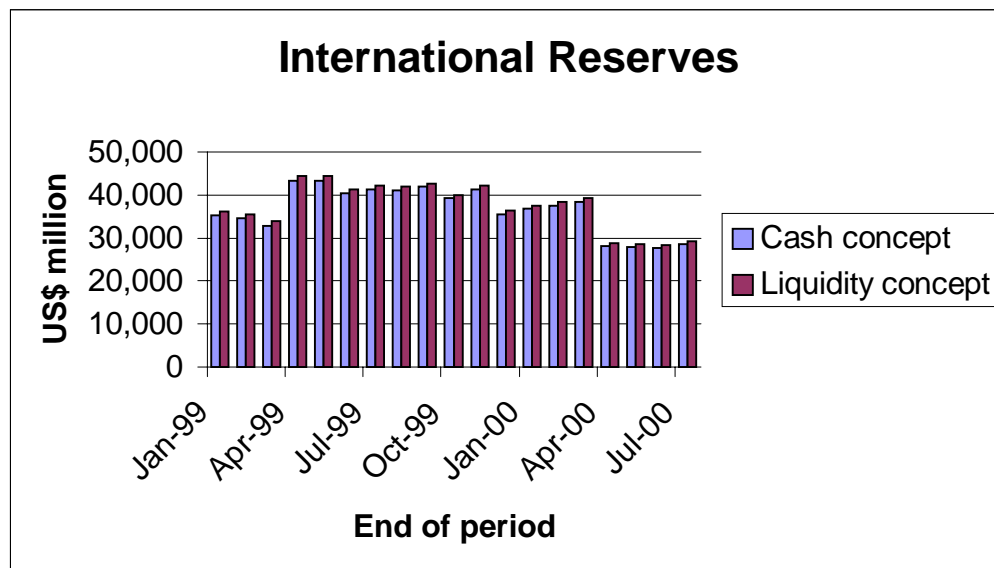
**Figure 4.2 Balance of current transactions and the external financing requirements as a percentage of the GDP.**



Source: Bacen

The next figure presents the behavior of the international reserves in the Central Bank of Brazil. In the month of July 2000, international reserves came to US\$ 28.6 billion in the cash concept and US\$ 29.2 billion in the international liquidity concept.

**Figure 2.3 International reserves in the Central Bank of Brazil**



Source: Banco Central do Brasil/BACEN

### A.3) Exchange rate and exchange system

The backgrounds to Brazil's financial crisis in early 1999 included both fiscal and balance payments weaknesses: in mid-1998, Brazil's consolidated fiscal position was showing a primary deficit as the government's expenditures, excluding interest payments, exceeded its income. The bulk of the government's domestic debt – which amounted to 40 percent of GDP – consisted of short-term financing. The current account deficit was approaching 5 percent of GDP, even as the

economy was sliding into a recession. Then, as often happens to vulnerable countries, an economic crisis erupted: after Russia defaulted on its debt in August, capital flows to Brazil came to a halt.

These events forced Brazil to float the Real and led to a panic in January 1999. In February, the Real plummeted to 2.15 to dollar, from 1.20 at the beginning of the year. The situation was ominous: Brazil could soon have found itself in all kinds of trouble. A panicky reaction to the devaluation could have created serious imbalances, fueling inflation while driving the economy into a deep recession. Observers predicted inflation rates ranging from 30 percent to 80 percent. Forecasts for GDP growth in 1999 ranged from -3 percent to -6 percent. But the reversal of the exchange rate overshooting, which occurred in March 2000, showed that these forecasts were exaggerated. As the table below can show the behavior of the foreign exchange rate is quite under control.

**Table 4.7 Foreign exchange rate1/ R\$/US\$**

| Period | Commercial    |          |              |          |                       |          |              |                    |         |              |
|--------|---------------|----------|--------------|----------|-----------------------|----------|--------------|--------------------|---------|--------------|
|        | End of period |          |              |          | Average exchange rate |          |              |                    |         |              |
|        | Buying Rate   | % change | Selling Rate | % change | Buying Rate           | % change | Selling Rate | Percentage changes |         |              |
|        |               |          |              |          |                       |          |              | In month           | In Year | In 12 months |
| 1995   | 0.9715        | 15.11    | 0.9725       | 14.95    | 0.9160                | 42.46    | 0.9177       | -                  | 42.28   | 42.28        |
| 1996   | 1.0386        | 6.91     | 1.0394       | 6.88     | 1.0044                | 9.65     | 1.0052       | -                  | 9.53    | 9.53         |
| 1997   | 1.1156        | 7.41     | 1.1164       | 7.41     | 1.0779                | 7.32     | 1.0787       | -                  | 7.31    | 7.31         |
| 1998   | 1.2079        | 8.27     | 1.2087       | 8.27     | 1.1603                | 7.64     | 1.1611       | -                  | 7.64    | 7.64         |
| 1999   | 1.7882        | 48.04    | 1.7890       | 48.01    | 1.8150                | 56.43    | 1.8158       | -                  | 56.39   | 56.39        |
| Jan    | 1.9824        | 64.12    | 1.9832       | 64.08    | 1.5011                | 24.61    | 1.5019       | 24.60              | 24.60   | 34.11        |
| Feb    | 2.0640        | 4.12     | 2.0648       | 4.11     | 1.9129                | 27.43    | 1.9137       | 27.42              | 58.76   | 69.79        |
| Mar    | 1.7212        | -16.61   | 1.7220       | -16.60   | 1.8960                | -0.88    | 1.8968       | -0.88              | 57.36   | 67.31        |
| Apr    | 1.6599        | -3.56    | 1.6607       | -3.56    | 1.6933                | -10.69   | 1.6941       | -10.69             | 40.54   | 48.45        |
| May    | 1.7232        | 3.81     | 1.7240       | 3.81     | 1.6827                | -0.63    | 1.6835       | -0.63              | 39.66   | 46.63        |
| Jun    | 1.7687        | 2.64     | 1.7695       | 2.64     | 1.7646                | 4.87     | 1.7654       | 4.86               | 46.46   | 52.90        |
| Jul    | 1.7884        | 1.11     | 1.7892       | 1.11     | 1.7995                | 1.98     | 1.8003       | 1.98               | 49.35   | 55.00        |
| Aug    | 1.9151        | 7.08     | 1.9159       | 7.08     | 1.8800                | 4.47     | 1.8808       | 4.47               | 56.03   | 60.52        |
| Sep    | 1.9215        | 0.33     | 1.9223       | 0.33     | 1.8973                | 0.92     | 1.8981       | 0.92               | 57.47   | 60.73        |
| Oct    | 1.9522        | 1.60     | 1.9530       | 1.60     | 1.9687                | 3.76     | 1.9695       | 3.76               | 63.39   | 65.73        |
| Nov    | 1.9219        | -1.55    | 1.9227       | -1.55    | 1.9291                | -2.01    | 1.9299       | -2.01              | 60.10   | 61.67        |
| Dec    | 1.7882        | -6.96    | 1.7890       | -6.95    | 1.8420                | -4.51    | 1.8428       | -4.51              | 52.88   | 52.88        |
| 2000   |               |          |              |          |                       |          |              |                    |         |              |
| Jan    | 1.8016        | 0.75     | 1.8024       | 0.75     | 1.8029                | -2.12    | 1.8037       | -2.12              | -2.12   | 20.09        |
| Feb    | 1.7677        | -1.88    | 1.7685       | -1.88    | 1.7745                | -1.58    | 1.7753       | -1.57              | -3.66   | -7.23        |
| Mar    | 1.7465        | -1.20    | 1.7473       | -1.20    | 1.7412                | -1.87    | 1.7420       | -1.87              | -5.47   | -8.16        |
| Apr    | 1.8059        | 3.40     | 1.8067       | 3.40     | 1.7674                | 1.50     | 1.7682       | 1.50               | -4.05   | 4.37         |
| May    | 1.8258        | 1.10     | 1.8266       | 1.10     | 1.8271                | 3.38     | 1.8279       | 3.38               | -0.81   | 8.58         |
| Jun    | 1.7992        | -1.46    | 1.8000       | -1.46    | 1.8075                | -1.07    | 1.8083       | -1.07              | -1.87   | 2.43         |
| Jul    | 1.7740        | -1.40    | 1.7748       | -1.40    | 1.7970                | -0.58    | 1.7978       | -0.58              | -2.44   | -0.14        |

Source: BACEN

#### A.4) Foreign direct investment

As mentioned earlier the inflow of external resources is the responsible for the equilibrium in the balance of payments. That's way many analysts point out that the country is still vulnerable to international crisis.

**Table 4.8 Inflow of external resources 1/****US\$ million**

| Itemization          | 1996   | 1997*   | 1998*   | 1999*   | 2000*  |        |
|----------------------|--------|---------|---------|---------|--------|--------|
|                      |        |         |         |         | I Q    | II Q   |
| Total                | 79 291 | 129 646 | 148 042 | 116 902 | 24 688 | 22 914 |
| Investments          | 35 444 | 57 382  | 60 131  | 49 440  | 12 205 | 11 954 |
| Portfolio            | 24 684 | 37 190  | 26 358  | 15 395  | 5 023  | 5 301  |
| Direct <sup>2/</sup> | 9 580  | 17 864  | 26 515  | 26 910  | 6 715  | 6 382  |
| Others               | 1 180  | 2 328   | 7 258   | 7 135   | 467    | 271    |
| Currency loans       | 28 078 | 35 534  | 58 128  | 43 360  | 8 865  | 5 827  |
| Financing            | 6 828  | 24 192  | 19 284  | 16 563  | 2 007  | 2 591  |
| Leasing and rent     | 1 868  | 4 002   | 3 848   | 2 804   | 732    | 783    |
| Prepaid exports      | 7 073  | 8 536   | 6 651   | 4 735   | 879    | 1 759  |

**Source: BACEN**

1/ Operations in national currency not included.

2/ Does not include investments in national currency, in merchandise, loans and interest conversions or reinvestments.

