



World Bank Discussion Papers



International Financial Flows to Brazil since the Late 1960s

An Analysis of Debt Expansion and
Payments Problems

Paulo Nogueira Batista, Jr.

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Washington, D.C.

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Abstract

This paper provides a detailed sequential analysis of the development of debt-creating financial flows to Brazil since the late 1960s. It first draws the important distinction between net and gross debt accumulation--the latter includes reserve accumulation. It then argues that it may be misleading to interpret the current account deficit as reflecting a net transfer of resources to a country or an excess of spending over income. These points are illustrated throughout the paper.

The accumulation of debt prior to the first oil shock reflected, above all, a rapid accumulation of international reserves. However, due to the high growth of output and exports, debt indicators did not deteriorate. In the 1973-78 period the growth of debt--and above all net debt--accelerated. It financed the trade deficit following the oil-price hike and then complemented the considerable mobilization of domestic resources which helped sustain the government's intensive investment drive. By 1977-78, however, the debt indicators had deteriorated considerably and interest payments now made up almost 50 percent of the current account deficit while trade deficits failed to shrink. The vulnerability to terms of trade and interest rate shocks had increased. This became clear in the 1979-82 period when a renewed oil-price shock and a rise in real interest rates, coupled with an inadequate domestic policy response, led to a dramatically worsened current account situation, a drastic fall in reserves, as well as inflation and recession. Despite a rapid expansion of foreign debt--and a dangerous shift toward the short term--the net transfer of resources came to a halt: the trade surpluses were insufficient to cover interest payments, which incorporated a component of principal repayment due to the high nominal interest rates. The Argentinian and Mexican debt crises then triggered the Brazilian crisis.

The paper concludes with a discussion of the rescheduling agreements between Brazil and its creditors. It criticizes these for failing to halt the continued net transfer of resources from debtors to creditors, which is inappropriate in terms of the long-run rationale for capital flows to developing countries.

Preface

The following country study was originally written as a background paper for the preparation of the World Development Report 1985. It is part of a series of eleven country studies which provide in-depth analyses of particular countries' experiences with capital flows and debt.

Country experiences with debt-creating capital flows over the past two decades illustrate the potential advantages as well as possible risks associated with the use of such funds. On the positive side, a country may use foreign capital to increase investment and thereby promote economic growth. Foreign capital may also be used to reduce the impact of internal or external shocks on the economy. On the negative side, foreign capital may finance inefficient investment, may be used to delay necessary adjustment, or may become a substitute for rather than a complement to domestic resource mobilization. The accumulation of debt also makes the economy more vulnerable to external financial market pressures, as the early 1980s have vividly demonstrated.

The determinants of foreign borrowing and the appropriateness of debt accumulation are matters of debate as well as of specific country experience. There are principles that need to be observed but no uniform borrowing guidelines to be followed. The extent to which a country should borrow abroad depends on the external environment it faces in world trade and capital markets, its physical and human resources, its macroeconomic policy stance, and the flexibility of its economic and political structures. The occurrence of a debt crisis in itself does not necessarily imply that borrowing has been inappropriate.

The studies examine individual countries' experiences with foreign capital and debt given the changing external environment over the past two decades. In each, the country's debt history is viewed in terms of its economic performance and its macroeconomic policies. The demand for capital, its uses, and the country's debt management capacity are assessed.

The studies were prepared for publication by Oliver Adler and Sandra Gain with editorial assistance from Jaunianne Fawkes and Victoria Macintyre.

Introduction

Since the late 1960s, Brazil's foreign debt has steadily increased at an extremely high rate. Between 1965 and 1984, its total gross debt grew from less than US\$4 billion to over US\$100 billion, rising sharply as a proportion of exports and GDP. The rapid growth of the foreign debt since 1967-68 has been associated with a growing reliance on international financial markets and, in particular, a large expansion in borrowing from commercial banks.

The purpose of this paper is to discuss the basic determinants and some of the main economic consequences of international financial flows to Brazil from the time of the so-called Brazilian economic miracle to the current debt crisis. An attempt is also made to draw implications with respect to debt management in the future and the solution of present debt-servicing problems.

As is well known, the increases in a country's net foreign debt in a given period are basically related to the excess of current account deficits and net lending to nonresidents (including capital flight) over net direct investments. The total increase of the gross foreign debt in turn reflects the increase in net debt and the change in the level of the international reserves of the monetary authorities. ^{1/}

In contrast to the experience of several other Latin American economies, capital flight was not a significant cause of debt growth in the Brazilian case, probably because of capital controls, mostly positive real domestic interest rates, and a generally realistic exchange-rate policy that rarely allowed significant overvaluation to develop. For this reason and also because inflows of direct investment were, as in most other countries,

relatively insignificant throughout this period, changes in Brazil's total debt correspond basically to changes in the level of reserves and to large current account deficits. As will be seen below, reserve growth constitutes a central element in the expansion of foreign debt in 1968-73 and again in 1976-78. In both periods, foreign debt and reserves seem to have increased not only as a consequence of a demand for reserves on the part of the monetary authorities, but also as an essentially unplanned result of supply pressures associated with a rapid overall expansion of liquidity in international financial markets.

The fact remains that net foreign debt, defined as the difference between gross debt and reserves, has increased at a rapid pace since the late 1960s, especially since 1974. The expansion of Brazil's total foreign debt is, in effect, predominantly related to the continuous growth of net debt and associated large current account deficits. However, any analysis of the domestic macroeconomic implications of these high current account deficits must avoid the simplistic identification of current account deficits with the absorption of real resources from abroad. The utilization of the current account balance as a central concept in the analysis of the macroeconomic implications of international financial flows must be qualified for at least three basic reasons: (1) in a world of high inflation and floating international interest rates, repayment of principal is partly transferred from the capital account to the current account of the balance of payments, thereby artificially increasing current deficits in net debtor countries; (2) high current account deficits may derive from net factor payments to nonresidents and may even be associated with substantial outward transfers of real resources in the form of net exports of goods and nonfactor services; and

(3) current account deficits may result not from an increase of domestic spending relatively to domestic output in real terms but from a deterioration in the terms of trade.

All these qualifications are relevant to the Brazilian case. Insofar as Brazil's still rather sketchy and incomplete National Accounts permit, our analysis of the net flow of foreign real resources therefore is based on the ratio of aggregate demand to domestic output expressed in constant prices. It will be shown that the absorption of real resources from abroad was relatively marginal before the oil crisis and that capital formation was almost entirely financed by internal resources. The absorption of foreign real resources rose transitorily in 1974-75, but declined continuously in 1976-79 and was followed by increasing outward transfers after 1980.

This paper opens with a discussion of Brazil's first involvement in international financial markets from 1968 to 1973 and then examines debt expansion as a response to external shocks during the Geisel administration of 1974-78. Next, it considers the impact of the new round of external shocks after 1979 and the outbreak of Brazil's balance of payments crisis in 1982. The paper closes with a critical look at debt rescheduling in 1983-84.

External Indebtedness Before the First Oil Crisis, 1968-73

The beginning of Brazil's large-scale involvement in international financial markets dates back to the late 1960s and coincides with a period of extraordinarily high domestic economic growth and relatively stable inflation rates, which lasted from 1968 to 1973. During this period, Brazil's medium- and long-term foreign debt, which had remained more or less constant during

most of the 1960s, ^{2/} rose from US\$3.3 billion in 1967 to US\$12.6 billion in 1973, increasing at an average rate of 25.1 percent per annum (Table 1). At the same time, the structure of the debt changed very rapidly. From 1967 to 1973, the share of loans from private sector sources in total public debt rose from 26.9 percent to as much as 64.1 percent, mainly as a result of the large increase in borrowing from financial institutions (see Appendix B, Table 29).

Table 1: Brazilian Foreign Debt, 1965-73
(Millions of dollars)

Year	Gross Foreign Debt <u>a/</u>	Net Foreign Debt <u>b/</u>
1965	3,644	3,161
1966	3,666	3,245
1967	3,281	3,083
1968	3,780	3,523
1969	4,403	3,747
1970	5,295	4,108
1971	6,622	4,899
1972	9,521	5,338
1973	12,572	6,156

a. Medium- and long-term debt outstanding at the end of the year. Includes private nonguaranteed external debt.

b. Gross debt minus gross international reserves of the monetary authorities (see table 4).

Source: Banco Central do Brasil.

The combination of this extremely rapid expansion of the foreign debt with unusually high GDP growth rates led one economist to describe Brazilian economic development in this period as a case of "debt-led" growth. ^{3/} However, the analysis of the nature and basic determinants of debt growth indicates that it had relatively little to do with the financing of economic growth at the time. In fact, aggregate expenditure exceeded domestic output by a small margin in this period. In 1970-73, net absorption of real resources from abroad, defined as the excess of total consumption and investment over domestic output, amounted to only 1.4 percent of GDP (Table 2). Although foreign resources may have been important at the margin, Brazil's high rate of capital formation was almost entirely financed by internal resources, that is, by an excess of GDP over total consumption (Table 3).

Table 2: Brazil - Components of Aggregate Demand, 1970-73
(as percentage of GDP)

Year	Consumption (1)	Gross Fixed		Gross Capital Formation (2) + (3) (4)	Domestic Demand (1) + (4) (5)	Exports (6)	Imports (7)
		Capital Formation (2)	Changes in Inventories (3)				
1970	74.9	23.8	1.7	25.5	100.4	7.0	7.4
1971	75.5	24.7	1.4	26.1	101.6	6.6	8.2
1972	75.8	24.9	0.9	25.8	101.6	7.3	8.9
1973	74.2	25.8	2.0	27.8	102.0	7.4	9.4
1970-73 ^a	75.1	24.8	1.5	26.3	101.4	7.1	8.5

Note: Measured in 1970 prices.

a. Average.

Source: Fundacao Getulio Vargas.

Table 3: Brazil - Contribution of Internal and External Resources to the Financing of Gross Capital Formation, 1970-73
(as percentage of GDP)

Year	GDP minus Consumption (1)	Imports minus Exports (2)	Gross Capital Formation (3)	(1)/(3) (%) (4)	(2)/(3) (%) (5)
1970	25.1	0.4	25.5	98.4	1.6
1971	24.5	1.6	26.1	93.9	6.1
1972	24.2	1.6	25.8	93.8	6.2
1973	25.8	2.0	27.8	92.8	7.2
1970-73 ^{a/}	24.9	1.4	26.3	94.7	5.3

Note: Measured in 1970 prices. Numbers may not add because of rounding.

a/ Average.

Source: Table 2.

This apparent contradiction between the substantial growth of the foreign debt and the limited absorption of real resources from abroad is basically due to the fact that up to 1973 debt growth was predominantly associated with a continuous increase of the international reserves of the Brazilian monetary authorities (Table 4). From 1968 to 1973, reserve growth accounted for as much as two-thirds of the increase in the gross medium- and long-term foreign debt (Appendix B, Table 30). Net foreign debt, defined as the difference between gross debt and international reserves, increased at a relatively moderate pace, rising from US\$3.1 billion in 1967 to US\$6.2 billion in 1973, at an average annual rate of only 12.2 percent (see Table 1).