**A.5) Borrowing from abroad**

In June 2000, the total external debt totaled US\$ 232.9 billion representing a reduction of almost US\$ 9 billion compared to the end of 1999. It reflects basically the payments of amortizations to multilateral institutions that occurred in the period. In terms of GDP the total external debt represented in 1999 a debt-GDP ratio of 43%.

**Table 4.9 Total external debt****US\$ million**

| Itemization                               | 1996           | 1997           | 1998           | 1999           | 2000 (March)   | 2000 (June)    |
|---|----------------|----------------|----------------|----------------|----------------|----------------|
| Registered debt                           | 144 092        | 167 760        | 220 350        | 219 196        | 220 470        | 211 235        |
| Non financial public sector <sup>1/</sup> | 84 229         | 76 205         | 92 021         | 97 448         | 98 189         | 89 209         |
| Banks                                     | 5 642          | 5 348          | 7 055          | 6 179          | 5 931          | 6 363          |
| Brazilian                                 | 910            | 954            | 1 216          | 1 167          | 1 166          | 1 011          |
| Foreign                                   | 4 732          | 4 394          | 5 839          | 5 011          | 4 765          | 5 352          |
| Multilateral                              | 8 880          | 9 236          | 20 552         | 26 211         | 25 888         | 17 612         |
| Bilateral (Paris Club included)           | 15 089         | 12 518         | 12 702         | 11 696         | 11 539         | 10 762         |
| Debt bond from banks                      | 51 239         | 41 930         | 40 418         | 35 324         | 33 763         | 32 943         |
| Others                                    | 3 379          | 7 173          | 11 293         | 18 038         | 21 069         | 21 529         |
| Private sector <sup>2/</sup>              | 59 863         | 91 555         | 128 329        | 121 748        | 122 282        | 122 026        |
| Banks                                     | 46 673         | 67 759         | 87 068         | 84 741         | 85 242         | 84 534         |
| Brazilian                                 | 5 448          | 8 863          | 9 937          | 10 849         | 11 358         | 10 773         |
| Foreign                                   | 41 225         | 58 896         | 77 131         | 73 892         | 73 884         | 73 761         |
| Multilateral                              | 2 513          | 3 150          | 3 835          | 4 318          | 4 317          | 4 527          |
| Bilateral                                 | 916            | 1 996          | 4 973          | 3 531          | 3 486          | 3 733          |
| Others                                    | 9 761          | 18 650         | 32 452         | 29 158         | 29 236         | 29 232         |
| Nonregistered debt                        | 35 843         | 32 238         | 21 294         | 22 272         | 22 061         | 21 681         |
| Public sector <sup>1/</sup>               | 5 232          | 5 737          | 3 383          | 3 318          | 3 921          | 3 581          |
| Private sector <sup>2/</sup>              | 30 611         | 26 501         | 17 911         | 18 954         | 18 140         | 18 100         |
| <b>Total external debt</b>                | <b>179 935</b> | <b>199 998</b> | <b>241 644</b> | <b>241 468</b> | <b>242 531</b> | <b>232 916</b> |
| Public sector <sup>1/</sup>               | 84 299         | 76 247         | 95 404         | 100 766        | 102 110        | 92 790         |
| Private sector                            | 95 636         | 123 751        | 146 240        | 140 702        | 140 422        | 140 126        |
| International reserves                    | 60 110         | 52 173         | 44 556         | 36 342         | 39 200         | 28 265         |
| Commercial banks assets                   | 11 675         | 9 639          | 7 380          | 7 534          | 5 943          | 4 585          |
| <b>Net total external debt</b>            | <b>108 150</b> | <b>138 186</b> | <b>189 708</b> | <b>197 591</b> | <b>197 388</b> | <b>200 066</b> |

**Source: Banco Central do Brasil/BACEN**

1/ Nonfinancial public sector. Excludes Petrobras and Vale do Rio Doce until 1997.

2/ Includes financial public sector.

The next table shows that the medium and long-term debt and the short-term debt figures didn't change significantly since the end of the year 1999. Of the total, US\$ 204.6 billion refer to the medium and long-term foreign debt and US\$ 26.7 billion to the short-term debt. From this total,

60.16% represents the private sector share, and 39.84%, represents the nonfinancial public sector share.

**Table 4.10 Total external debt by debtor US\$ million**

| Itemization                             | 1997    | 1998    | 1999    | 2000 (May) |
|---|---------|---------|---------|------------|
| Medium and long-term debt <sup>1/</sup> | 163 283 | 215 214 | 214 076 | 204 650    |
| Nonfinancial public sector              | 79 967  | 91 984  | 97 363  | 88 491     |
| Private sector                          | 83 316  | 123 230 | 116 713 | 116 159    |
| Short-term debt                         | 36 715  | 26 430  | 27 392  | 26 696     |
| Nonfinancial public sector              | 5 737   | 3 383   | 3 318   | 3 682      |
| Private sector                          | 30 978  | 23 047  | 24 074  | 23 014     |
| Total external debt                     | 199 998 | 241 644 | 241 468 | 231 346    |

Source: Banco Central do Brasil/BACEN

<sup>1/</sup> Registered debt at Banco Central do Brasil.

The next table shows the distribution of the registered external debt by debtor and creditor. It is important to notice the importance of import financing, currency loans and bonds in the total of the registered debt.

**Table 4.11 Registered external debt (as of 03.31.2000)  
Distribution by type of debtor and creditor US\$ million**

| Itemization                      | Total   | Public sector | Private sector |
|----------------------------------|---------|---------------|----------------|
| IMF loans                        | 8 679   | 8 679         | 0              |
| Import financing                 | 63 182  | 33 527        | 29 655         |
| International entities           | 21 526  | 19 123        | 2 402          |
| World Bank                       | 6 658   | 6 615         | 42             |
| IDB                              | 9 137   | 8 996         | 141            |
| IFC                              | 1 955   | 0             | 1 955          |
| Others                           | 3 776   | 3 512         | 264            |
| Government agencies              | 14 910  | 12 017        | 2 893          |
| USAID - project loans            | 89      | 89            | 0              |
| Eximbank - USA                   | 46      | 7             | 39             |
| Eximbank - Japan                 | 2 163   | 2 020         | 143            |
| KFW                              | 1 143   | 321           | 822            |
| OPIC                             | 18      | 0             | 18             |
| PL-480 (USA Government)          | 2       | 2             | 0              |
| Paris Club                       | 8 184   | 8 184         | 0              |
| Others                           | 3 265   | 1 394         | 1 871          |
| Other financing sources          | 26 746  | 2 387         | 24 359         |
| Foreign commercial banks         | 11 429  | 892           | 10 536         |
| Brazilian banks                  | 2 074   | 872           | 1 203          |
| Nonfinancial institutions        | 13 243  | 623           | 12 620         |
| Currency loans                   | 89 538  | 9 703         | 79 834         |
| Foreign commercial banks         | 64 673  | 7 297         | 57 377         |
| Brazilian banks                  | 9 023   | 988           | 8 035          |
| Nonbanks                         | 15 841  | 1 419         | 14 423         |
| Program loans (AID)              | 115     | 115           | 0              |
| Bonds                            | 53 568  | 53 445        | 123            |
| Other loans                      | 11      | 11            | 0              |
| Total medium and long-term debts | 215 092 | 105 479       | 109 613        |
| Total short term debts           | 5 378   | 976           | 4 402          |
| Foreign commercial banks         | 2 547   | 73            | 2 474          |
| Brazilian banks                  | 1 427   | 872           | 555            |
| Nonfinancial institutions        | 1 404   | 31            | 1 374          |
| Total                            | 220 470 | 106 455       | 114 015        |

Source: Bacen

## B. DOMESTIC ENVIRONMENT

### B.1) Economic Growth

The next table presents the evolution of both the GDP and the per capita GDP from 1986 to 1999. The performance of GDP in 1999 was much better than had been expected at the start of that year. The early forecasts were made in the context of crisis in the Asian nations and in Russia. These and other events that marked that period contributed to the formation of highly pessimistic expectations as regards the performance of the Brazilian economy last year. The performance of the agricultural sector was one of the major factors responsible for GDP expansion.

**Table 4.12 Gross Domestic Product (GDP)**

| Year    | GDP at current prices in R\$ | Implicit deflator (%) | Real change rates (%)     |          |          |       | Real GDP index 1999=100 | Population (1,000 inh.) | Per capita GDP                |                      |                     |
|---------|------------------------------|-----------------------|---------------------------|----------|----------|-------|-------------------------|-------------------------|-------------------------------|----------------------|---------------------|
|         |                              |                       | Agriculture and livestock | Industry | Services | GDP   |                         |                         | At constant 1999 prices (R\$) | Real change rate (%) | Real index 1999=100 |
| 1986    | 1 274                        | 149.2                 | - 8.0                     | 11.7     | 8.1      | 7.5   | 78.5                    | 134 653                 | 5 898.41                      | 5.4                  | 95.6                |
| 1987    | 4 038                        | 206.2                 | 15.0                      | 1.0      | 3.1      | 3.5   | 81.3                    | 137 268                 | 5 990.29                      | 1.6                  | 97.1                |
| 1988    | 29 376                       | 628.0                 | 0.8                       | - 2.6    | 2.3      | - 0.1 | 81.2                    | 139 819                 | 5 877.47                      | - 1.9                | 95.2                |
| 1989    | 425 595                      | 1 304.4               | 2.8                       | 2.9      | 3.5      | 3.2   | 83.8                    | 142 307                 | 5 957.19                      | 1.4                  | 96.5                |
| 1990    | 11 548 795                   | 2 737.0               | - 3.7                     | - 8.2    | - 0.8    | - 4.3 | 80.1                    | 144 091                 | 5 627.51                      | - 5.5                | 91.2                |
| 1991    | 60 285 999                   | 416.7                 | 1.4                       | 0.3      | 2.0      | 1.0   | 81.0                    | 146 408                 | 5 595.50                      | - 0.6                | 90.7                |
| 1992    | 640 958 768                  | 969.0                 | 4.9                       | - 4.2    | 1.5      | - 0.5 | 80.5                    | 148 684                 | 5 480.09                      | - 2.1                | 88.8                |
| 1993    | 14 097 114 182               | 1 996.2               | - 0.1                     | 7.0      | 3.2      | 4.9   | 84.5                    | 150 933                 | 5 664.03                      | 3.4                  | 91.8                |
| 1994    | 349 204 679 000              | 2 240.2               | 5.5                       | 6.7      | 4.7      | 5.9   | 89.4                    | 153 143                 | 5 908.86                      | 4.3                  | 95.7                |
| 1995    | 646 191 517 000              | 77.6                  | 4.1                       | 1.9      | 4.5      | 4.2   | 93.2                    | 155 319                 | 6 071.94                      | 2.8                  | 98.4                |
| 1996    | 778 886 727 000              | 17.4                  | 3.1                       | 3.3      | 2.3      | 2.7   | 95.7                    | 157 482                 | 6 147.84                      | 1.2                  | 99.6                |
| 1997    | 864 111 026 000              | 7.1                   | - 0.2                     | 5.8      | 2.7      | 3.6   | 99.1                    | 159 636                 | 6 283.22                      | 2.2                  | 101.8               |
| 1998    | 899 814 132 000              | 4.3                   | 0.0                       | - 1.3    | 0.8      | - 0.1 | 99.0                    | 161 790                 | 6 192.13                      | - 1.4                | 100.3               |
| 1999 1/ | 1011 930 709 675             | 11.3                  | 9.5                       | - 1.7    | 1.3      | 1.0   | 100.0                   | 163 948                 | 6 172.28                      | - 0.3                | 100.0               |

Source: IBGE 1/ Banco Central do Brasil estimates, except the population and the GDP real change rates.

The next table shows that in the first half of 2000 GDP expanded by 3.84% in relation to the same period of the previous year. Economic performance in the period is attributed for the most part to improvements in credit conditions, growing exports, particularly in the area of manufactured products, and the result of the farm harvest. Furthermore, growth was stimulated by a depressed basis of comparison due, to a great extent, to the impact on economic activity of the Russian crisis and the uncertainties that prevailed in the early months of 1999 in the wake of Brazil's decisions to alter its exchange system.

**Table 4.13 GDP – 2nd quarter of 1999 to 2nd quarter of 2000**

| Rates comparison   | 2 <sup>nd</sup> quarter 1999 | 3 <sup>rd</sup> quarter 1999 | 4 <sup>th</sup> quarter 1999 | 1 <sup>st</sup> quarter 2000 | 2 <sup>nd</sup> quarter 2000 |
|--|------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| Quarter/previous quarter seasonally adjusted basis           | 0.04                         | 0.05                         | 2.14                         | 1.38                         | 0.23                         |
| Quarter/ same quarter in the previous year                   | -0.08                        | 0.32                         | 3.92                         | 3.76                         | 3.92                         |
| Cumulated until the quarter/same period in the previous year | 0.15                         | 0.21                         | 1.12                         | 3.76                         | 3.84                         |

Source: IBGE

## B.2) Inflation rate

In the beginning of September the country moved amid concerns about recent, higher rates of inflation. In the government's view, international oil prices increases, and a damaged harvests because of bad weather in various regions, explain the fluctuation in rates. But the indications are that the items that had influenced the index up to the end of August have fallen consistently. The IPC-FIPE forecasts a inflation from 0.3% to 0.2% in September, and the IPCA index slowed to 0.45% compared to 1.99% in the 30-day period between mid-September and mid-August compared to the mid-August/mid-July period. Under these circumstances the target of 6% (plus or minus 2% points) for the year is recognized to be achieved without problems. The important point is that nowadays the discussion is about single-digit-inflation rates or, at times, he decimals that go with the precentage. A completely different reality compared to the situation of seven years ago when the annual inflation rate was 2,700% - 30% to 40% a month.

**Table 4.14 Price indices****Percentage change**

| Period | IGP-M1/  |                | IPC-Fipe2/ |                | IPCA3/   |                | INPC4/   |                |       |
|--------|----------|----------------|------------|----------------|----------|----------------|----------|----------------|-------|
|        | Average  | In 12 months   | Average    | In 12 months   | Average  | In 12 months   | Average  | In 12 months   |       |
| 1991   | 410.07   | 458.35         | 410.59     | 458.61         | 432.79   | 472.70         | 429.76   | 475.10         |       |
| 1992   | 986.77   | 1 174.00       | 965.20     | 1 129.49       | 951.96   | 1 119.10       | 980.80   | 1 149.06       |       |
| 1993   | 2 006.82 | 2 567.40       | 1 920.41   | 2 490.99       | 1 927.36 | 2 477.15       | 1 936.32 | 2 489.11       |       |
| 1994   | 2 036.30 | 869.79         | 2 149.26   | 941.25         | 2 075.89 | 916.46         | 2 111.61 | 929.32         |       |
| 1995   | 58.75    | 15.24          | 67.34      | 23.17          | 66.01    | 22.41          | 65.96    | 21.98          |       |
| 1996   | 12.11    | 9.20           | 16.48      | 10.03          | 15.76    | 9.56           | 15.52    | 9.12           |       |
| 1997   | 8.02     | 7.74           | 6.44       | 4.82           | 6.93     | 5.22           | 5.99     | 4.34           |       |
| 1998   | 4.36     | 1.78           | 1.43       | - 1.79         | 3.20     | 1.65           | 3.78     | 2.49           |       |
| 1999   | 10.73    | 20.10          | 2.56       | 8.64           | 4.86     | 8.94           | 4.85     | 8.43           |       |
|        |          | <b>Monthly</b> |            | <b>Monthly</b> |          | <b>Monthly</b> |          | <b>Monthly</b> |       |
| 1999   | Jan      | 0.84           | 1.66       | 0.50           | - 1.53   | 0.70           | 1.65     | 0.65           | 2.28  |
|        | Feb      | 3.61           | 5.14       | 1.41           | 0.01     | 1.05           | 2.24     | 1.29           | 3.05  |
|        | Mar      | 2.83           | 7.92       | 0.56           | 0.81     | 1.10           | 3.02     | 1.28           | 3.86  |
|        | Apr      | 0.71           | 8.55       | 0.47           | 0.66     | 0.56           | 3.35     | 0.47           | 3.88  |
|        | May      | - 0.29         | 8.09       | - 0.37         | - 0.24   | 0.30           | 3.14     | 0.05           | 3.19  |
|        | Jun      | 0.36           | 8.07       | - 0.08         | - 0.50   | 0.19           | 3.32     | 0.07           | 3.10  |
|        | Jul      | 1.55           | 9.92       | 1.09           | 1.36     | 1.09           | 4.57     | 0.74           | 4.16  |
|        | Aug      | 1.56           | 11.81      | 0.74           | 3.14     | 0.56           | 5.69     | 0.55           | 5.25  |
|        | Sep      | 1.45           | 13.52      | 0.91           | 4.77     | 0.31           | 6.25     | 0.39           | 5.99  |
|        | Oct      | 1.70           | 15.37      | 1.13           | 5.93     | 1.19           | 7.50     | 0.96           | 6.89  |
|        | Nov      | 2.39           | 18.50      | 1.48           | 7.98     | 0.95           | 8.65     | 0.94           | 8.08  |
|        | Dec      | 1.81           | 20.10      | 0.49           | 8.64     | 0.60           | 8.94     | 0.74           | 8.43  |
| 2000   | Jan      | 1.24           | 20.58      | 0.57           | 8.72     | 0.62           | 8.85     | 0.61           | 8.39  |
|        | Feb      | 0.35           | 16.78      | - 0.23         | 6.95     | 0.13           | 7.86     | 0.05           | 7.06  |
|        | Mar      | 0.15           | 13.74      | 0.23           | 6.61     | 0.22           | 6.92     | 0.13           | 5.84  |
|        | Apr      | 0.23           | 13.20      | 0.09           | 6.20     | 0.42           | 6.77     | 0.09           | 5.44  |
|        | May      | 0.31           | 13.87      | 0.03           | 6.63     | 0.01           | 6.47     | - 0.05         | 5.34  |
|        | Jun      | 0.85           | 14.43      | 0.18           | 6.90     | 0.23           | 6.51     | 0.30           | 5.58  |
|        | Jul      | 1.58           | 14.46      | 1.40           | 7.23     | 1.61           | 7.06     | 1.39           | 6.26  |
|        | Ago      | 2.39           | 15.39      | 1.55           | -----    | -----          | -----    | -----          | ----- |

Source: FGV, Fipe, IBGE

1/ General price index (market).

2/ Consumer price index (Fipe).

3/ National consumer price index (extended).

4/ National consumer price index.

**B.3) Consumption**

The following table shows the behavior of the consumption along the period 1991 to 1998. In the beginning of his decade we can notice that the family consumption had a negative performance due to the recessionary adjustment of that period. In 1994 and 1995 the family consumption rates increased enormously due to the wealth redistributive effect of the Real Plan. But again the recession that came after this period and the end of the redistributive effect induced a reduction of this component. At the same time we can notice that the government's consumption didn't show the same oscillating fluctuations during this period.

**Table 4.15 GDP components – annual variation rate****Percentage change**

| GDP components                    | 1991  | 1992  | 1993 | 1994 | 1995 | 1996 | 1997 | 1998  |
|-----------------------------------|-------|-------|------|------|------|------|------|-------|
| GDP                               | 1.03  | -0.54 | 4.92 | 5.85 | 4.22 | 2.66 | 3.60 | -0.12 |
| Final consumption                 | 0.50  | 0.09  | 4.07 | 5.87 | 7.01 | 3.13 | 3.18 | 0.46  |
| Family consumption                | -0.10 | -0.70 | 4.55 | 7.50 | 8.71 | 3.70 | 3.33 | -0.08 |
| Public administration consumption | 2.33  | 2.84  | 2.31 | 0.33 | 1.34 | 1.38 | 2.7  | 2.34  |

Source: IBGE

**B.4) Gross capital formation**

The following table shows the performance of the gross capital formation along the period 1991 to 1998. We can observe an unstable behavior of this component along the period as a result of unstable performance of the economy along the same period. An estimate released by the



Institute of Economic and Applied Research (IPEA) identified an investment rate of 19.3% of GDP in June 2000, indicating the recovery of the investments after the decline observed last year. According to the IBGE, the performance of capital goods output in the half-year period was impacted positively by growth in various subsectors as a reflex of the improvement in the economic conditions.