Table 4: International Reserves of the Brazilian Monetary Authorities, 1965-73
(millions of dollars)

Year	Special Drawing Rights	Reserve Position in the IMF ^{a/}	Foreign Exchange ^{b/}	Gold ^{c/}	Gross Reserves (1+2+3+4)	Short-term Liabilities of the Monetary Authorities	Net Reserves (5)-(6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1965	-	-	420	63	483	1,260	-777
1966	-	12	364	45	421	9	412
1967	-	13	140	45	198	815	-617
1968	-	12	199	45	257	745	-488
1969	-	12	598	45	656	513	143
1970	62	117	962	45	1,187	401	786
1971	111	116	1,450	46	1,723	310	1,413
1972	170	126	3,836	50	4,183	477	3,706
1973	190	140	6,030	56	6,416	422	5,994

Note: The monetary authorities are Banco Central and Banco do Brasil. Numbers may not add because of rounding.

a/ Unconditional IMF related reserve assets.

b/ Claims against foreigners in the form of bank deposits, Treasury Bills, and other documents that may be used to cover balance of payments deficits, including non-negotiable credit bills obtained through agreements between central banks or governments.

c/ National valuation.

Source: Banco Central do Brasil and International Monetary Fund.

In these years, the Brazilian economy experienced growth rates that were not only more than twice as high as those of her main trading partners (Appendix B, Table 31), but also much larger than Brazil's long-term growth rate in the postwar period. ^{4/} Extremely high economic growth rates, sustained over six consecutive years did of course lead to a rapid increase in imports. From 1967 to 1973, imports increased by as much as 27.5 percent per year in value terms and 18.3 percent per year in volume terms (Table 5, and

Appendix B, Table 32), not only because of high domestic growth, but also because of import liberalization. ^{5/}

However, the increase in imports was nearly matched by a substantial rise in exports. Between 1967 and 1973, merchandise exports grew at an average annual rate of 24.6 percent in value terms and 13.1 percent in volume terms (Table 5, and Appendix B, Table 32). With export and import unit values rising on the average, by 9.2 percent and 6.3 percent a year, respectively, the terms of trade improved significantly, by as much as 18.8 percent in this period (Appendix B, Table 32). The rapid growth of exports can undoubtedly be attributed to the strong expansion of external demand. ^{6/} It should be noted, however, that as a result of the export promotion policies followed by Brazil throughout this period, Brazilian exports were increasing relative to world exports and to domestic output (Appendix B, Table 33). ^{7/}

With exports and imports increasing at approximately the same rate, Brazil's trade accounts remained in equilibrium in 1968-73. The country's average current account deficit of US\$1 billion per year was basically related to an equivalent deficit in services, about 40 percent of which resulted from interest payments and profit remittances (Table 5). Net direct investments, although relatively small when compared to inflows of financial capital, covered about 30 percent of the deficit on current account in this period. As a result, the country's net foreign debt increased by about US\$530 million per year on the average, ^{8/} falling substantially as a proportion of merchandise exports and GDP. In fact, virtually all basic relative indicators improved significantly up to 1973 (Table 6).

The improving overall situation of the Brazilian economy's external sector cannot be understood of course without taking into account the favorable behavior of the international environment. Until 1973, Brazil could

Table 5: Brazilian Balance-of-Payments, 1965-73
(millions of dollars)

Item	1965	1966	1967	1965-67 <u>a/</u>	1968	1969	1970	1971	1972	1973	1968-73 <u>a/</u>
A - TRADE BALANCE	655	438	213	435	26	318	232	-343	-241	7	0
Exports (FOB)	1,596	1,741	1,654	1,664	1,881	2,311	2,739	2,904	3,991	6,199	3,338
Imports (FOB)	-941	-1,303	-1,441	-1,228	-1,855	-1,993	-2,507	-3,247	-4,232	-6,192	-3,338
B - SERVICES	-362	-463	-527	-451	-556	-630	-815	-980	-1,250	-1,722	-992
Interest (Net)	-156	-155	-184	-165	-144	-182	-234	-302	-359	-514	-289
Profits and Dividends (Net) <u>b/</u>	-18	-42	-73	-44	-84	-81	-119	-118	-161	-198	-127
Other Services (Net)	-188	-266	-270	-242	-328	-367	-462	-560	-730	-1,010	-576
C - UNREQUITED TRANSFERS	75	79	77	77	22	31	21	14	5	27	20
D - Current Account Balance (A+B+C)	368	54	-237	62	-508	-281	-562	-1,309	-1,486	-1,688	-972
E - NET CAPITAL MOVEMENTS	-6	124	27	48	541	871	1,015	1,846	3,492	3,512	1,880
Direct Investment (Net) <u>c/</u>	70	74	76	73	61	177	132	168	318	940	299
Loans and Financing <u>d/</u>	363	508	530	467	583	1,023	1,433	2,037	4,299	4,495	2,312
Amortizations (Net) <u>d/</u>	-304	-350	-444	-366	-484	-493	-672	-850	-1,202	-1,673	-896
Other (Net)	-135	-108	-135	-126	381	164	122	491	77	-251	164
F - ERRORS AND OMISSIONS	-31	-25	-35	-30	-1	-41	92	-7	433	355	139
SURPLUS OR DEFICIT (D+E+F)	331	153	-245	80	32	549	545	530	2,439	2,179	1,046
FINANCING	-331	-153	245	-80	-32	-549	-545	-530	-2,439	-2,179	-1,046
IMF Operations	20	-39	-33	-17	-12	-	-167	-47	-70	-33	-55
Short-term Assets (increase -)	-246	-9	262	2	-97	-531	-396	-634	-2,565	-2,798	-1,170
Short-Term Liabilities (decrease -)	-181	-127	24	-95	77	-18	18	152	200	658	181
Monetary Gold (increase -)	28	18	-	15	-	-	-	-1	-4	-6	-2
Other	48	4	-8	15	-	-	-	-	-	-	-

a/ Annual average.

b/ Excludes reinvested profits.

c/ Excludes reinvestments.

d/ From 1969 to 1973, medium- and long-term.

Notes: Numbers may not add because of rounding.

Source: Banco Central do Brasil.

Table 6: Brazil - Foreign Debt and Reserve Indicators, 1965-73
(percentage)

Year	<u>Net Debt a/</u> Merchandise Exports	<u>Net Debt a/</u> GDP <u>b/</u>	<u>Debt Service c/</u> Merchandise Exports	<u>Gross Reserves</u> Merchandise Imports	<u>Gross Reserves</u> Gross Debt <u>d/</u>	<u>Net Reserves</u> Merchandise Imports	<u>Net Reserves</u> Gross Debt <u>d/</u>
1965	198.1	13.6	28.8	51.3	13.3	-82.6	-21.3
1966	186.4	11.3	29.0	32.3	11.5	31.6	11.2
1967	186.4	9.5	38.0	13.7	6.0	-42.8	-18.8
1968	187.3	9.8	33.4	13.9	6.8	-26.3	-12.9
1969	162.1	9.4	29.2	32.9	14.9	7.2	3.2
1970	150.0	9.6	33.1	47.3	22.4	31.4	14.8
1971	168.7	9.9	39.7	53.1	26.0	43.5	21.3
1972	133.8	9.2	39.1	98.8	43.9	87.6	38.9
1973	99.3	7.8	35.3	103.6	51.0	96.8	47.7

a/ Medium- and long-term debt minus gross reserves.

b/ GDP data for 1965-69 are not fully comparable with those for later years.

c/ Net interest payments plus net amortizations.

d/ Medium- and long-term debt.

Source: Banco Central do Brasil, Fundacao Getulio Vargas and International Monetary Fund.

rely not only on a strong and expanding external demand for its exports and on improving terms of trade, but also on a continuous expansion of liquidity in international financial markets. In the context of massive US balance of payments deficits and of predominantly expansionary policies in the United States and other industrialized countries, the supply of international bank credit increased at an extremely rapid pace, allowing a great number of middle-income developing countries that previously had no regular access to international financial markets to become borrowers on a large and increasing scale. ^{9/}

The rapid increase of Brazil's foreign debt cannot therefore be seen as an isolated phenomenon or as the result of a fully planned strategy of the Brazilian economic authorities. It is of course true that the net absorption of foreign resources, although of relatively small quantitative significance, was welcomed by the Brazilian government as a positive contribution to the country's growth effort. As we have seen, however, debt expansion was predominantly connected to the increase of reserves, and although supply pressures were probably the major factor, it can be plausibly argued that this increase was to some extent demand determined. In fact, at the beginning of this period, despite several years of subnormal domestic growth, international reserves were clearly too low. In 1967-68, gross reserves in the form of foreign exchange and gold were not sufficient to cover even one month's merchandise imports (Table 6). Moreover, net reserves were negative by as much as US\$617 million in 1967 and US\$488 million in 1968 (Table 4). It seems reasonable therefore to assume that subsequent debt growth may be at least partly attributed to the monetary authorities' demand for international reserves.

By 1970, however, net reserves had already become significantly positive and had increased substantially as a proportion of imports and of foreign debt (tables 4 and 6). Nevertheless, gross debt and reserves went on expanding at even higher rates. By the end of this period, capital inflows and reserve growth had become overwhelmingly supply determined and were clearly excessive from the point of view of internal monetary control. ^{10/} In 1972-73, the monetary effects of the overabundant supply of foreign bank credit and resulting net capital inflows could no longer be sterilized by expanding the internal public debt. In this context, Brazilian authorities imposed a succession of restrictive measures aimed at increasing the cost of external credit and reducing the overall balance of payments surplus. ^{11/}

As is well known, Brazil's large-scale involvement with foreign banks began in the context of a "borrower's market" that lasted until 1974. Together with Brazil's favorable short-term macroeconomic performance, this led to a substantial reduction in spreads charged and to a significant extension of loan maturities. ^{12/}

However, as a result of the above-mentioned change in the structure of the country's foreign debt and of the increase in the relative weight of loans from private sources with generally higher interest rates and shorter maturities, the average cost of the foreign debt-- defined as the ratio of net interest payments to net debt outstanding--rose from 4.7 percent in 1968 to 9.6 percent in 1973 (Table 7); and the average maturity of the medium- and long-term debt fell from 5.6 years in 1970 to 5.3 years in 1973. ^{13/} For the same reason, the share of variable interest rate loans in outstanding public debt increased sharply, from 15.6 percent in 1971 to 34.3 percent in 1973, whereas the share of concessional loans fell from 35.8 percent to 20.5 percent. ^{14/}

Table 7: Average Cost of Brazil's Foreign Debt in Nominal and Real Terms, 1968-73

Year	Net Interest Payments (Millions of dollars) (1)	Net Foreign Debt <u>a/</u> (Millions of dollars) (2)	Average Cost In Nominal Terms (in percent) (3)=(1)/(2)	U.S. Inflation <u>b/</u> (in percent) (4)	Average Cost in Real Terms <u>c/</u> (in percent) (5)=(3)/(4)
1968	144	3,083	4.7	4.4	0.3
1969	182	3,523	5.2	5.1	0.1
1970	234	3,747	6.2	5.4	0.8
1971	302	4,108	7.4	5.0	2.3
1972	359	4,899	7.3	4.2	3.0
1973	514	5,338	9.6	5.8	3.6

a/ Gross medium- and long-term debt minus gross international reserves. Debt outstanding at the beginning of the year.

b/ GNP implicit price deflator.

c/ If i represents the average cost in nominal terms, p the growth of the GNP deflator and r the average cost in real terms, $i = r + p + rp$.

Source: Banco Central do Brasil and U.S. Department of Commerce

Nevertheless, in the wake of falling spreads and relatively low real interest rates in international financial markets, the average cost of the debt remained at tolerable levels in real terms (Table 7). The strong expansion of credit supply in international markets also allowed Brazilian authorities to increase minimum maturity requirements and to retain control over the debt profile in this period. ^{15/} Moreover, the rapid and largely undesired accumulation of reserves was to prove extremely helpful in facing the effects of external shocks in 1974-75.