**Table 4.16 GDP and Fixed Gross Capital Formation (FGCF)**

| YEAR | FGCF/GDP (%) | GDP real annual variation (%) | FGCF real annual variation (%) |
|------|--------------|-------------------------------|--------------------------------|
| 1991 | 18.11        | 1.03                          | -4.72                          |
| 1992 | 18.42        | -0.54                         | -6.62                          |
| 1993 | 19.28        | 4.92                          | 6.33                           |
| 1994 | 20.75        | 5.85                          | 14.25                          |
| 1995 | 20.54        | 4.22                          | 7.29                           |
| 1996 | 19.26        | 2.66                          | 1.20                           |
| 1997 | 19.93        | 3.60                          | 9.25                           |
| 1998 | 19.92        | -0.12                         | -0.82                          |
| 1999 | 18.29        | 1.00                          | ----                           |

Source: IBGE

### B.5) Money supply

Among money supply components, the stock of currency outside banks has followed the seasonal standard and has adjusted to the evolution of price levels. Based on data from which seasonal impacts have been withdrawn, this aggregate has been highly volatile and has registered no clearly definable tendency in recent months.

The monetary base, which has been declining steadily since February 2000 in terms of monthly average balances, accumulated a drop of 18.8% in the year up to July. The 12 month percentage change remained at a negative 3.1%, reflecting reductions in demand for banking reserves resulting from cutbacks in compulsory reserve rates on demand resources.

In the expanded concept (M4), the money supply balance totaled R\$ 601.9 billion at the end of July, for growth of 0.9% in the month. The M4/GDP ratio closed at 51.8%, as compared to 51.96%, in the month of May 2000.

**Table 4.17 Monetary base and money supply (M1) Balances in R\$ million**

| Period   | Monetary base   |                  |        |                 |                  |        | Money supply           |                 |        |                        |                 |        |
|----------|-----------------|------------------|--------|-----------------|------------------|--------|------------------------|-----------------|--------|------------------------|-----------------|--------|
|          | End of period   |                  |        | Daily average1/ |                  |        | End of period          |                 |        | Daily average1/        |                 |        |
|          | Currency Issued | Banking reserves | Total  | Currency issued | Banking reserves | Total  | Currency outside banks | Demand deposits | Total  | Currency outside Banks | Demand deposits | Total  |
| 1995 Dec | 13 770          | 7 911            | 21 682 | 13 155          | 7 591            | 20 746 | 12 367                 | 16 126          | 28 493 | 11 329                 | 15 255          | 26 585 |
| 1996 Dec | 17 188          | 2 608            | 19 796 | 16 780          | 3 326            | 20 106 | 15 317                 | 14 491          | 29 807 | 14 641                 | 14 352          | 28 993 |
| 1997 Dec | 20 251          | 11 578           | 31 828 | 19 972          | 12 311           | 32 283 | 18 079                 | 29 284          | 47 363 | 17 538                 | 28 073          | 45 612 |
| 1998 Dec | 24 167          | 15 018           | 39 184 | 23 550          | 15 735           | 39 285 | 21 185                 | 29 522          | 50 707 | 20 463                 | 28 517          | 48 981 |
| 1999 Dec | 29 838          | 18 592           | 48 430 | 27 307          | 18 101           | 45 407 | 25 951                 | 36 794          | 62 744 | 23 573                 | 35 459          | 59 032 |
| 2000 Jan | 24 200          | 17 693           | 41 893 | 26 403          | 19 350           | 45 753 | 20 701                 | 35 932          | 56 633 | 22 951                 | 35 141          | 58 092 |
| Feb      | 23 069          | 18 852           | 41 920 | 24 285          | 17 913           | 42 197 | 19 826                 | 34 212          | 54 038 | 21 129                 | 33 329          | 54 458 |
| Mar      | 22 732          | 16 361           | 39 094 | 23 640          | 17 266           | 40 906 | 19 736                 | 33 519          | 53 255 | 20 432                 | 33 033          | 53 465 |
| Apr      | 23 280          | 14 441           | 37 721 | 23 576          | 14 974           | 38 549 | 20 007                 | 33 661          | 53 669 | 20 323                 | 33 436          | 53 759 |
| May      | 22 470          | 13 405           | 35 876 | 23 512          | 14 948           | 38 460 | 19 256                 | 33 720          | 52 976 | 20 283                 | 33 735          | 54 018 |
| Jun      | 23 227          | 9 089            | 32 316 | 23 890          | 14 034           | 37 924 | 20 095                 | 34 190          | 54 286 | 20 603                 | 34 071          | 54 674 |

Source: Banco Central do Brasil/BACEN

1/ Based on working days of the month indicated.

Note: Programming of the monetary base for the second quarter of 2000: R\$ 35.4 billion - R\$ 41.5 billion (forecast average point: 5.2% in twelve months).

Monetary programming to M1 for the second quarter of 2000: R\$ 51.1 billion - R\$ 59.9 billion (forecast average point: 22.3% in twelve months).

## B.6) Employment

The stronger economic activity growth has been leading to reductions in the unemployment rate. Analysis of employment level data point to recovery after the second quarter of this year. In August of this year, 7.10% of the economically active population was classified as unemployed, compared to 7.20% in July and 7.68% in the same month of last year. And the perspectives are optimistic. A survey conducted in August 2000 by the American Chamber of Commerce between member companies showed that 71% of the companies are planning to hire new people next year, while 29% plan no staff increases. An important aspect is that no company indicated it plans to reduce its workforce.

**Table 4.18 – Unemployment rate<sup>1/</sup>**

| Period | Average rate | São Paulo | Rio de Janeiro |      |
|--------|--------------|-----------|----------------|------|
| 1989   | Dec          | 2.36      | 1.95           | 2.51 |
| 1990   | Dec          | 3.93      | 4.22           | 3.07 |
| 1991   | Dec          | 4.15      | 4.98           | 3.04 |
| 1992   | Dec          | 4.50      | 4.78           | 3.47 |
| 1993   | Dec          | 4.39      | 4.58           | 3.90 |
| 1994   | Dec          | 3.42      | 3.61           | 2.70 |
| 1995   | Dec          | 4.44      | 5.09           | 3.15 |
| 1996   | Dec          | 3.82      | 4.06           | 2.90 |
| 1997   | Dec          | 4.84      | 5.18           | 3.76 |
| 1998   | Dec          | 6.32      | 7.26           | 4.07 |
| 1999   | Dec          | 6.28      | 6.51           | 4.54 |
| 2000   | Jan          | 7.63      | 8.20           | 5.61 |
|        | Feb          | 8.16      | 8.85           | 5.65 |
|        | Mar          | 8.05      | 8.15           | 6.25 |
|        | Apr          | 7.84      | 8.04           | 6.12 |
|        | May          | 7.79      | 8.38           | 5.91 |
|        | Jun          | 7.40      | ---            | ---  |
|        | Jul          | 7.20      | ---            | ---  |
|        | Ago          | 7.10      | ---            | ---  |

Source: IBGE

<sup>1/</sup> Obtained on basis of ratio of number of people seeking employment or awaiting the result of an employment proposal at the time of the survey to the number of economically active people of 15 years of age or more.

## C. Fiscal Position

### a) Government Revenues and Expenditures

The following table shows the performance of the federal revenues in terms of cash flow. In accumulated terms for the first seven months, the revenues totaled R\$ 102.9 billion, as against R\$ 85.7 billion in the same period of 1999. It represented an increase of 20.07% in nominal terms. This is a result of a better performance of the fiscal revenues in the period.

**Table 4.19 National Treasury revenues** **Flows in R\$ million**

| End Of Period | Fiscal revenue | Revenues of government credit operations | Earnings on available resources in the Banco do Brasil | Total revenues |
|---------------|----------------|--|--|----------------|
| 1996          | 91 878         | 5 125                                    | 129  | 97 132         |
| 1997          | 108 731        | 7 200                                    | 103  | 116 034        |
| 1998          | 130 681        | 8 278                                    | 127  | 139 086        |
| 1999          | 147 366        | 11 386                                   | 29   | 158 781        |
| 2000          |                |  |  |                |
| Jan           | 11 128         | 852                                      | 1  | 11 981         |
| Feb           | 12 640         | 769                                      | 1  | 13 410         |
| Mar           | 15 119         | 734                                      | 3  | 15 856         |
| Apr           | 13 448         | 1 205                                    | 2  | 14 655         |
| May           | 13 801         | 689                                      | 1  | 14 491         |
| Jun           | 13 761         | 1 893                                    | 7  | 15 661         |
| Jul           | 11 825         | 5 073                                    | 1  | 16 899         |

Source: STN (Secretaria do Tesouro Nacional)

<sup>1/</sup> Values prior to July 1994 were converted by the URV dated 6.30.1994.

The following table shows the performance of the federal expenditures in terms of cash flow. In accumulated terms for the first seven months, the expenditures totaled R\$ 98.1 billion, as against R\$ 95.9 billion in the same period of 1999. It represented an increase of 2.37% in nominal terms.

**Table 4.20 National Treasury Expenditures – Cash basis** **Flows in R\$ million**

| End Of period | Payroll and social levies | Transfers to states and municipalities | Other earmarkings | Federal security charges <sup>2/</sup> | Government credit operations | Charges on contracted debt - domestic and external | Current expenditures and investment | Amount to be paid | Total expenditures |
|---------------|---------------------------|--|-------------------|--|------------------------------|--|-------------------------------------|-------------------|--------------------|
| 1996          | 40 505                    | 20 830                                 | 6 357             | 10 809                                 | 2 288                        | 5 183  | 18 007                              | 2 278             | 106 257            |
| 1997          | 42 848                    | 25 042                                 | 7 151             | 10 169                                 | 2 522                        | 7 806  | 24 252                              | 1 890             | 121 680            |
| 1998          | 47 296                    | 29 166                                 | 9 302             | 18 475                                 | 2 394                        | 9 231  | 32 469                              | 0                 | 148 333            |
| 1999          | 50 169                    | 33 432                                 | 6 630             | 24 618                                 | 2 414                        | 11 321   | 35 125                              | 0                 | 163 709            |
| 2000          |                           |  |                   |  |                              |  |                                     |                   |                    |
| Jan           | 5 620                     | 3 314                                  | 867               | 456                                    | 91                           | 304  | 1 296                               | 0                 | 11 948             |
| Feb           | 4 284                     | 3 196                                  | 689               | 1 155                                  | 193                          | 506  | 2 471                               | 0                 | 12 494             |
| Mar           | 4 030                     | 3 123                                  | 280               | 2 645                                  | 263                          | 778  | 2 332                               | 0                 | 13 451             |
| Apr           | 3 988                     | 3 250                                  | 32                | 2 176                                  | 193                          | 2 774  | 2 337                               | 0                 | 14 750             |
| May           | 4 192                     | 3 709                                  | 1 672             | 1 597                                  | 209                          | 650  | 2 508                               | 1                 | 14 538             |
| Jun           | 5 010                     | 2 933                                  | 644               | 2 020                                  | 132                          | 1 026  | 3 950                               | 0                 | 15 715             |

Source: STN

1/ Values prior to July 1994 were converted by the URV dated 6.30.1994.

2/ Excludes charges on Banco Central's portfolio.

The following table shows the performance of the social security system in terms of cash flow. In July, the social security system registered a deficit of R\$ 653 million, practically the same amount registered in the previous months. Up to July 2000, the accumulated deficit for the year is R\$ 4.3 billion, representing 0.64 of GDP.

**Table 4.21 Social security – Cash basis** **R\$ million**

| End of period | Revenues Total | Expenditures Total | Operating balance | Social security balance |
|---------------|----------------|--------------------|-------------------|-------------------------|
| 1996          | 50 707         | 51 977             | - 1 270           |                         |
| 1997          | 58 588         | 56 253             | 2 335             |                         |
| 1998          | 51 330         | 69 979             | - 18 649          |                         |
| 1999          | 68 414         | 68 226             | 188               | - 9 412                 |
| 2000          |                |                    |                   |                         |
| Jan           | 6 140          | 5 719              | 421               | - 725                   |
| Feb           | 5 329          | 5 516              | - 187             | - 588                   |
| Mar           | 5 557          | 5 531              | 26                | - 448                   |
| Apr           | 5 517          | 5 533              | - 16              | - 641                   |
| May           | 5 972          | 5 827              | 145               | - 623                   |
| Jun           | 6 193          | 5 917              | 276               | - 637                   |
| Jul           | 6 404          | 6 134              | 270               | - 653                   |

Source: Ministério da Previdência e Assistência Social

The following table shows the behavior of voluntary transfers from the central government to the five major regions. It can be noted that these transfers are different from region to region expressing the interregional differences that prevail in the country and the attempt to promote the development of the least developed regions, the North, the Northeast and the Central regions.

**Table 4.22 Voluntary transfer by region** **R\$ 1,000**

| Brazilian regions | 1999 (total) | 2000 (Jan-July) | Transfer per inhabitant |
|-------------------|--------------|-----------------|-------------------------|
| North             | 780,941      | 147,496         | 13,22                   |
| Northeast         | 3,151,079    | 555,726         | 12,36                   |
| Southeast         | 3,774,561    | 535,667         | 8,08                    |

|              |                  |                  |              |
|--------------|------------------|------------------|--------------|
| South        | 1,367,914        | 221,073          | 9,56         |
| Central      | 822,697          | 129,087          | 12,57        |
| <b>TOTAL</b> | <b>9,897,192</b> | <b>1,589,049</b> | <b>10,20</b> |

Source: SIAFI gerencial

#### b) Central Government Fiscal Result

Central government accounts registered a primary surplus of R\$ 424.1 million in the month of July 2000, as against R\$ 2.1 billion in the same month of 1999. The reduction reflects a drop in the National Treasury surplus as a result of the non-programmed collections of tax arrears that occurred last year and that not have been repeated in the current year. In accumulated terms for the year, the Central Government surplus came to R\$ 15.7 billion, as against R\$ 14.8 billion in the same period of 1999. Expressed as a proportion of GDP, there was a reduction from 2.62% to 2.33%. The following table shows the performance of the federal revenues in terms of cash flow. In accumulated terms for the first seven months, the revenues totaled R\$ 102.9 billion, as against R\$ 85.7 billion in the same period of 1999. It represented an increase of 20.07% in nominal terms.

**Table 4.23 Primary result of central government, 1999-2000 R\$ million**

| Itemization                                      | JUL 2000 | JAN - JUL 1999 | JAN - JUL 2000 |
|--|----------|----------------|----------------|
| I. Total revenue                                 | 18 588.7 | 117 946.3      | 130 902.5      |
| II. Transfers to states and municipalities       | 3 170.8  | 20 032.4       | 22 928.5       |
| III. Total net revenue (I-II)                    | 15 418.0 | 97 913.9       | 107 974.0      |
| IV. Total expenditures                           | 14 895.1 | 82 753.2       | 91 869.3       |
| V. Primary result of federal government (III-IV) | 522.9    | 15 160.7       | 16 104.7       |
| VI. Primary result of Central Bank               | -98.7    | -397.2         | -415.0         |
| VII. Primary result of central government (V+VI) | 424.1    | 14 763.5       | 15 689.7       |
| VIII. Primary result/GDP                         |          | 2.62%          | 2.33           |

Source: Secretaria do Tesouro Nacional

#### c) Public Borrowing

The public sector debt moved to R\$ 542.3 billion or 46.5% of GDP in June 2000, as against R\$ 516.6 billion or 46.9% of GDP in December 1999. From this total, R\$ 431.6 billion, or 37% of GDP, represented the internal net debt and R\$ 110.7 billion, or 9.5% of GDP, the foreign net debt. The Federal Government and Banco Central accounted for R\$ 334.3 billion in debt, corresponding to 28.7% of GDP; the states were responsible for R\$ 152.9 billion, or 13.1% of GDP; while the municipalities accounted for R\$ 25.2 billion, or 2.2% of GDP. State enterprises were responsible for debt corresponding to R\$ 30.0 billion, or 2.6% of GDP.

**Table 4.24 Net public sector debt****R\$ million**

| Itemization                      | 1998     |       | 1999     |       | 2000     |       |
|----------------------------------|----------|-------|----------|-------|----------|-------|
|                                  | December |       | December |       | June     |       |
|                                  | Balances | % GDP | Balances | % GDP | Balances | % GDP |
| Total net debt                   | 385 870  | 42.4  | 516 579  | 46.9  | 542 326  | 46.5  |
| Federal government and the Bacen | 231 268  | 25.4  | 316 222  | 28.7  | 334 277  | 28.7  |
| State governments                | 113 160  | 12.4  | 147 935  | 13.4  | 152 867  | 13.1  |
| Local governments                | 17 745   | 1.9   | 22 851   | 2.1   | 25 165   | 2.2   |
| State enterprises                | 23 697   | 2.6   | 29 571   | 2.7   | 30 016   | 2.6   |
| Internal net debt                | 328 693  | 36.1  | 407 810  | 37.0  | 431 606  | 37.0  |
| Federal government and the Bacen | 192 455  | 21.1  | 233 058  | 21.1  | 249 556  | 21.4  |
| State governments                | 107 673  | 11.8  | 139 400  | 12.6  | 144 242  | 12.4  |
| Local governments                | 17 084   | 1.9   | 21 984   | 2.0   | 24 208   | 2.1   |
| State enterprises                | 11 481   | 1.3   | 13 369   | 1.2   | 13 599   | 1.2   |
| Foreign net debt                 | 57 177   | 6.3   | 108 769  | 9.9   | 110 721  | 9.5   |
| Federal government and Bacen3/   | 38 812   | 4.3   | 83 164   | 7.5   | 84 721   | 7.3   |
| State governments                | 5 487    | 0.6   | 8 535    | 0.8   | 8 625    | 0.7   |
| Local governments                | 661      | 0.1   | 867      | 0.1   | 957      | 0.1   |
| State enterprises                | 12 216   | 1.3   | 16 203   | 1.5   | 16 417   | 1.4   |
| IMF - Indicative target          |          |       |          |       |          |       |
| Total net debt                   | -        | -     | 513 519  | 51.0  | 547 665  | 51.9  |

Source: BCB – Banco Central do Brasil

The consolidated public sector registered a primary surplus of R\$ 23.7 billion in the first half of 2000, as against R\$ 15.4 billion in the same 1999 period. With the exception of municipal governments and the Social Security System, which generated results practically equal of those of 1999, there was an across-the-board improvement in fiscal performance.

The consolidated public sector primary surplus was R\$ 7.6 billion higher than the fiscal performance criterion stated in the government's economic program for the first six months of the year, contributing significantly to improvements in the perception of Brazil's country risk.

An interest aspect to observe is that the appropriation of nominal interest on the net consolidated public sector debt in the first half of 2000 corresponded to R\$ 39.9 billion, as compared to R\$ 85.3 billion in the same 1999 period. This difference was generated by exchange devaluation in the early months of 1999 and by reductions in interest rates. This can explain why the nominal deficit for the first half of 2000 came to R\$ 16.2 billion, or 2.84% of GDP (as can be observed in the table 26), as compared to R\$ 69.9 billion, or 14.57% of GDP, registered in the same period of 1999.