Table 8: Brazilian Balance-of-Payments, 1974-78
(Millions of dollars)

Item	1968-73 <u>a/</u>	1974	1975	1976	1977	1978	1974-78 <u>a/</u>
A - TRADE BALANCE	0	-4,690	-3,540	-2,255	97	-1,024	-2,282
Exports (FOB)	3,338	7,951	8,670	10,128	12,120	12,659	10,306
Imports (FOB)	-3,338	-12,641	-12,210	-12,383	-12,023	-13,683	-12,588
B - SERVICES	-992	-2,433	-3,162	-3,763	-4,134	-5,062	-3,711
Interest (Net)	-289	-652	-1,498	-1,810	-2,104	-2,696	-1,752
Profits and Dividends (Net) <u>b/</u>	-127	-248	-235	-380	-455	-561	-376
Other Services (Net)	-576	-1,533	-1,429	-1,573	-1,575	-1,805	-1,583
C - UNREQUITED TRANSFERS	20	1	2	1	0	71	15
D - CURRENT ACCOUNT BALANCE (A+B+C)	-972	-7,122	-6,700	-6,017	-4,037	-6,015	-5,978
E - NET CAPITAL MOVEMENTS	1,880	6,254	6,189	6,594	5,278	10,916	7,046
Direct Investment (Net) <u>c/</u>	299	887	892	959	810	1,071	924
Loans and Financing <u>d/</u>	2,312	6,891	5,933	7,772	8,424	13,811	8,566
Amortizations (Net) <u>d/</u>	-896	1,920	-2,172	-2,987	-4,060	-5,324	-3,293
Other (Net)	164	396	1,536	850	105	1,358	849
F - ERRORS AND OMISSIONS	139	-68	-439	615	-611	-639	-228
SURPLUS OR DEFICIT (D+E+F)	1,046	-936	-950	1,192	630	4,262	840
FINANCING	-1,046	936	950	-1,192	-630	-4,262	-840
IMF Operations	-55	-10	8	-56	-18	13	-13
Short-Term Assets (increase -)	-1,170	784	1,288	-2,878	-683	-4,271	-1,152
Monetary Gold (increase -)	-2	-	-	-	-8	-4	-2
Other	181	162	-346	1,742	79	-	327

a/ Annual average.

b/ Excludes reinvested profits.

c/ Excludes reinvestments.

d/ Medium- and long-term.

Note: Numbers may not add because of rounding.

Source: Banco Central do Brasil.

Debt Expansion as a Response to External Shocks, 1974-78

As a result of severe external shocks, the nature and basic determinants of debt growth underwent a fundamental change after 1974. Merchandise imports jumped from US\$6.2 billion in 1973 to US\$12.6 billion in 1974 and remained at about that level in subsequent years. At the same time, export growth rates fell significantly from an annual average of 24.6 percent in 1968-73 to 15.3 percent in 1974-78. As a result, the trade balance moved from equilibrium in 1968-73 to an average annual deficit of US\$2.3 billion in 1974-78. Large trade deficits together with substantially higher interest and other service payments produced a sixfold increase in the current account deficit (Table 8).

Given the relatively limited contribution of direct investment, these higher current account deficits led to an unprecedented increase in the country's net external debt. ^{16/} The latter rose from US\$6.2 billion in 1973 to US\$31.6 billion in 1978 (Table 9), increasing more than three times as fast as in 1968-73, at the extraordinarily high average rate of 38.7 percent per year. Gross foreign debt also increased at a somewhat higher average rate in this period (28.2 percent per year) than in 1968-73 (25.1 percent per year), a fact that reflects not only the rapid increase of net debt, but also a significant increase in the level of reserves (Table 10).

It should be noted, however, that external shocks in the form of terms of trade losses and recession in OECD countries were concentrated mainly in 1974-75. Moreover, in these two years international financial markets went through a period of relatively tight liquidity. ^{17/} In this context, Brazil's current account deficits exceeded net capital inflows for the first time since 1967 and led to substantial reserve losses (tables 8 and 10). In 1974-75, Brazil's rapidly increasing net debt was therefore partly

Table 9: Brazilian Foreign Debt, 1973-78
(millions of dollars)

<u>Year</u>	<u>Gross Foreign Debt <u>a/</u></u>	<u>Net Foreign Debt <u>b/</u></u>
1973	12,572	6,156
1974	17,166	11,897
1975	21,171	17,130
1976	25,985	19,441
1977	32,037	24,781
1978	43,511	31,616

a/ Medium- and long-term debt outstanding at the end of the year. Includes private nonguaranteed external debt.

b/ Gross debt minus gross international reserves of the monetary authorities (see Table 10).

Source: Banco Central do Brasil.

Table 10: International Reserves of the Brazilian Monetary Authorities, 1973-78
(millions of dollars)

Year	Special Drawing Rights	Reserve Position in the IMF ^{a/}	Foreign Exchange ^{b/}	Gold ^{c/}	Gross Reserves (1+2+3+4)	Short-term Liabilities of the Monetary Authorities	Net Reserves (5) - (6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1973	190	140	6,030	56	6,416	422	5,994
1974	199	140	4,873	56	5,269	399	4,870
1975	191	140	3,653	56	4,041	373	3,668
1976	199	188	6,101	56	6,544	887	5,657
1977	211	195	6,787	64	7,256	1,040	6,216
1978	240	181	11,406	68	11,895	360	11,535

Note: The monetary authorities are Banco Central and Banco do Brasil. Numbers may not add because of rounding.

a/ Unconditional IMF related reserve assets.

b/ Claims against foreigners in the form of bank deposits, Treasury Bills, and other documents that may be used to cover balance of payments deficits, including non-negotiable credit bills obtained through agreements between central banks or governments.

c/ National valuation.

Source: Banco Central do Brasil and International Monetary Fund.

associated with a significant reduction in the level of international reserves. But after 1976, somewhat lower current account deficits and substantially larger net capital inflows led once more to a rapid expansion of reserves. By 1976-78, reserve growth had again become a major factor in obstructing attempts at internal monetary control. ^{18/}

Despite the rapid growth of reserves in 1976-78 and despite the fact that Brazil continued to intensify her reliance on loans from private financial institutions in this period (Appendix B, Table 29), there can be no doubt that the nature of the country's external indebtedness underwent a basic change after 1974. In contrast to what had happened between 1968 and 1973, the increase in net debt accounted for as much as 82 percent of the increase in the gross medium- and long-term debt between end-1973 and end-1978 (Appendix B, Table 30). By 1978, as a result of the extraordinarily rapid expansion of net debt and of the slowdown in export and output growth, the ratio of net debt to exports and to GDP had increased to 249.8 percent and 15.2 percent respectively (Table 11).

As indicated above, the rapid growth of Brazil's net foreign debt in this period must be attributed to the adverse evolution of the international environment after 1973-74. Given that imports accounted for as much as 81 percent of Brazil's apparent consumption of oil in 1973, ^{19/} the sharp increase in oil prices could hardly fail to have a serious effect on Brazil's terms of trade (Appendix B, Table 32). At the same time, Brazilian exports were negatively affected by the international recession of 1974-75 and the subsequent slow recovery of the world economy. ^{20/}

Brazilian policymakers could of course have attempted to reduce the growth in the deficit on current account and in the country's net foreign debt

Table 11: Brazil - Foreign Debt and Reserve Indicators, 1973-78
(Percentage)

Year	<u>Net Debt a/</u>	<u>Net Debt a/</u>	<u>Debt Service b/</u>	<u>Gross Reserves</u>	<u>Gross Reserves</u>	<u>Net Reserves</u>	<u>Net Reserves</u>
	Merchandise Exports		Merchandise Exports	Merchandise Imports		Gross Debt c/	
1973	99.3	7.8	35.3	103.6	51.0	96.8	47.7
1974	149.6	11.4	32.3	41.7	30.7	38.5	28.4
1975	197.6	13.8	42.3	33.1	19.1	30.0	17.3
1976	192.0	12.8	47.4	52.8	25.2	45.7	21.8
1977	204.5	14.1	50.9	60.4	22.6	51.7	19.4
1978	249.8	15.2	63.4	86.9	27.3	84.3	26.5

a/ Medium- and long-term debt minus gross reserves.

b/ Net interest payments plus net amortizations.

c/ Medium- and long-term debt.

Source: Banco Central do Brasil, Fundacao Getulio Vargas and International Monetary Fund.

by more restrictive domestic demand management and/or a more aggressive exchange-rate policy. Rapid debt growth therefore reflects not only external shocks but also internal policy decisions. In fact, Brazil's balance of payments adjustment strategy was officially presented as an attempt to produce a gradual reduction of current account deficits. ^{21/} Thus the substantial expansion of net debt in this period should also be seen as a result of an internal decision to spread adjustment to external shocks over time and to follow an essentially gradualist balance of payments policy.

There was in any case a substantial reduction of domestic growth rates after 1974. In fact, Brazil's considerably higher deficits on current account cannot be blamed on an increasing divergence between domestic growth rates and those of the country's main trading partners. On the contrary, the average difference in annual GDP growth rates between Brazil and OECD countries actually fell in this period, from 6.2 percentage points in 1968-73 to 4.5 percentage points in 1974-78 (Appendix B, Table 31).

There can be no doubt, however, that the absorption of foreign capital played an important role in sustaining relatively high GDP growth rates; these were still high when compared with those of the rest of the world and more or less equivalent to the Brazilian economy's long-term rate of expansion. In this period, the absorption of foreign real resources increased substantially, from 1.4 percent in 1970-73 to 2.4 percent of GDP on the average (Table 12). The proportion of gross capital formation financed with external resources rose from 5.3 percent in 1970-73 to 7.9 percent in 1974-78 (Table 13).

This greater reliance on external resources was accompanied by a substantial rise in the rate of investment, from 26.3 percent in 1970-73 to as much as 29.6 percent in 1974-78. Higher rates of capital formation were

Table 12: Brazil - Components of Aggregate Demand, 1970-78
(as percentage of GDP)

Year	Consumption	Gross Fixed Capital Formation	Changes in Inventories	Gross Capital Formation (2)+(3)	Domestic Demand (1)+(4)	Exports	Imports
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1970-73 <u>a/</u>	75.1	24.8	1.5	26.3	101.4	7.1	8.5
1974	73.8	27.3	3.0	30.3	104.1	6.9	11.0
1975	70.6	29.2	2.9	32.1	102.7	7.3	10.0
1976	72.4	29.0	1.0	30.0	102.4	6.6	9.0
1977	73.4	26.9	1.3	28.2	101.6	6.2	7.8
1978	73.6	27.0	0.5	27.5	101.1	6.7	7.8
1974-78 <u>a/</u>	72.8	27.9	1.7	29.6	102.4	6.7	9.1

Note: Measured in 1970 prices.

a/ Average.

Source: Fundacao Getulio Vargas.

Table 13: Brazil - Contribution of Internal and External Resources to the Financing of Gross Capital Formation, 1970-78 (as percentage of GDP)

Year	GDP minus Consumption (1)	Imports minus Exports (2)	Gross Capital Formation (3)	(1)/(3) (%) (4)	(2)/(3) (%) (5)
1970-73 <u>a/</u>	24.9	1.4	26.3	94.7	5.3
1974	26.2	4.1	30.3	86.5	13.5
1975	29.4	2.7	32.1	91.6	8.4
1976	27.6	2.4	30.0	92.0	8.0
1977	26.6	1.6	28.2	94.3	5.7
1978	26.4	1.1	27.5	96.0	4.0
1974-78 <u>a/</u>	27.2	2.4	29.6	92.1	7.9

Note: Measured in 1970 prices. Numbers may not add because of rounding.

a/ Average.