**Table 4.25 Public sector borrowing requirements with exchange devaluation**  
**R\$ million**

| Itemization                                    | Current prices |          |         |
|--|----------------|----------|---------|
|  | 1999           |          | 2000    |
|  | Jan-Jun        | Year     | Jan-Jun |
| Nominal  | 69 870         | 96 158   | 16 237  |
| Central government                             | 55 298         | 62 439   | 8 327   |
| Federal government and the Bacen <sup>2/</sup> | 55 207         | 66 209   | 10 307  |
| Federal enterprises                            | 91             | -3 771   | -1 980  |
| Regional government                            | 14 572         | 33 719   | 7 910   |
| State government                               | 11 035         | 26 098   | 6 660   |
| Local government                               | 1 626          | 4 490    | 1 001   |
| State enterprises                              | 1 529          | 2 743    | 254     |
| Local government enterprises                   | 382            | 387      | - 4     |
| Nominal interest                               | 85 342         | 127 245  | 39 951  |
| Central government                             | 69 086         | 91 517   | 26 329  |
| Federal government and the Bacen <sup>2/</sup> | 67 743         | 88 881   | 25 940  |
| Federal enterprises                            | 1 343          | 2 635    | 389     |
| Regional government                            | 16 256         | 35 728   | 13 621  |
| State government                               | 11 974         | 27 673   | 10 408  |
| Local government                               | 2 663          | 5 021    | 2 036   |
| State enterprises                              | 1 514          | 2 847    | 1 097   |
| Local government enterprises                   | 106            | 188      | 80      |
| Primary  | -15 472        | -31 088  | -23 714 |
| Central government                             | -13 788        | -29 078  | -18 003 |
| Federal government and the Bacen               | -16 214        | -31 991  | -19 369 |
| INSS   | 3 678          | 9 318    | 3 736   |
| Federal enterprises                            | -1 252         | -6 406   | -2 370  |
| Regional government                            | -1 684         | -2 010   | -5 711  |
| State government                               | - 939          | -1 574   | -3 748  |
| Local government                               | -1 037         | - 531    | -1 035  |
| State enterprises                              | 16             | - 103    | - 843   |
| Local government enterprises                   | 276            | 199      | - 84    |
| IMF - Basic path - Primary balance             |                |          | -16 175 |
| GDP accumulated in the year                    | 479 700        | 1013 036 | 571 499 |

Source: BCB – Banco Central do Brasil

1/ Flows at prices of the last month of the period, base on the GPI-DS.

2/ Includes INSS

( + ) Deficit ( - ) Surplus

In the next table we can observe the public sector borrowing requirements (with exchange devaluation) as a percentage of the GDP. In nominal terms we can notice the improvement in the performance when compared the results of the first half of 2000 (2.84% of GDP) with the same results for the first half of 1999 (14.57% of GDP). In the primary concept it can also be noticed the increase in the superavit when compared the results of the current year (4.15% of GDP) with the last year's (3.23% of GDP) ones.

As indicated earlier these results were influenced by the reduction in the interest rates and by the behavior of the exchange rates that permitted a reduction in the appropriation of nominal interest on the net consolidated public sector debt in the first semester of 2000 in comparison with the same period in 1999.

**Table 4.26 Public sector borrowing requirements (with exchange devaluation)  
% of GDP**

| Itemization                                    | Current prices |       |         |
|--|----------------|-------|---------|
|  | 1999*          |       | 2000*   |
|  | Jan-Jun        | Year  | Jan-Jun |
| Nominal  | 14.57          | 9.49  | 2.84    |
| Central government                             | 11.53          | 6.16  | 1.46    |
| Federal government and the Bacen <sup>2/</sup> | 11.51          | 6.54  | 1.80    |
| Federal enterprises                            | 0.02           | -0.37 | -0.35   |
| Regional government                            | 3.04           | 3.33  | 1.38    |
| State government                               | 2.30           | 2.58  | 1.17    |
| Local government                               | 0.34           | 0.44  | 0.18    |
| State enterprises                              | 0.32           | 0.27  | 0.04    |
| Local government enterprises                   | 0.08           | 0.04  | 0.00    |
| Nominal interest                               | 17.79          | 12.56 | 6.99    |
| Central government                             | 14.40          | 9.03  | 4.61    |
| Federal government and the Bacen <sup>2/</sup> | 14.12          | 8.77  | 4.54    |
| Federal enterprises                            | 0.28           | 0.26  | 0.07    |
| Regional government                            | 3.39           | 3.53  | 2.38    |
| State government                               | 2.50           | 2.73  | 1.82    |
| Local government                               | 0.56           | 0.50  | 0.36    |
| State enterprises                              | 0.32           | 0.28  | 0.19    |
| Local government enterprises                   | 0.02           | 0.02  | 0.01    |
| Primary  | -3.23          | -3.07 | -4.15   |
| Central government                             | -2.87          | -2.87 | -3.15   |
| Federal government and the Bacen               | -3.38          | -3.16 | -3.39   |
| INSS   | 0.77           | 0.92  | 0.65    |
| Federal enterprises                            | -0.26          | -0.63 | -0.41   |
| Regional government                            | -0.35          | -0.20 | -1.00   |
| State government                               | -0.20          | -0.16 | -0.66   |
| Local government                               | -0.22          | -0.05 | -0.18   |
| State enterprises                              | 0.00           | -0.01 | -0.15   |
| Local government enterprises                   | 0.06           | 0.02  | -0.01   |

Source: BACEN

1/ Flows at prices of the last month of the period, based on the GPI-DS.

2/ Includes INSS.

(+) Deficit (-) Surplus

## 4.3 Tax Structure: Institutions and the Reality

### A) BRAZILIAN TAX STRUCTURE

#### A.1) Organization

The Brazilian tax policy and administration is under the jurisdiction of the Ministry of Finance, which is basically responsible for formulating and executing economic policy. Besides the SECRETARIAT OF FEDERAL REVENUE (SRF), belongs to its structure the National Finance Attorney General and the School of Financial Administration (ESAF).

#### A.2) The Secretariat of Federal Revenue (SRF)

The Secretariat of Federal Revenue was established as an organ of the Ministry of Finance by the Decree n° 63,659 in 1968. The SRF is chiefly responsible for conducting the planning, the supervision, the execution, the control and the assessment of all activities related to the federal taxes, including the customs duty. Only the payroll taxes are collected by two other agencies: the INSS – Instituto Nacional do Seguro Social (National Institute of Social Security) and the CEF – Caixa Economica Federal (Federal Savings Bank).

Current organizational structure of the SRF consist of 3 levels: Central, which is responsible for conducting general direction and advisory; Regional, which is responsible for conducting supervision and control; and Local, which is responsible for execution.

The Central level is headed by the Secretary of Federal Revenue. He is assisted by 3 advisors in his duties. The Central level has the following components: the Internal Audit Coordination; the Cabinet; the Taxation and Economic Studies Coordination; the Special Advisory; the International Affairs Coordination; the Taxpayer Counseling Coordination; the Taxation System Coordination; the Revenue and Collection Coordination; the Examination Coordination; the Customs Coordination; the Research and Investigation Coordination; the Technology and Information Systems Coordination and the Logistics Coordination.

The country is divided in 10 Regional Taxation Bureaus and 578 Tax Offices.

The number of employees of the Secretariat of Federal Revenue was 19,687 in December 1999. Main staff represents 69.8% of this employees and supporting staff represents 30.2%. Distribution of the staff is as follows: 95.8% to the Regional and Local units and 4.2% to the Central Level. The SRF recruits main staff members through a national contest and a university graduation is required to be recruited. The contest is conducted by the SCHOOL OF FINANCIAL ADMINISTRATION (ESAF) and is divided in two stages. The first stage is a test and the applicants that have passed this test are submitted to the second stage – the Formation Course – for about 3 months. This course has an evaluation process and can eliminate some applicants. Those applicants who have passed in these two stages are hired in the first grade of the career.

### A.3) Brazilian present tax system

The Brazilian tax system is defined by the Federal Constitution of 1988. The next table presents the current taxes in force in the country divided by the competence.

The table presents the different taxes according to the the following division: foreign trade taxes, property and income taxes, and consumer taxes.

**Table 4.27 Present tax structure in Brazil by competence**

| TAXES  | COMPETENCE            |
|--|-----------------------|
| <b>- Foreign trade taxes</b>   |                       |
| - Import tax   | <b>Federal</b>        |
| - Export tax   | <b>Federal</b>        |
| <b>- Property and income taxes</b>   |                       |
| - Urban real estate property tax   | <b>Municipalities</b> |
| - Rural property tax   | <b>Federal</b>        |
| - Real estate acquisition tax  | <b>Municipalities</b> |
| - Inheritance and gift taxes   | <b>States</b>         |
| - Vehicle property tax   | <b>States</b>         |
| - Income tax (individual and corporate)  | <b>Federal</b>        |
| <b>- Consumer taxes</b>  |                       |
| - Tax on industrialized products (federal value added tax) -IPI                      | <b>Federal</b>        |
| - Tax on the circulation of merchandises and services (state value added tax) – ICMS | <b>States</b>         |
| - Tax on services  | <b>Municipalities</b> |
| - Tax on financial operations  | <b>Federal</b>        |

Source: Secretaria da Receita Federal

Remark: the Federal District can impose both State and Municipal taxes.



Besides these taxes the Constitution establishes many others social contributions that can be imposed by the Federal government to finance the social security system. We can distinguish the following contributions:

- **COFINS** – Contribution to the Finance of the Social Security System;
- **PIS/PASEP** – Social Integration Plan/ Program of Assistance to Civil Servant;
- **CSLL** – Social Contribution on Net Profits;
- **CPMF** - Provisory Contribution on Financial Transactions
- **Social Security Contribution of private employers and employees (payroll tax)**

The Brazilian Constitution endows the central government, each of the 26 states, the federal district and all the 5,548 municipalities with the competence to rule and collect their own taxes. But the Federal government has the biggest part, leaving to the States and to the municipalities a smaller part. To correct regional disequilibrium and to promote a better distribution of the revenues between these entities according to their necessities the Constitution establishes a transfer of revenues between them. The table below describes how this transfer system works.

**Table 4.28 Constitutional transfers flow**

| FROM/TO                      | % of Revenue Transferred by Tax Species   |
|------------------------------|---|
| UNION to STATES<br>(Federal) | 21,50% of income tax and federal value added tax (IPI)                          |
|                              | 30% of financial operations tax levied on gold transactions                     |
|                              | 10% of IPI, in proportion to exported amount of manufactured goods              |
|                              | total of income tax withheld from each state's public servants                  |
|                              | 3,0% of income tax and IPI  |
| UNION TO MUNICIPALITIES      | 22,50% of income tax and IPI  |
|                              | 70% of financial operations tax levied on gold transactions                     |
|                              | 50% of rural property tax   |
|                              | total of income tax withheld from each municipality's public servants           |
| STATES TO MUNICIPALITIES     | 50% of vehicle property tax to the municipality where the vehicle is registered |
|                              | 25% of state value added tax (ICMS)   |

Source: Constituição Federal.

#### **A.4) Tax burden**

In 1999, the gross tax burden in Brazil, considered the three government partners and the social security system totaled 30,27% of the GDP, representing a total collecting amount of R\$ 306.26 billion (US\$ 168.54 billion). It is the second time in the history that the tax burden surpassed the level of 30% of the GDP. As can be noted the tax burden is increasing in the period 1991-1999. The Union, the States and the Municipalities contributed with 70.4%, 25.6% e 4.0%, respectively. The following table shows the evolution of the tax burden as a percentage of the GDP in the period 1990 to 1999. An interesting aspect is that the income tax represents only 5.47% of the GDP, while the indirect taxes have a major importance in the total tax burden. We can observe that the most representative tax in terms of percentage of the GDP is a state tax, the state value added tax (ICMS).

**Table 4.29 Tax burden as a percentage of GDP**

(%)

| YEAR                                      | 1990         | 1991         | 1993         | 1994         | 1995         | 1996         | 1997         | 1998         | 1999         |
|---|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>UNION</b>                              | <b>20.53</b> | <b>16.72</b> | <b>18.47</b> | <b>20.46</b> | <b>20.01</b> | <b>19.35</b> | <b>19.80</b> | <b>20.73</b> | <b>21.33</b> |
| <i>Fiscal Budget</i>                      | <b>9.25</b>  | <b>6.99</b>  | <b>7.78</b>  | <b>8.55</b>  | <b>8.24</b>  | <b>7.60</b>  | <b>7.49</b>  | <b>8.28</b>  | <b>8.39</b>  |
| - INCOME TAX                              | 4.83         | 3.64         | 3.98         | 4.07         | 4.82         | 4.65         | 4.48         | 5.30         | 5.47         |
| Individual                                | 0.36         | 0.15         | 0.21         | 0.27         | 0.32         | 0.30         | 0.31         | 0.31         | 0.30         |
| Corporate                                 | 1.65         | 0.86         | 1.03         | 1.23         | 1.40         | 1.60         | 1.41         | 1.34         | 1.27         |
| Withholding                               | 2.82         | 2.63         | 2.74         | 2.56         | 3.10         | 2.75         | 2.76         | 3.65         | 3.89         |
| - Federal value added tax                 | 2.55         | 2.23         | 2.44         | 2.18         | 2.08         | 1.96         | 1.92         | 1.79         | 1.61         |
| - Financial operations tax                | 1.41         | 0.62         | 0.81         | 0.69         | 0.50         | 0.36         | 0.44         | 0.39         | 0.48         |
| - Tax on international trade              | 0.42         | 0.44         | 0.45         | 0.52         | 0.76         | 0.54         | 0.59         | 0.72         | 0.78         |
| - Rural property tax                      | 0.00         | 0.02         | 0.01         | 0.00         | 0.02         | 0.03         | 0.03         | 0.02         | 0.02         |
| - Temporary tax on financial transactions |              |              | 0.07         | 1.06         | 0.02         | 0.00         | 0.00         | 0.00         | 0.00         |
| - Others                                  | 0.04         | 0.04         | 0.04         | 0.04         | 0.05         | 0.05         | 0.04         | 0.05         | 0.03         |
| <i>Social Security Budget</i>             | <b>9.17</b>  | <b>7.88</b>  | <b>8.94</b>  | <b>9.76</b>  | <b>9.45</b>  | <b>9.51</b>  | <b>10.08</b> | <b>9.93</b>  | <b>10.58</b> |
| <i>Others</i>                             | <b>2.11</b>  | <b>1.84</b>  | <b>1.75</b>  | <b>2.15</b>  | <b>2.32</b>  | <b>2.24</b>  | <b>2.23</b>  | <b>2.51</b>  | <b>2.36</b>  |
| <b>STATES</b>                             | <b>9.04</b>  | <b>7.31</b>  | <b>6.48</b>  | <b>8.00</b>  | <b>8.34</b>  | <b>8.21</b>  | <b>7.95</b>  | <b>7.89</b>  | <b>7.74</b>  |
| - State value added tax                   | 8.47         | 6.87         | 6.11         | 7.37         | 7.31         | 7.15         | 6.89         | 6.77         | 6.72         |
| - Vehicle property tax                    | 0.19         | 0.08         | 0.13         | 0.17         | 0.38         | 0.40         | 0.44         | 0.49         | 0.44         |
| - Inheritance and gift tax                | 0.02         | 0.01         | 0.02         | 0.02         | 0.03         | 0.03         | 0.03         | 0.04         | 0.03         |
| - Others                                  | 0.35         | 0.35         | 0.22         | 0.44         | 0.62         | 0.63         | 0.59         | 0.59         | 0.54         |
| <b>MUNICIPALITIES</b>                     | <b>0.94</b>  | <b>1.19</b>  | <b>0.78</b>  | <b>1.00</b>  | <b>1.39</b>  | <b>1.40</b>  | <b>1.34</b>  | <b>1.28</b>  | <b>1.20</b>  |
| - Tax on services                         | 0.34         | 0.34         | 0.35         | 0.42         | 0.51         | 0.56         | 0.52         | 0.50         | 0.48         |
| - Urban real state property tax           | 0.24         | 0.46         | 0.15         | 0.21         | 0.43         | 0.43         | 0.42         | 0.39         | 0.36         |
| - Real estate acquisition tax             | 0.07         | 0.13         | 0.06         | 0.08         | 0.10         | 0.09         | 0.09         | 0.09         | 0.08         |
| - Others                                  | 0.29         | 0.27         | 0.23         | 0.27         | 0.35         | 0.33         | 0.31         | 0.29         | 0.28         |
| <b>TOTAL</b>                              | <b>30.51</b> | <b>25.22</b> | <b>25.73</b> | <b>29.46</b> | <b>29.74</b> | <b>28.96</b> | <b>29.09</b> | <b>29.90</b> | <b>30.27</b> |

Source: Secretaria de Receita Federal

**A.5) Tax assessment and collection procedures**

All federal taxes are self assessed and the liabilities are paid to the commercial banks, never directly to the tax officials or to the tax offices. Even when the tax authorities assess the liability (in case of tax examinations procedures) the payment is made through the banks. Currently, a total of 135 banks, totalizing 18,931 branches are permitted to collect tax payments. Up to 1967 the payments were made directly to the tax offices.

The tax administration has access to the values deposited in the banks five days after the payment. These revenues are transferred from the banks to the Unified Treasury Account in the Central Bank of Brazil through a transfer from their banking reserve account in the Central Bank.

**A.6) Federal taxes main characteristics****A.6.1) Import tax**

Depending on the kind of product, it will applied either a specific rate or an ad valorem rate. The rates are that constant in the tariff code (Tarifa Externa Comum – TEC). The Executive can change the rates in order to adjust them to the objectives of the exchange rate policy and the foreign trade policy. In December 1998, the calculated average rate was 17% and the effective average rate was 9.3%. The tax liability is due by the time the import statement is registered.

### A.6.2) Federal value added tax - IPI

This tax is levied on goods classified as manufactured by the law, no matter whether from domestic origin or imported from abroad.

The tax base is the bare value of the transaction. In case of imported products, the tax base will be the price of the product plus the import tax and other expenses incurred in the process of importing. In the other cases, the tax rate is variable depending on the essentiality of the product obeying a Constitutional command. For example, cigarettes bear the highest rate (330%). The effective tax rate in this case is 41.25%. On the other hand, food and clothes, for example, are subject to a zero rate and manufactured products intended to be exported are exempted.

The taxpayers must assess and pay the tax liability each ten days. They must file a return in magnetic media enclosed with the corporate income tax return until the end of June.

### A.6.3) Income tax

We can divide the income tax in three other ones: the personal income tax, the corporation income tax and the withholding tax.

In the case of the individual income tax, the tax base are all the revenues received during the year adjusted by the allowed deductions. The revenues includes the wages and salaries from public or private employment, rental revenues, rural income, pension plans, capital gains, profits, interests, alimony received, etc. The basic deductions include dependents (with limits), medical expenses (without limits), educational expenses (with limits), contribution to official (without limits) and private (with limits) pension plans, alimony paid (without limits), etc.

Every taxpayer must file a tax return by the end of April, unless he or she is relieved for a reason specified in the law such as not having earned more than certain amount in the fiscal year. The taxpayer can file a complete return or a simplified one, the most advantageous for him/her. In the case of the simplified tax return no deductions are allowed only the standard deduction specified by the tax authority. For the personal income tax, the rates are as follows:

**Table 4.30 Individual Income Tax**

| Tax base in R\$ (annually) |               | Tax rate % | Amount to be deducted in R\$ |
|----------------------------|---------------|------------|------------------------------|
| Over                       | Not over than |            |                              |
| 0                          | 10,800.00     | -          | -                            |
| 10,800.00                  | 21,600.00     | 15.0       | 1,620.00                     |
| 21,600.00                  | -             | 27.5       | 4,320.00                     |

In the case of the corporate income tax there are also two rates, but no threshold. Annual profits not over R\$ 240,000.00 are subject to a rate of 15%. The amount which exceeds that value are liable to an additional 10% rate. The taxpayer must assess and pay the tax liability quarterly. Optionally, it can assess and pay the tax liability monthly. The taxpayer must file a tax return by the end of June.

In the case of small and micro-enterprises there is a special rule. They can assess and pay the corporate tax according to the Simplified Tax System (SIMPLES). The Simplified Tax includes income and consumption taxation with one single calculation basis – the company's invoicing – and has brackets ranging from 3% to 10%. It substitutes the corporate tax, the contribution to finance social security (COFINS), the social integration program (PIS), the federal value added tax (IPI), the social contribution on the net profit (CSLL), the management's contribution on payrolls, some others quasi-fiscal contributions, and, depending on the adhesion of the states and municipalities, the tax on the circulation of merchandises and services (ICMS) and the tax on services (ISS), respectively.