Source: Table 12.

achieved not only by a larger absorption of foreign resources, but also by reducing aggregate consumption from 75.1 percent of GDP in 1970-73 to 72.8 percent of GDP in 1974-78. In fact, the increased contribution of internal resources accounts for over two-thirds of the increase in the rate of capital formation between 1970-73 and 1974-78 (Table 13).

This significant investment effort was central to the Brazilian government's development strategy in this period. The latter involved a wide-ranging and ambitious attempt to maintain high growth rates and to diversify the country's industrial structure by stimulating import substitution of capital goods and basic raw materials (steel, nonferrous metals, chemicals, fertilizers, etc.). ^{22/} Reflecting the emphasis on import substitution, the ratio of imports to GDP, after rising to a peak of 11 percent in 1974, fell substantially between 1975 and 1977. By contrast, exports remained more or less constant as a proportion of domestic output (Table 12). In fact, export promotion seems to have played a relatively less important role in this period.^{23/}

Gradual adjustment through import substitution had to be supplemented by an array of measures to stimulate the inflow of foreign loans. ^{24/} In this context, external borrowing by the public sector became increasingly important. Public enterprises, state governments, and other public agencies were forced to increase their reliance on foreign credit in this period. As a result, the share of public and publicly guaranteed debt in total medium- and long-term debt rose from 51.7 percent in 1973 to as much as 63.3 percent in 1978. ^{25/}

Insofar as balance of payments financing is concerned, this policy was undoubtedly successful in the short run. After 1976, Brazil was able to finance and even overfinance high current account deficits and increasing debt

amortizations without great difficulties. In fact, Brazil's approach to balance of payments adjustment found support in the rapid expansion of liquidity in international financial markets and in the relatively low level of foreign interest rates in real terms. ^{26/}

However, higher spreads ^{27/} and the increasing relative weight of loans from private sources (Appendix B, Table 29) led to an increase in the average cost of the foreign debt in real terms, from 1.7 percent in 1968-73 to 3.6 percent in 1974-78 (tables 7 and 14). Moreover, all basic relative indicators suffered a substantial deterioration in this period (Table 11). By 1977-78, external indebtedness had become a largely self-reinforcing process, with net interest payments accounting for almost 50 percent of the deficit on current account.

Table 14: Average Cost of Brazil's Foreign Debt in Nominal and Real Terms, 1973-78

Year	Net Interest Payments (Millions of dollars) (1)	Net Foreign Debt ^{a/} (Millions of dollars) (2)	Average Cost In Nominal Terms (in percent) (3)=(1)/(2)	U.S. ^{b/} Inflation (in percent) (4)	Average Cost in Real Terms ^{c/} (in percent) (5)=(3)/(4)
1973	514	5,338	9.6	5.8	3.6
1974	652	6,156	10.6	8.8	1.7
1975	1,498	11,897	12.6	9.3	3.0
1976	1,810	17,130	10.6	5.2	5.1
1977	2,104	19,441	10.8	5.8	4.7
1978	2,696	24,781	10.9	7.4	3.3

^{a/} Gross medium- and long-term debt minus gross international reserves. Debt outstanding at the beginning of the year.

^{b/} GNP implicit price deflator.

^{c/} If i represents the average cost in nominal terms, p the growth of the GNP deflator and r the average cost in real terms, $i = r + p + rp$.

Source: Banco Central do Brasil and U.S. Department of Commerce.

The sharp deterioration in all basic relative indicators and the increasingly self-reinforcing character of external indebtedness suggest that Brazil's balance of payments position was basically weak even before the second round of oil price increases and the rise in international interest rates after 1979. In fact, Brazil's vulnerability to this second wave of external shocks is closely related to the way in which economic policy was conducted in 1974-78. ^{28/} Brazil's response seems to have been based on a clearly mistaken assessment of the nature of external shocks. Since the latter were interpreted as essentially temporary disturbances that would have no lasting effect on Brazil's long-term growth path, economic policy tended to react rather slowly. Decisive measures to contain imports were only taken in 1975, more than one year after the first large increase in oil prices. ^{29/} As a result, merchandise imports increased by 104 percent in a single year, the trade deficit moved from equilibrium in 1973 to a record US\$4.7 billion deficit in 1974, and the net foreign debt increased by as much as 93 percent from end-1973 to end-1974 (tables 8 and 9).

Because of excessively optimistic expectations concerning domestic oil production and the real price of oil in international markets, substitution of oil imports proceeded at a relatively slow pace in this period. ^{30/} A steady increase in consumption and a decline of domestic production in fact led to an increase in the country's already high dependence on oil imports. Between 1973 and 1978, the share of imported oil in apparent consumption rose from 81 percent to 85 percent. ^{31/} By the end of this period, Brazil's vulnerability to further oil price shocks had therefore increased significantly. Moreover, as a consequence of the continuous and rapid increase of the foreign debt and of the growing share of variable

interest rate loans (Table 15), the country's external vulnerability acquired a specifically financial dimension that was to prove extremely damaging in subsequent years.

Table 15: Share of Concessional and Variable Interest Rate Loans in Brazil's Public Foreign Debt, 1971-78 (percentage)

<u>Year</u>	<u>Concessional Loans</u>	<u>Variable Interest Rate Loans <u>a/</u></u>
1971	35.8	16.5
1972	26.0	25.0
1973	20.5	34.3
1974	15.4	43.2
1975	12.5	51.2
1976	9.8	54.8
1977	7.8	53.9
1978	5.9	56.3

Note: Debt outstanding and disbursed.

a/ Proportion of debt carrying interest rates that float with movements in a key market rate: for example, the London interbank offered rate (LIBOR) or the U.S. prime rate.

Source: World Bank.

From the Second Oil Shock to the Debt Crisis, 1979-1982

As of 1979 Brazil suffered a new round of external shocks in the form of terms of trade losses, recession and protectionism in OECD countries and in other markets, and an unprecedented rise in international interest rates. In 1979-82, external shocks were in fact even more severe than in the preceding period. As indicated above, Brazil's terms of trade had declined substantially after the first oil shock by about 20 percent in 1974-75. With the rapid improvement in export prices and the stabilization of oil prices, however, the terms of trade by 1977, had exceeded the level of 1973. After 1978 the terms of trade suffered a continuous and much more substantial deterioration, amounting to almost 40 percent between 1978 and 1982. In contrast to what had happened in the period following the first oil crisis, when the terms of trade loss was due entirely to the rise in oil prices, ^{32/} after 1978 the terms of trade excluding oil also declined continuously, by as much as 18 percent between 1978 and 1982 (Appendix B, Table 32). The adverse evolution of Brazil's terms of trade is undoubtedly related to the world recession of 1980-82. As is well known, the recession experienced by OECD countries after the second oil shock lasted longer and was somewhat deeper than the one of 1974-75 (Appendix B, Table 31), and reinforced the trend toward protectionism in Brazil's main export markets.

However, the basic and decisive difference between external shocks in 1974-78 and 1979-82 seems to lie in the behavior of international interest rates, particularly those in the United States and other industrialized countries. Average eurodollar deposit rates rose from 8.1 percent in 1974-78 to 14.0 percent in 1979-82 in nominal terms and from 0.7 percent to 5.3 percent in real terms. ^{33/} It can be argued that this sharp and unprecedented

rise in international interest rates after 1979 constitutes the main destabilizing factor from the point of view of Brazil, not only because of its substantial direct impact on interest payments, but also because of its negative effects on the prices of primary products exported by Brazil, on the level of activity and employment in the industrialized countries, and on the import capacity of Brazilian markets in developing and Eastern European countries.

Brazil's extreme vulnerability to an interest rate shock was due to a combination of factors, the first of which was the continuing increase in the already large share of debts vis-a-vis commercial banks and other financial institutions in the form of floating or variable interest rate loans. By 1982, debt outstanding to financial institutions had reached 74.8 percent of total medium- and long-term public debt (Appendix B, Table 29). The share of variable interest rate loans, which had been increasing continuously since the early 1970s, rose even further in this period, from 56.3 percent in 1978 to 70.2 percent of public debt in 1982 (Table 16). Moreover, with loans denominated in U.S. dollars accounting for more than three-quarters of total public debt (Table 17), Brazil was particularly vulnerable to the effects of U.S. economic policy on dollar interest rates.

As a result, net interest payments increased from US\$2.7 billion in 1978 to US\$11.4 billion in 1982, a fact that reflects not only the sharp rise in international interest rates, but also the rapid growth of net debt and the higher spreads paid by Brazilian borrowers after 1980. ^{34/} The average cost of the debt rose from 10.9 percent in 1978 to 21.1 percent in 1982 in nominal terms and from 3.3 percent to 14.2 percent in real terms (Table 18). ^{35/}

Table 16: Share of Concessional and Variable Interest Rate Loans in Brazil's Public Foreign Debt, 1978-83 (percentage)

<u>Year</u>	<u>Concessional Loans</u>	<u>Variable Interest Rate Loans <u>a/</u></u>
1978	5.9	56.3
1979	4.9	59.1
1980	4.1	61.1
1981	3.5	67.3
1982	3.2	70.2
1983	-	75.2 <u>b/</u>

Note: Debt outstanding and disbursed.

a/ Proportion of debt carrying interest rates that float with movements in a key market rate: for example, the London interbank offered rate (LIBOR) or the U.S. prime rate.

b/ Share of variable interest rate loans in public and private debt outstanding and disbursed.

Source: Banco Central do Brasil and World Bank.

Table 17: Currency Breakdown of Brazilian Foreign Debt, 1973-82
(percentage)

Year	U.S. Dollar	German Mark	Japanese Yen	French Franc	British Pound	Swiss Franc	Other
1973	79.9	4.0	2.5	2.9	6.3	0.7	3.6
1974	83.3	3.2	2.2	2.6	4.7	0.5	3.5
1975	86.7	2.6	2.3	2.1	3.1	0.3	2.9
1976	84.9	4.1	3.3	1.7	2.2	0.5	3.3
1977	78.9	7.6	6.0	1.7	2.0	1.1	2.6
1978	75.0	9.0	8.6	2.1	1.4	1.5	2.5
1979	75.8	9.0	7.2	2.2	2.2	1.6	2.0
1980	76.1	8.2	7.9	2.3	2.1	1.3	2.1
1981	80.7	6.8	6.2	1.8	1.3	1.1	2.1
1982	82.9	5.8	5.7	1.7	0.9	0.9	2.1

Note: Public debt outstanding and disbursed at the end of the year.
Numbers may not add because of rounding.

Source: World Bank.

Table 18: Average Cost of Brazil's Foreign Debt
in Nominal and Real Terms, 1978-83

Year	Net Interest Payments (Millions of dollars) (1)	Net Foreign Debt <u>a/</u> (Millions of dollars) (2)	Average Cost In Nominal Terms (in percent) (3)=(1)/(2)	U.S. Inflation <u>b/</u> (in percent) (4)	Average Cost in Real Terms (in percent) (5)=(3)/(4)
1978	2,696	24,781	10.9	7.4	3.3
1979	4,186	31,616	13.2	8.6	4.2
1980	6,311	40,215	15.7	9.2	6.0
1981	9,161	46,935	19.5	9.4	9.2
1982	11,353	53,904	21.1	6.0	14.2
1983	9,555	66,204	14.4	4.2 <u>d/</u>	9.8

a/ Gross medium- and long-term debt minus gross international reserves. Debt outstanding at the beginning of the year.

b/ GNP implicit price deflator.

c/ If i represents the average cost in nominal terms, p the growth of the GNP deflator and r the average cost in real terms, $i = r + p + rp$.

d/ Preliminary.

Source: Banco Central do Brasil and U.S. Department of Commerce

This new round of external shocks, combined with a generally inappropriate policy response, produced a probably unprecedented deterioration of Brazil's overall economic performance. After 1979, balance of payments deficits increased dramatically and inflation rose to record levels. ^{36/} GDP growth rates, after remaining relatively high in 1979-80, fell precipitously (Appendix B, Table 31) and the Brazilian economy went through its worst recession since the early 1930s. ^{37/} Brazil's deepening economic crisis reflected not only the above-mentioned exogenous shocks, but also a considerable decline in the effectiveness of economic policymaking after 1979. In fact, the second oil price increase took place at a time of significant weakening of domestic demand management. Moreover, exchange rate policy became extremely unstable after 1979 and the quality of external debt management deteriorated substantially. ^{38/}

Severe external shocks coupled with a weak policy response led to increasingly serious balance of payments difficulties. In 1979-80, trade deficits rose to almost US\$1 billion per year and annual current account deficits to more than US\$11 billion on the average. The trade balance's subsequent swing into surplus was swamped by sharply rising interest payments and, as a result, the current account deficit reached almost US\$15 billion in 1982 (Table 19).

These substantially higher current account deficits were to a large extent financed by massive net inflows of financial capital. Brazil's gross foreign debt therefore continued to increase at the relatively high rate of 12.7 percent per year in 1979-82 (Table 20). With current account deficits exceeding net capital movements in every year except 1981, Brazil's international reserves fell sharply and net debt increased at the even higher rate of 20.3 percent per year between end-1978 and end-1982 (tables 20 and 21).

Table 19 Brazilian Balance-of-Payments, 1979-83
(millions of dollars)

Item	1974-78 ^a	1979	1980	1981	1982	1983
A - TRADE BALANCE	-2,282	-2,840	-2,823	1,202	780	6,470
Exports (FOB)	10,306	15,244	20,132	23,293	20,175	21,899
Imports (FOB)	-12,588	-18,084	-22,955	-22,091	-19,395	-15,429
B - SERVICES	-3,711	-7,199	-9,741	-12,394	-15,527	-12,721
Interest (Net)	-1,752	-4,186	-6,311	-9,161	-11,353	-9,555
Profits and Dividends (Net) ^b	-376	-636	-310	-370	-585	-758
Other Services (Net)	-1,583	-2,377	-3,120	-2,863	-3,589	-2,408
C - UNREQUITED TRANSFERS	15	18	168	199	-8	108
D - CURRENT ACCOUNT BALANCE (A+B+C)	-5,978	-10,021	-12,396	-10,993	-14,755	-6,143
E - NET CAPITAL MOVEMENTS	7,046	6,936	9,268	12,031	6,295	843
Direct Investment (Net) ^c	924	1,491	1,121	1,584	991	664
Loans and Financing ^d	8,566	11,228	10,596	15,553	12,515	8,153
Amortizations (Net) ^d	-3,293	-6,385	-5,010	-6,242	-6,952	-9,120
Other (Net)	849	601	2,561	1,135	-259	1,146
F - ERRORS AND OMISSIONS	-228	-130	-343	-414	-368	-670
SURPLUS OR DEFICIT (D+E+F)	840	-3,215	-3,472	625	-8,828	-5,969
FINANCING	-840	3,215	3,472	-625	8,828	5,969
IMF Operations	-13	-106	-35	26	378	282
Short-Term Assets (increase -)	-1,152	3,325	3,507	-651	3,083	-957
Monetary Gold (increase -)	-2	-4	-	-	1,191	402
Other	327	-	-	-	4,177	6,242

a. Annual average. b. Excludes reinvested profits. c. Excludes reinvestments. d. Medium- and long-term.

Note: Numbers may not add because of rounding.

Source: Banco Central do Brasil.

Table 20: Brazilian Foreign Debt, 1978-83
(Millions of dollars)

Year	Gross Foreign Debt <u>a/</u>	Net Foreign Debt <u>b/</u>
1978	43,511	31,616
1979	49,904	40,215
1980	53,848	46,935
1981	61,411	53,904
1982	70,198	66,204
1983	81,319	79,756

a/ Medium- and long-term debt outstanding at the end of the year. Includes private nonguaranteed external debt.

b/ Gross debt minus gross international reserves of the monetary authorities (see table 21).

Source: Banco Central do Brasil.

Table 21 International Reserves of the Brazilian Monetary Authorities, 1978-83
(millions of dollars)

Year	Special Drawing Rights (1)	Reserve Position in the IMF <u>a/</u> (2)	Foreign Exchange <u>b/</u> (3)	Gold <u>c/</u> (4)	Gross Reserves (1+2+3+4) (5)	Short-term Liabilities of the Monetary Authorities <u>d/</u> (6)	Net Reserves (5-6) (7)
1978	240	181	11,406	68	11,895	360	11,535
1979	383	242	8,342	722	9,689	246	9,443
1980	384	344	5,042	1,143	6,913	1,750	5,163
1981	451	263	5,888	905	7,507	1,812	5,695
1982	1	287	3,641	65	3,994	6,326	-2,332
1983	-	-	4,355	207	4,563	4,477	86

Note: The monetary authorities are Banco Central and Banco do Brasil. Numbers may not add because of rounding.

a/ Unconditional IMF related reserve assets.

b/ Claims against foreigners in the form of bank deposits, Treasury Bills, and other documents that may be used to cover balance of payments deficits, including non-negotiable credit bills obtained through agreements between central banks or governments.

c/ National valuation.

d/ Excludes use of IMF resources.

Source: Banco Central do Brasil and International Monetary Fund.

Basic foreign debt and reserve indicators, which had already deteriorated significantly in the preceding period, continued to worsen after 1979. By 1982, net debt had risen to 328.1 percent of exports and to 23.5 percent of GDP (Table 22).

It should be stressed, moreover, that the official debt statistics reproduced in tables 20 and 22 account for a diminishing share of Brazil's total foreign debt after 1980. In fact, nonregistered short-term debt seems to have increased at an extremely high rate in this period. Estimates based on data from the Bank for International Settlements and Brazilian Central Bank ^{39/} suggest that short-term debt rose from about US\$4.6 billion in 1978 to as much as US\$17.3 billion in 1982, increasing at an average rate of 39.3 percent per year (Table 23). ^{40/}

Thus, after 1980 Brazil's foreign debt increased at a faster pace than indicated by official debt statistics. Net debt, redefined as the difference between total debt (including estimates of short-term debt) and gross reserves, rose at the average annual rate of 23.2 percent between end-1978 and end-1982 (see tables 21 and 23). At the same time, its average maturity shortened considerably. In fact, although the average maturity of the registered debt increased slightly--from 4.5 years in December 1978 to 4.7 years in December 1982 ^{41/}--the share of nonregistered short-term debt in Brazil's total foreign debt is estimated to have doubled in this same period (Table 23).

Moreover, loans extended by foreign branches and subsidiaries of official and private Brazilian banks seem to have accounted for a growing share of Brazil's registered medium- and long-term debt. By 1981-82, Brazilian banks held almost 10 percent of the country's outstanding registered debt. ^{42/} These foreign branches and subsidiaries of Brazilian banks were

Table 22 Brazil - Foreign Debt and Reserve Indicators, 1978-83
(percentage)

Year	Net Debt ^a		Debt Service ^b	Gross Reserves		Net Reserves	
	Merchandise Exports	GDP	Merchandise Exports	Merchandise Imports	Gross Debt ^c	Merchandise Imports	Gross Debt ^c
1978	249.8	15.2	63.4	86.9	27.3	84.3	26.5
1979	263.8	17.1	69.3	53.6	19.4	52.2	18.9
1980	233.1	18.8	56.2	30.1	12.8	22.5	9.6
1981	231.4	19.6	66.1	34.0	12.2	25.8	9.3
1982	328.1	23.5	90.7	20.6	5.7	-12.0	-3.3
1983	350.5	37.0	85.3	29.6	5.6	0.6	0.1

a/ Medium- and long-term debt minus gross reserves.

b/ Net interest payments plus net amortizations.

c/ Medium- and long-term debt.

Source: Banco Central do Brasil, Fundacao Getulio Vargas and International Monetary Fund.

Table 23 Brazil: Gross Medium- and Long-Term Debt
and Estimates of Short-Term Debt, 1977-83
 (billions of dollars)

Date	Medium- and Long-Term Gross Debt (1)	Estimated Short-Term Debt (2)	Total Debt (1) + (2) (3)	(2)/(3) % (4)
1977 - December	32.0	3.7	35.7	10.4
1978 - December	43.5	4.6	48.1	9.6
1979 - December	49.9	6.2	56.1	11.1
1980 - June	51.6	7.5	59.1	12.7
- December	53.8	10.8	64.6	16.7
1981 - June	56.1	10.0	66.1	15.1
- December	61.4	14.1	75.5	18.7
1982 - June	64.4	14.8	79.2	18.7
- December	70.2	17.3	87.5	19.8
1983 - June	76.4	17.4	93.8	18.6
- December	81.3	14.9	96.2	15.5

Source: Gross medium- and long-term debt, Banco Central do Brasil;
 Short-term debt, author's estimates (see Appendix A).

funding themselves chiefly through short-term interbank credits. As a result, a growing proportion of Brazil's supposedly long-term debt was in effect a short-term debt of Brazilian banks operating abroad. In other words, the shortening of the foreign debt's profile was actually more significant than could be perceived by looking at official statistics or even at unofficial estimates of the short-term foreign debt of Brazilian residents. By December 1982, Brazil's short-term debt (including about 10 percent of the country's medium- and long-term debt held by the foreign branches and subsidiaries of Brazilian banks) had reached an estimated US\$24.3 billion, or the equivalent of 27.8 percent of total foreign debt. If we take into account not only the short-term debt of Brazilian residents, but also the so-called net interbank debt of foreign branches and subsidiaries of Brazilian banks, ^{43/} Brazil's total debt at the end of 1982 was approximately US\$90 billion, which was the equivalent of about four and a half times the value of the country's merchandise exports.

What role did the expansion of foreign debt and the massive inflow of financial capital play in the period? It should be made clear first of all that by 1980 external indebtedness had become a preponderantly self-reinforcing process. In fact, net interest payments accounted for as much as 70 percent of current account deficits in 1980-82. Inflows of financial capital, defined as net capital movements minus net direct investments, were almost entirely absorbed by net interest payments in 1980-81. By 1982, interest payments exceeded net inflows of financial capital by as much as US\$6 billion (Table 19).