The withholding system is applied to revenues from work (wages and salaries), financial operations gains (stocks and bonds operations), interests and fees remitted to foreigners,

remuneration for services, lotteries and prizes, etc. The tax rates vary according to the source of revenue.

#### **A.6.4) Financial operation tax**

This tax is levied on credit operations (loans and financing operations), exchange rate operations and insurance operations.

The tax rates vary according to the operation:

- For credit operations: 1.88% per year or 0.0052% per day (corporate operations) and 6.38% per year or 0.0175% per day (individuals);
- For exchange rate operations: 25% (most cases the rate is zero or the operation is exempt);
- For insurance operations: 2%.

The taxpayer must assess the tax on a weekly basis.

#### **A.6.5) Contribution to finance social security (COFINS) and social integration program (PIS)/ program of assistance to civil servant (PASEP)**

These two contributions can be put under the same heading because both are collected on the turnover of almost all firms. The basic difference is that the first one encompasses even the banking sector. The tax rate are 3% in the first case (COFINS), and 0.65% in the second one (PIS/PASEP). The taxpayer must assess and pay these taxes on a monthly basis.

The problem with these taxes is that both are cumulative, and this cascading effect is said to be harmful for the competitiveness of Brazilian exports.

#### **A.6.6) Social contribution on the net profit (CSLL)**

This tax has a very similar tax base with the corporate income tax. Its tax base is the period net profit, adjusted, before the income tax provision. The most significant aspect is that this tax revenue is totally allocated to social insurance budget. Its tax rate is 8%. The tax must assess this tax on a monthly basis and pay it in the same period as the corporate income tax.

#### **A.6.7) Provisory contribution on financial transactions - CPMF**

This is a very controversial tax because it is a cumulative one. Everyone who keeps a banking account should pay it whenever a withdrawal is processed. Even when the money remains in the bank, being simply transferred to an interest yielding account the tax is due. The tax rate is 0.30%. In this case, the banks in which the taxpayer keeps his/her account assess the tax liability and pay it on behalf of the taxpayer on a weekly basis.

The following table shows the revenues collected by the Secretariat of Federal Revenue in 1999 by tax species. The most important source of revenue is the income tax, but we can observe the significant importance of the different contributions like the social contribution on the net profit, the contribution to finance social security, the social integration program, the program of assistance to civil servant and the provisory contribution on financial operations to the total revenue.

**Table 4.31 Revenue by Tax Species – 1999**

| Taxes  | Revenue        |               | GDP %        |
|--|----------------|---------------|--------------|
|  | R\$ million*   | US\$ thousand |              |
| <b>Import tax</b>  | 7,916          | 4,364         | 0.78         |
| <b>Federal value added tax</b>   | 16,503         | 9,098         | 1.64         |
| <b>Income tax</b>  | 51,516         | 28,400        | 5.10         |
| <b>Financial operation tax</b>   | 4,877          | 2,689         | 0.48         |
| <b>Social contribution on the net profit</b>                             | 7,303          | 4,026         | 0.72         |
| <b>Contribution to finance social security</b>                           | 32,184         | 17,743        | 3.19         |
| <b>Social integration program/program of assistance to civil servant</b> | 9,835          | 5,422         | 0.97         |
| <b>Provisory contribution on financial operations</b>                    | 7,956          | 4,386         | 0.79         |
| <b>Federal public servant social security contribution</b>               | 3,142          | 1,732         | 0.31         |
| <b>Others</b>  | 1,325          | 730           | 0.13         |
| <b>TOTAL</b>   | <b>142,557</b> | <b>78,590</b> | <b>14.11</b> |

Source: SRF/COSAR-COGET

#### **A.7) The tax appellate system**

A taxpayer may institute an administrative protest when he disagrees with any tax authority's disposition. In Brazil, the tax appellate system consist of three stages: the first is the appeal tax office, the second is the taxpayer's council and the third is the superior chamber of tax appeals. The taxpayer objection must be filed with the same office making the contested disposition within the thirty days following the day the taxpayer was made aware of that disposition.

An interesting aspect in the Brazilian case is that the taxpayer can go to a judicial court at any time even without a final decision at the administrative level. In this case the administrative protest is terminated and it is deemed that the decision has been unfavourable to the petitioner. But it is important to notice that the administrative decisions can be completely modified by the judicial decisions. Many taxpayers use the protest just as a way to postpone the tax compliance as they know that any decision in the administrative or the judicial via usually takes a long time to be implemented.

## **4.4 Country-Specific Fiscal Issues**

Along with numerous strides and positive results witnessed in Brazil since the introduction of the Real Plan in 1994, there have also been many frustrations. Most noticeable are the delays involving key institutions reforms, which were part of President Fernando Henrique Cardoso's platform when he was first elected. This means all are overdue by more than six years. There is a parliamentary element in the delays, since Cardoso's party, the PSDB, does not control a majority of seats, and is unable to approve government proposals on its own. The coalition that supports the government in Congress however, does have enough votes to carry any proposal through, which only adds to the frustration of seeing vital changes going nowhere. But perhaps the most annoying side to the delays is the apparent lack of political will by the Executive itself.

Tax reform is one of the most glaring examples of this harmful procrastination. Years of wrangling have resulted in little or no progress, and it now appears as if this reform will not be discussed again until 2001. Meanwhile, Brazil suffers the effects of the ineffective, unfair patchwork quilt that is its tax system.

According to Gustavo Loyola, a former Central Bank President, one of the reasons for this lack of interest by the Executive is that a true and complete tax reform, which would eliminate cascading taxes (taxes which incide over already taxed accounts), would carry with it the risk of

lower revenues collected by the government during the transition from one tax regime to another, and, apparently the government did not want to risk that, at a time when fiscal adjustment is of the utmost importance.

It is possible to identify two main problems in the Brazilian tax system that should be addressed by a tax reform. First, the so-called cascading taxes, like CPMF (a tax on each bank transaction) and PIS/COFINS (employer's contribution for social funds), which are assessed in cumulative fashion, and cause serious distortions in the economy. Second, the complete flop that is our most important value added tax, the ICMS (a State tax), which is not homogeneous throughout the country as it needs to be. There are bigger differences in ICMS charged by different Brazilian State governments, than by the governments of member countries of the European Community. These differences engender horizontal conflicts (taxation at the origin or destination, fiscal wars) and vertical ones (exports exemption, hindering harmonization in integration processes such as Mercosul and globalization).

So there are complex obstacles facing tax reform in Brazil. The biggest one is the need to review the way revenues and responsibilities are distributed among the three levels of the federation. The three levels are not only competitors for the revenue pie – there are also serious mismatches between State governments, whose economies are profoundly dissimilar. Another serious obstacle is the fear of losing revenues when there is a great need for fiscal adjustments. If the tax reform continues to be an unresolved problem in Brazil it is possible to forecast a less economic growth in coming years, which will leave Brazil further from solving its serious social problems.

## **4.5 Conclusion: Where We Stand and Where We Go?**

From 1983 to 1992, economic growth in Brazil was negligible, averaging 2.1% per year. But by the end of 2002, the country's economy may close out a ten-year period in which it will have grown 40%. From this year (2000) to 2002, the government is projecting GDP growth at an average of 4.5% a year – since the country now enjoys ideal conditions for this to happen. The important point is that this positive outlook is shared by the government internal analysis and by many private enterprises.

The recent performance of the Brazilian economy shows that it is effectively happening. According to IBGE, GDP grew 3.92% in the second quarter of 2000 when compared to the same period of the previous year. Considering the data revision, the economy grew 3.84% in the first half of the year over the same period of 1999.

The conjunction of budget surplus, exchange rates freely determined by the market, inflation rate under control and interest rates (16.5% p.a.) at close to international rates shows that the economy is becoming more manageable.

Now the economy is open, the country has currency reserves and meets agreements with the IMF without many difficulties. Many reforms were introduced like the administrative reform, the pension system reform and the fiscal responsibility law. But there are some obstacles to growth that still must be addressed.

Tax reform, as mentioned above, is a major concern of many analysts of the Brazilian economy. And we still have the vulnerability to international crisis to worry about because the public debt (internal plus external) totals more than 45% of GDP and the current account deficit is around 4% of GDP. This explains why the recent fiscal crisis in Argentina affected the exchange rate (that reached the lowest level since the financial crisis of the beginning of 1999) and the stock market in Brazil.

Then, the total calm is not yet a reality. To maintain a sustained cycle of development the country needs a competitive advantage. To achieve this, beyond the reforms in discussion in Congress, it is necessary to invest heavily in education and security.

## References

*Almanaque Abril 2000- Ed. Brazil*, Ed. Abril, Sao Paulo, 2000.

*Central Bank of Brazil Home Page* – [www.bancocentral.gov.br](http://www.bancocentral.gov.br). Inflation Report, September/2000, Press Release (Foreign Sector, Monetary Policy and Fiscal Policy – September/2000)

*Folha de Sao Paulo*, a Brazilian journal – [www.uol.com.br](http://www.uol.com.br). (various Internet editions)

*Instituto Brasileiro de Geografia e Estatistica Home Page* – [www.ibge.com.br](http://www.ibge.com.br). Statistical tables.

*Ministerio do Desenvolvimento, Industria e Comercio Exterior (Ministry of Development, Industry and Foreign Trade) Home Page* – [www.mdic.gov.br](http://www.mdic.gov.br). Statistics tables about foreign trade 2000

*Ministry of Finance of Brazil Home Page* – [www.fazenda.gov.br](http://www.fazenda.gov.br). Statements by the Minister various editions 2000.

*Ministry of Foreign Affairs* – [www.mre.gov.br](http://www.mre.gov.br). An introduction to Brazil.

*O Estado de Sao Paulo*, a Brazilian journal – [www.estado.com.br](http://www.estado.com.br). (various Internet editions)

*Secretaria da Receita Federal Home Page* – [www.receita.fazenda.gov.br](http://www.receita.fazenda.gov.br). Tax Burden in Brazil 1999. Federal Taxes Legislation – a synthesis.

*Secretaria do Tesouro Nacional Home Page* – [www.stn.gov.br](http://www.stn.gov.br). Central Government Fiscal Results – July/2000.