In reality, substantially higher current account deficits had very little to do with the absorption of real resources from abroad after 1979. The very use of the current account deficit as an indicator of the

contribution of "external savings" becomes particularly inappropriate in this period for a number of reasons. First, variable interest rates and relatively high dollar inflation meant that total nominal interest payments included a compensation to the lenders for the erosion in the real value of the debt; current account deficits were therefore significantly inflated by the fact that repayments of principal were partly transferred from the capital account to the current account. ^{44/} Second, higher current account deficits were largely associated with a substantial increase in factor payments to nonresidents and not to higher net imports of goods and nonfactor services. ^{45/} Third, the increase in current account deficits also reflected the above-mentioned sharp deterioration in the terms of trade. As a result of increasing factor payments and declining terms of trade, domestic income diminished significantly as a proportion of GDP in this period. ^{46/}

After 1980, international financial flows and large current account deficits ceased to be associated with an excess of domestic demand over GDP (Table 24). The latter began to exceed aggregate consumption and investment by an increasing margin. The outward transfer of resources, measured as the excess of exports over imports of goods and nonfactor services in constant prices, increased from 0.4 percent of GDP in 1980 to about 3 percent of GDP in 1981-82 and to as much as 5 percent of GDP in 1983. It should be noted, moreover, that the outward transfer of resources effected in 1981-83 was much more significant as a proportion of domestic output than the inward transfer obtained in the mid-1970s (see tables 12 and 24). Thus, in contrast to what had happened up to 1978, the rate of gross fixed capital formation fell continuously, from 27.9 percent in 1974-78 to 19 percent in 1983 (Table 24). ^{47/}

Table 24: Brazil - Components of Aggregate Demand, 1974-83
(as percentage of GDP)

Year	Consumption	Gross Fixed Capital Formation	Changes in Inventories	Gross Capital Formation (2)+(3)	Domestic Demand (1)+(4)	Exports	Imports
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1974-78 <u>a/</u>	72.8	27.9	1.7	29.6	102.4	6.7	9.1
1979	74.7	26.4	-0.1	26.3	101.0	6.9	7.9
1980	72.1	26.3	1.2	27.5	99.6	7.9	7.5
1981	73.4 <u>b/</u>	23.5	-	-	96.9	9.7	6.6
1982	75.1 <u>b/</u>	22.3	-	-	97.4	8.8	6.2
1983	76.0 <u>b/</u>	19.0	-	-	95.0	10.3	5.3
1979-83 <u>a/</u>	74.5	23.5	-	-	98.0	8.7	6.7

Note: Measured in 1970 prices.

a/ Average.

b/ Includes in changes in inventories.

Source: Fundacao Getulio Vargas.

As a result of the negative contribution of external resources, gross capital formation had to be entirely financed by internal resources. In fact, an increasing share of the latter was used to cover factor payments to non-residents (Table 25).

Table 25: Brazil: Contribution of Internal and External Resources to the Financing of Gross Capital Formation, 1974-83
(as percentage of GDP)

Year	GDP minus Consumption (1)	Imports minus Exports (2)	Gross Capital Formation (3)	(1)/(3) (%) (4)	(2)/(3) (%) (5)
1974-78 <u>a/</u>	27.2	2.4	29.6	92.1	7.9
1979	25.3	1.0	26.3	96.2	3.8
1980	27.9	-0.4	27.5	101.5	-1.5
1981	-	-3.1	-	-	-
1982	-	-2.6	-	-	-
1983	-	-5.0	-	-	-
1979-83 <u>a/</u>	-	-2.0	-	-	-

Note: Measured in 1970 prices. Numbers may not add because of rounding.

a/ Average.

Source: Table 24.

Severe balance of payments pressures therefore resulted in a sharp compression of the ratio of imports to GDP and in a similarly sharp increase in the ratio of exports to GDP (Table 24). From 1978 to 1983, imports fell by 27.6 percent in volume terms, and export volume increased by as much as 69 percent, at a considerably higher rate than in 1974-78. ^{48/} Despite the

decline in export unit values, Brazil's share of total world exports rose from 1.09 percent in 1974-78 to 1.17 percent in 1979-83. The Brazilian share of world manufactured exports increased rather more significantly, from 0.55 percent in 1974-78 to 0.90 percent in 1979-82 (Appendix B, Table 33), as a result of the increase in competitiveness associated with the devaluation of the effective cruzeiro exchange rate (Appendix B, Table 34) and other export incentives. ^{49/}

However, this substantial adjustment effort was not sufficient to prevent a full-scale balance of payments crisis in 1982. Merchandise exports fell for the first time since 1967, the deficit on account of interest and other services rose sharply and thus the deficit on current account increased from US\$11 billion to nearly US\$15 billion. At the same time, in the wake of the Malvinas war and Mexico's moratorium, Brazil's access to international credit declined sharply and the country's already low level of reserves virtually disappeared. ^{50/} Despite repeated official denials, by September-October 1982 it had become clear that Brazil would no longer be able to continue normal debt servicing and that some sort of rescheduling was inevitable. At the end of the year the Brazilian government officially accepted an extended financing arrangement with the IMF as a precondition for a rescheduling of the country's debt with foreign commercial banks.

Debt Rescheduling in 1983-84

At the end of 1982, Brazil announced the decision to seek maximum access to IMF funds and to renegotiate its debt vis-a-vis bank creditors, thereby inaugurating a completely new phase in the country's international financial relations. Beginning in 1983, the previous system of "recycling"

debt service by means of essentially voluntary lending was replaced by the rescheduling of amortizations due to bank creditors and the extension by them of "forced" loans in exchange for the acceptance by the debtor country of an IMF adjustment program. In this context, Brazil and its foreign bank creditors established a four-point financial package for 1983, involving: (a) a "jumbo-loan" of US\$4.4 billion to be provided by commercial banks in proportion to their outstanding credits to Brazil (Project I); (b) the rescheduling of medium- and long-term principal payments to commercial banks falling due in 1983 (Project II); (c) the renewal of short-term commercial bank credit (Project III); and (d) the restoration of interbank credit for foreign branches and subsidiaries of Brazilian banks to the level observed in mid-1982 (Project IV). 51/

Brazil's rescheduling scheme for 1983 seems to have been based on the assumption that the interruption in the inflow of bank credit was a temporary phenomenon that could be dealt with by stop-gap measures and short-term schemes such as the one set forth above. However, the debt crisis was to prove a much more serious and lasting problem than Brazil or its main foreign bank creditors were initially prepared to admit. Moreover, it soon became evident that Brazil's financial package for 1983 was completely inadequate even as a short-term operation. In fact, "new money" needs had been substantially underestimated, and the banking community's willingness to voluntarily sustain short-term credit lines, especially interbank lines to Brazilian banks abroad, had been clearly overestimated. By December 1983, Brazil had accumulated payment arrears of US\$2.3 billion. 52/

Nevertheless, one of the basic elements of Brazil's balance of payments adjustment scheme for 1983 was fully achieved and even slightly surpassed: the surplus in the balance of trade increased by as much as 729

percent in a single year, rising from US\$0.8 billion in 1982 to US\$6.5 billion in 1983 (see Table 19). As indicated above, this large swing in the balance of trade involved a sharp reduction in domestic expenditure relative to domestic output. Exports rose to 10.3 percent of GDP and imports fell to only 5.3 percent of GDP (Table 24). As a result, a large share of factor payments (mainly interest) was financed by an outward transfer of real resources, equivalent to 5 percent of total domestic output.

The sharp contraction of bank credits therefore led to a massive net transfer from Brazil to foreign commercial banks. As could be expected, this outward transfer was obtained at an extremely high cost to the Brazilian economy. ^{53/} In fact, as a consequence of the measures taken to ensure the US\$6 billion surplus in the trade accounts, inflation shot up to previously unseen levels and per capita GDP declined by as much as 5.5 percent. ^{54/}

By mid-1983 the weaknesses of the first phase of debt rescheduling had become evident. Thus, Brazil and her bank creditors began to design a more consistent package for 1984. This new deal, concluded in March 1984 after protracted negotiations, had a number of advantages over the rescheduling scheme established for 1983. First, the amount of "new money" extended by commercial banks was raised from US\$4.4 billion to US\$6.5 billion. Second, the grace period for repayment of the new loan and of the amortizations rescheduled in 1984 was increased from 2 1/2 to 5 years and the final amortization period from 8 to 9 years. Third, the banks' commitment to sustain the level of short-term commercial and interbank lines was reinforced by the introduction of a formal contract wherein each individual bank agreed to maintain during one year the amount of short-term credit outstanding in June 1983. ^{55/} Finally, the financial package negotiated with the banks was

supplemented by an agreement to reschedule debts extended or guaranteed by the governments of industrialized countries under the aegis of the Paris Club. ^{56/}

However, this second phase of debt rescheduling retained one of the essential features of the previous agreement. In exchange for the above-mentioned financial support, Brazil pledged to fully eliminate interest arrears and to generate an even larger trade surplus in 1984. In reality, actual results exceeded the original target of a US\$9 billion trade surplus by about US\$4 billion, basically as a result of the strong positive impact of the unexpectedly rapid recovery of the United States on Brazil's exports. In 1984, the excess of exports over imports of goods and nonfactor services reached an estimated US\$11.4 billion, or the equivalent of 104 percent of factor payments including interest, profits, and dividends. ^{57/}

The attempt to solve serious debt-servicing difficulties by forcing debtor countries to run large and increasing trade surpluses is not of course a specific feature of the Brazilian case. In the last two years, the approach to the international debt crisis has been generally based on a massive transfer of resources from debtors in the developing countries and Eastern Europe to the banking system of the industrialized countries. ^{58/} The end purpose of this process is to achieve a sizable reduction in the high degree of relative exposure of major banks in the United States and in other industrialized countries vis-a-vis "problem" debtors such as Brazil, Mexico, and Argentina. ^{59/} A reduction in the level of bank exposure depends, of course, on a substantial reduction in the amount of "new money" extended by the banks to these countries. Given the extremely high level of international interest rates, the reduction in the rate of growth of bank exposure results necessarily in a large outward transfer of resources from the debtor countries to the banks.

The essentially premature character of this large-scale net transfer of resources from developing countries to the banking system of the industrialized countries was emphasized recently by the president of the World Bank:

New commercial-bank lending to developing countries, especially to major borrowers, has fallen dramatically. As a result, the net transfer from commercial banks to developing countries (that is, new lending minus debt-service payments) is now negative. The developing countries are repaying more to the banks than the banks are lending.

According to the World Bank's Debtor Reporting System, the net transfer of medium and long-term lending from private sources to developing countries was \$16 billion in 1981. But in 1982, the net transfer was a negative \$7 billion. We estimate a negative net transfer of \$21 billion for 1983.

Productive investment yields a return, and foreign investors should get back more than they invest. But it is premature for developing countries, as a group, to be transferring resources to the high-income countries on this scale. In 1983, the net transfer from the 13 major borrowers among the developing countries to private lenders was equivalent to 2 percent of their national income. ^{60/}

It is in fact difficult to accept this sharp reversal in the net flow of resources, which forces relatively poor and capital-scarce economies to transfer to highly developed countries a substantial share of their output and exports, as an adequate way of dealing with present widespread debt-servicing problems. In the medium- and long-term, resources should flow from relatively more advanced and capital-abundant economies toward less developed economies. In this sense, the situation of these last two years must be seen as essentially abnormal and unsustainable.

Appendix A
Estimates of Short-Term Debt

Estimates of the short-term debt of Brazilian residents presented in Table 23 were constructed by combining data from the Bank for International Settlements (BIS) with data from the Central Bank of Brazil.

The BIS semiannual review of international bank lending provides statistics on the maturity breakdown of the external assets of banks in its reporting area on a country-by-country basis. ^{61/} The banks' external assets in each country are classified according to the following four categories: (a) up to and including one year; (b) over one year up to and including two years; (c) over two years; and (d) unallocated. The unallocated portion probably includes a significant share of credits with a remaining maturity of one year or less. In the absence of further information, it was simply assumed that the maturity distribution of unallocated assets is equal to that of allocated assets, that is, that the share of credits with a residual maturity of one year or less is identical in both cases.

For our purposes it was also necessary to estimate the share of outstanding credits with an original maturity of one year or less. Data provided by the Brazilian Central Bank on the profile of medium- and long-term debt ^{62/} was used to establish the value of medium- and long-term amortizations due to commercial banks with a remaining maturity of one year or less. In the absence of sufficiently detailed information, it was assumed that debt vis-a-vis commercial banks corresponds to currency loans (emprestimos em moeda) and import financing, except from official (multilateral and bilateral) sources.

Brazil's short-term debt, as indicated in column 2 of Table 23, corresponds to the difference between bank debt with a residual maturity of one year or less (including estimates of unallocated assets with a residual maturity of one year or less) and estimated medium- and long-term amortizations of bank credits with a residual maturity of one year or less.

It should be noted that these estimates of short-term debt exceed the Brazilian government's own estimates by a significant margin in every year for which the latter are available. From 1979 to 1983, Central Bank data on short-term debt fall short of estimates presented in this paper by US\$2 billion to US\$4 billion (Appendix A, Table 28).

There is, however, no reason to believe that our estimates of short-term debt overstate the total amount of Brazil's short-term obligations. On the contrary, there are a number of reasons to assume that the figures presented in Table 23 underestimate Brazil's short-term foreign debt: (a) BIS data do not include short-term loans made by nonbank sources (official and private) that may be of some significance; (b) although the coverage of the BIS semiannual review is quite complete, it does not include all international banking operations; ^{63/} (c) since statistics on short-term lending tend to be less complete than data on medium- and long-term lending, the share of short-term credits in the unallocated portion of the external assets of banks in the BIS reporting area may be larger than their share in allocated credits; ^{64/} and (d) since Brazilian official data on currency loans and import financing from private sources include amortization due to nonbank sources (e.g., intercompany loans and suppliers' credits), ^{65/} estimates presented in this paper are based on an overstatement of the ratio of medium- and long-term bank credits falling due in the short term to total bank debt with a residual

maturity of one year or less. Brazil's total short-term debt can therefore be assumed to substantially exceed official estimates of short-term or nonregistered foreign debt.

Table 28: Estimates of Brazilian Short-Term Debt, 1979-83
(billions of dollars)

Year	Estimated Short-Term Debt <u>a/</u> (1)	Official Estimate of Short-Term Debt <u>b/</u> (2)	Official Estimate of Short-Term Debt <u>c/</u> (3)
1979	6.2	4.0	-
1980	10.8	7.0	-
1981	14.1	10.5	-
1982	17.3	13.0	15.1
1983	14.9	10.3 <u>d/</u>	12.2 <u>d/</u>

a/ Author's estimate of debt outstanding at the end of the year.

b/ Nonregistered debt outstanding at the end of the year. Includes foreign assets of Brazilian commercial banks. Figures for 1979 and 1980 are not fully comparable to those for later years.

c/ Excludes foreign assets of Brazilian commercial banks.

d/ Includes payment arrears.

Source: Column 1, author's estimates as described in text; columns 2 and 3, Banco Central do Brasil.

APPENDIX B
STATISTICAL TABLES

Table 29 Structure of Brazil's Public Foreign Debt by Lender Groups, 1967-1983
(as percentage of total)

Year	Concessional Bilateral Loans and Official Export Credits	Multilateral Loans	Suppliers' Credits	Financial Institutions	Bonds	Other Private Sources	Total Private Source Loans (3 + 4 + 5 + 6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1967	58.9	14.2	1.8	12.6	-	12.6	26.9
1968	52.6	13.8	5.1	17.8	-	10.8	33.6
1969	44.4	14.2	7.4	25.4	-	8.7	41.4
1970	44.7	13.2	11.4	24.5	-	6.2	42.0
1971	38.4	13.6	11.4	31.7	-	4.8	47.9
1972	28.6	12.7	12.9	40.8	1.7	3.3	58.6
1973	23.5	12.3	11.9	47.9	1.9	2.4	64.1
1974	20.1	11.6	8.9	56.3	1.6	1.6	68.4
1975	18.1	11.4	6.6	61.6	1.2	1.2	70.6
1976	15.7	10.1	6.6	64.6	2.0	0.9	74.1
1977	13.8	9.4	7.1	63.3	5.5	1.0	76.9
1978	11.6	7.9	6.6	65.3	7.9	0.7	80.5
1979	9.8	7.8	4.9	68.6	8.3	0.5	82.4
1980	9.5	7.9	4.2	69.8	8.2	0.4	82.6
1981	9.4	7.7	2.8	73.1	6.5	0.4	82.8
1982	8.7	8.4	2.3	74.8	5.5	0.3	82.8
1983	8.7	9.8	2.5	73.5	5.3	0.3	81.5

Note: Debt outstanding and disbursed at the end of the year. Includes public and publicly guaranteed debt. Excludes short-term debt. Numbers may not add because of rounding.

Source: World Bank.

Table 30 Changes in Brazil's Gross Foreign Debt, International Reserves and Net Foreign Debt, 1968-83
(millions of dollars)

Year	Change in Gross Debt <u>a/</u> (1)	Change in Gross Reserves (2)	Change in Net Debt (3)	(2)/(1) (%) (4)	(3)/(1) (%) (5)
1968	499	59	440	11.8	88.2
1969	623	399	224	64.0	36.0
1970	892	531	361	59.5	40.5
1971	1,327	536	791	40.4	59.6
1972	2,899	2,460	439	84.9	15.1
1973	3,051	2,233	818	73.2	26.8
1968-73 <u>b/</u>	9,291	6,218	3,173	66.9	34.2
1974	4,594	-1,147	5,741	-25.0	125.0
1975	4,005	-1,228	5,233	-30.7	130.7
1976	4,814	2,503	2,311	52.0	48.0
1977	6,052	712	5,340	11.8	88.2
1978	11,474	4,639	6,835	40.4	59.6
1974-78 <u>b/</u>	30,939	5,479	25,460	17.7	82.3
1979	6,393	-2,206	8,599	-34.5	134.5
1980	3,944	-2,776	6,720	-70.4	170.4
1981	7,563	594	6,969	7.9	92.1
1982	8,243	-3,513	11,756	-42.6	142.6
1983	11,665	569	11,096	4.9	95.1
1979-83 <u>b/</u>	37,808	-7,332	45,140	-19.4	119.4

a/ Medium and long-term debt outstanding at the end of the year. Includes private nonguaranteed external debt.

b/ Cumulative increase.

Source: Banco Central do Brasil.

Table 31 Growth of Real GDP at Market Prices in Brazil
and in the OECD Area, 1965-83
(percentage changes)

Year	Brazil (1)	Total OECD (2)	(1) - (2) (3)
1965	2.1	5.3	-3.2
1966	5.4	5.3	0.1
1967	4.7	3.8	0.9
1965-67 <u>a/</u>	4.1	4.8	-0.7
1968	11.0	5.4	5.6
1969	10.2	5.1	5.1
1970	8.3	3.1	5.2
1971	12.0	3.6	8.4
1972	11.1	5.4	5.7
1973	13.6	6.1	7.5
1968-73 <u>a/</u>	11.0	4.8	6.2
1974	9.7	0.7	9.0
1975	5.4	-0.3	5.7
1976	9.7	4.8	4.9
1977	5.7	3.8	1.9
1978	5.0	4.0	1.0
1974-78 <u>a/</u>	7.1	2.6	4.5
1979	6.4	3.1	3.3
1980	7.2	1.2	6.0
1981	-1.6	2.0	-3.6
1982	0.9	-0.5	1.4
1983	-3.2 <u>b/</u>	2.4 <u>c/</u>	-5.6
1979-83 <u>a/</u>	1.9	1.6	0.3

a/ Average.

b/ Preliminary.

c/ GNP.

Source: Fundacao Getulio Vargas and Organisation for
Economic Co-operation and Development.

Table 32 Brazilian Foreign trade and Terms of Trade Indices, 1966-83
(1977 = 100)

Year	Exports		Imports				Terms of Trade	
	Unit Value	Volume	Total		Crude Oil		Total	Oil Excluded
			Unit Value	Volume	Unit Value	Volume		
1966	33	44	40	28	15	30	82	67
1967	33	42	41	31	17	28	80	67
1968	32	48	42	38	17	33	76	62
1969	33	55	41	39	16	35	80	65
1970	38	56	42	47	16	42	89	73
1971	36	60	44	58	20	50	82	69
1972	41	76	47	70	22	61	87	72
1973	56	88	59	85	28	85	95	82
1974	71	89	91	115	93	87	78	78
1975	71	98	94	109	94	91	76	76
1976	82	99	96	108	96	101	85	85
1977	100	100	100	100	100	100	100	100
1978	92	113	107	105	101	111	86	84
1979	101	124	128	115	135	124	79	81
1980	107	152	164	115	226	107	65	76
1981	101	183	182	99	270	104	55	71
1982	95	167	176	91	260	98	54	69
1983	89	191	167	76	235	90	53	64

Source: Fundacao Getulio Vargas.

Table 33 Share of Brazilian Exports in World Exports, 1968-83
(percentage)

Year	Brazilian Share of World Exports of Manufactures	Brazilian Share of Total World Exports
1968	0.14	0.87
1969	0.17	0.93
1970	0.22	0.96
1971	0.27	0.91
1972	0.35	1.05
1973	0.42	1.18
1968-73 <u>a/</u>	0.26	0.98
1974	0.49	1.02
1975	0.52	1.08
1976	0.49	1.11
1977	0.59	1.16
1978	0.64	1.06
1974-78 <u>a/</u>	0.55	1.09
1979	0.70	1.00
1980	0.82	1.07
1981	1.09	1.26
1982	0.98	1.18
1983	--	1.32
1979-83 <u>a/</u>	0.90 <u>b/</u>	1.17

a/ Average.

b/ 1979-82.

Source: Banco Central do Brasil, General Agreement on Tariffs and Trade, and the International Monetary Fund.

Table 34 Indices of the Effective Exchange Rate for the Cruzeiro, 1970-83
(1975 = 100)

Year	Index of the Nominal Effective Exchange Rate <u>a/</u>	Index of the Real Effective Exchange Rate <u>b/</u>
1970	48.49	82.02
1971	56.87	85.03
1972	67.88	90.45
1973	75.38	95.89
1974	81.87	98.36
1975	100.00	100.00
1976	123.74	98.54
1977	168.22	103.02
1978	235.85	111.17
1979	364.86	121.22
1980	717.18	132.63
1981	1,119.96	107.94
1982	1,985.89	100.75
1983	6,084.13	130.86

a/ Weights based on the share of seven countries in Brazilian exports and in world exports (U.S. dollar 0,29823; German mark 0,18988; Japanese yen 0,13033; Dutch guilder 0,10648; French franc 0,09784; British pound 0,09148; Italian lira 0,08578).

b/ Nominal effective exchange rates adjusted for wholesale inflation differentials.

Source: Fundacao Getulio Vargas.

Footnote References

- 1/ Ignoring errors and omissions, gold monetization, and valuation changes, the increase in total debt can be decomposed as follows:

$$\Delta GD = CA + L - DI + \Delta R$$

where GD = gross foreign debt; CA = current account deficit; L = net lending to nonresidents (including capital flight); DI = net direct investments; and R = international reserves of the monetary authorities.

- 2/ Roberto S. Ogasavara, "Leasing no Brasil: aspectos do arrendamento mercantil," Revista Brasileira de Economia, vol. 35, no. 3 (July/September 1981), Table 7, p. 307.
- 3/ Albert Fishlow, "Brazilian Development in Long-Term Perspective," American Economic Review, vol. 70, no. 2 (May 1980), pp. 106-107.
- 4/ From 1946 to 1967, real GDP is estimated to have grown by 6.7 percent per year on average. Ralph M. Zerkowski and Maria Alice de Gusmão Veloso, "Seis décadas de economia através to PIB," in Revista Brasileira de Economia, vol. 36, no. 3 (July/September 1972), pp.337-38.
- 5/ Average realized import tariffs declined from 13 percent in 1969 to less than 8 percent by 1974. Pedro S. Malan and Regis Bonelli, "The Brazilian Economy in the Seventies: Old and New Developments," World Development, vol. 5 nos. 1/2 (1977), p. 25.
- 6/ World manufactured exports and total world exports increased at an average rate of 19.9 percent and 19.5 percent per year respectively, from 1968 to 1973. International Monetary Fund, International Financial Statistics, Yearbook - 1982 (Washington, D.C.), p. 69; General Agreement on Tariffs and Trade, International Trade - 1977/78, p. 2.
- 7/ Malan and Bonelli, "The Brazilian Economy in the Seventies," pp. 22, 24-25; Maria Helena T.T. Horta, "Fontes de crescimento das exportações brasileiras na década de 70," Pesquisa e Planejamento Econômico, vol. 13, no. 2, (August 1983), pp. 516-20.
- 8/ Ignoring net lending to nonresidents, gold monetization and valuation adjustments, the change in a country's net foreign debt corresponds to the difference between the deficit on current account (including errors and omissions) and net direct investments:

ND = net foreign debt.

CA = current account deficit (minus net errors and omissions).

DI = net direct investments.

From 1968 to 1973, Brazil's current account deficit (adjusted for errors and omissions) averaged US\$834 million and net direct investment US\$299 million (Table 5). Balance of payments flows suggest, therefore, a US\$3.210 million increase in the net foreign debt from end-1967 to end-1973. The almost exact correspondence between this estimate and the cumulative increase in net medium- and long-term debt registered in Table 1 suggests that Brazilian official statistics were essentially accurate in this period.

- 9/ P. A. Wellons, Borrowing by Developing Countries on the Euro-Currency Market, (Paris: Organisation for Economic Co-operation and Development, Development Centre Studies, 1977), *passim*; Paulo Nogueira Batista Jr., "Participação Brasileira no Mercado Financeiro Internacional: Custo e Perfil da Dívida Externa (1968-1979)," in Paulo Nogueira Batista, Jr., Antonio Carlos B. Lemgruber, Roberto de Rezende Rocha and José Maria Gouvêa Vieira, Ensaio Sobre o Setor Externo da Economia Brasileira, (Rio de Janeiro: 1981), Fundação Getúlio Vargas, Estudos Especiais IBRE - N.º 2, pp. 7-10. Toward the end of this period Brazil even managed to gain access to the relatively more restricted bond market (see Appendix B, Table 29).
- 10/ Banco Central do Brasil, Relatório Anual - 1973, pp. 78 and 79; Sattossi Abe and Carlos Eduardo de Freitas, "Crédito externo - endividamento e desenvolvimento," Conjuntura Econômica, vol. 27, no. 11 (November 1973), pp. 137-39.
- 11/ For a detailed description of the restrictions imposed in 1972-73 see José Eduardo de Carvalho Pereira, Financiamento Externo e Crescimento Econômico no Brasil: 1966/73, IPEA/INPES, Relatório de Pesquisa n.º 27 (Rio de Janeiro, 1974), pp. 29-38.
- 12/ Nogueira Batista, Jr., "Participação Brasileira," pp. 7-8.
- 13/ Ibidem., p. 8.
- 14/ World Bank, World Debt Tables (Washington, D.C., December 1981), p. 127.
- 15/ Carvalho Pereira, Financiamento Externo, pp. 26-37.
- 16/ For an analysis of the relationship between balance of payments and external debt statistics in this period see Paulo Nogueira Batista, Jr., "A dívida externa de curto prazo," Conjuntura Econômica, vol. 35, no. 3 (March 1981), pp. 69-70.
- 17/ Nogueira Batista Jr., "Participação Brasileira," pp. 13-14.
- 18/ Maria Silvia Bastos Marques, "Inflação, Política Econômica, Mecanismos de Realimentação e Choques de Oferta: 1973-83", FGV/IBRE/CEMEI (September 1984, processed pp. 24-27).
- 19/ Banco Central do Brasil, Relatório Anual - 1980, p. 110.

- 20/ For an analysis of the effects of external shocks and policy responses on the balance of payments in Brazil in this period see Bela Balassa, André Barsony, and Anne Richards, The Balance of Payments Effects of External Shocks and of Policy Responses to these Shocks in Non-OPEC Developing Countries, (Paris: Organisation for Economic Co-operation and Development, Development Centre Studies, 1981), pp. 29-51; and Antonio Carlos Lemgruber, Paulo Nogueira Batista, Jr., and Roberto Fendt Jr., Choques Externos e Respostas de Política Econômica no Brasil: O Primeira Choque do Petróleo, Fundação Getúlio Vargas, Estudos Especiais IBRE - No. 3, (Rio de Janeiro: 1981), passim.
- 21/ See, for instance, Mário Henrique Simonsen, A Política Financeira do Atual Governo, Ministério da Fazenda, Gabinete do Ministro (Brasília, August 1977), pp. 16-21.
- 22/ II Plano Nacional de Desenvolvimento (1975-79), passim.
- 23/ Horta, "Fontes de crescimento," pp. 518-20. After increasing almost continuously from 1968 to 1973, Brazil's share of total world exports remained approximately constant in 1974-78. Brazil's share of world exports of manufactures continued to increase significantly, but did so at a much slower pace than in 1968-73 (Appendix B, Table 33).
- 24/ For a description of these measures see Nogueira Batista, Jr., "Participação Brasileira," pp. 16-22. There was no significant attempt to favor inflows of direct investment. Legislation pertaining to foreign investment and profit remittances remained essentially unaltered in this period. As can be seen from Table 8, net inflows in the form of direct investment remained roughly constant in nominal terms during this period. Direct investment as a proportion of net capital inflow fell from 15.9 percent in 1968-73 to 13.1 percent in 1974-78 (Table 8).
- 25/ Marta Castelo Branco, "O Dilema da Política Cambial no Brasil: Origens e Debate no Início dos Anos 80", Dissertação de Mestrado (Departamento de Economia, PUC-RJ, 1981, processed, Table 11, p. 37).
- 26/ Nogueira Batista Jr., "Participação Brasileira," pp. 22-24, 33-34.
- 27/ Spreads paid by Brazilian borrowers for eurocurrency credits rose from less than 1 percent over LIBOR in 1973 to about 2 percent over LIBOR in 1977. Ibid., pp. 8, 25-31.
- 28/ For an overall evaluation of Brazil's response to external shocks in this period see Lemgruber et al, Choques Externos, pp. 11-16.
- 29/ Dércio Garcia Munhoz, "Importações - etapas da política de controle", Conjuntura Econômica, vol. 30, no. 1 (January 1976), pp. 76-80.
- 30/ Lemgruber et al., Choques Externos, pp. 10, 14-15.
- 31/ Banco Central do Brasil, Relatório Anual - 1980, p. 110.

- 32/ In fact, if oil is excluded, Brazil's terms of trade in 1976-78 were 9 percent higher than in 1973.
- 33/ LIBOR rates are averages of prime banks' bid rates for six months at or near end of month. Morgan Guaranty Trust Company of New York, World Financial Markets, various issues. Real rates of interest are calculated by deflating nominal interest rates by the annual change in the United States' GNP implicit price deflator (see tables 14 and 18).
- 34/ Spreads for Brazilian borrowers averaged 1.7 percent over LIBOR in 1978 and 0.9 percent over LIBOR in 1979. Nogueira Batista Jr., "Participação Brasileira," p. 34. Average spreads in syndicated loans arranged for Brazilian borrowers rose to 1.3 percent over LIBOR in 1980 and to 2.1 percent in 1981-82. Moreover, in 1981 and 1982 all major loans obtained by Brazil carried the U.S. prime rate as an optional reference rate, a fact that tends to significantly increase effective spreads. Banco Central do Brasil, Informativo Mensal, January 1981, p. 13; October 1981, p. 9; and June 1982, p. 9. On the effect of the U.S. prime option and of other factors on the effective cost of loans to Brazilian borrowers see Paulo Nogueira Batista, Jr., "O Custo Financeiro Efetivo da Dívida Externa", in Mito e Realidade na Dívida Externa Brasileira, (Rio de Janeiro: Paz e Terra) 1983, pp. 117-24. Between 1974-78 and 1979-82, interest rates charged by the World Bank and by the IDB also increased significantly, from 7.9 percent and 8.1 percent to 10.1 percent and 9 percent, respectively. The US Eximbank's rates rose from 8.3 percent in 1974-78 to 10.2 percent in 1979-82. Banco Central do Brasil, Relatorio Anual, various issues.
- 35/ It should be mentioned, however, that figures reproduced in Table 18 tend to overstate the average cost of the debt in this period, since net interest payments include interest related to short-term debt, whereas the stock of net foreign debt does not include estimates of the short-term debt of Brazilian residents. If the latter are included, the average cost of the debt rises from 9.5 percent in 1978 to 16.8 percent in 1982 in nominal terms and from 2.0 percent to 10.2 percent in real terms (see tables 18 and 23).
- 36/ The average annual increase in the GDP implicit price deflator rose from 40.9 percent in 1974-78 to 86.6 percent in 1979-82. Conjuntura Economica, vol. 38, no. 6 (June 1984), p. 89.
- 37/ From 1921 to 1980, total output is estimated to have registered positive real growth rates in all years except four (1929, 1930, 1931 and 1942). In 1929-31, domestic output declined by an estimated 7.6 percent in real terms. Zerkowski and Gusmão Veloso, "Seis décadas," pp. 337-338.
- 38/ On the evolution of Brazilian economic policy after 1979 see Edmar L. Bacha and Pedro S. Malan, "Brazil's Debt: From the Miracle to the Fund," preliminary draft of paper presented at Conference on "Democratizing Brazil?" Yale University, March 1983, pp. 17-22; Pedro S. Malan and

Regis Bonelli, "Crescimento Econômico, Industrialização e Balanço de Pagamentos: O Brasil dos anos 70 aos Anos 80," INPES/IPEA, Textos para Discussão Interna - No. 60 (November 1983, processed), pp. 20-46; Nogueira Batista, Jr., Mito e Realidade, pp. 49-53, pp. 149-89. Insofar as debt management is concerned, one of the basic flaws of policymaking in this period was the absence of any attempt to diversify away from the U.S. dollar and into weakening currencies that carried lower interest rates throughout this period. See "Currency Diversification for LDC External Debt," in World Financial Markets, (New York: Morgan Guaranty Trust, August 1984), pp. 1-6.

- 39/ See Appendix A.
- 40/ The rapid growth in the nonregistered short-term debt is reflected in the large discrepancy between balance of payments flows and the increase in the registered foreign debt in this period. From 1980 to 1982, the total current account deficit reached US\$38.1 billion, errors and omissions a negative US\$1.1 billion and net direct investments US\$3.7 billion (Table 19). Brazil's net lending to nonresidents amounted to US\$1.5 billion. Banco Central do Brasil, Relatório Anual, various issues. Balance of payments flows therefore suggest an increase of about US\$37 billion in the net foreign debt between end-1979 and end-1982, a figure that exceeds the officially registered increase in net debt by as much US\$11 billion (Table 20). This discrepancy is explained by the estimated increase in the nonregistered short-term debt of Brazilian residents (Table 23), suggesting that the estimates of short-term debt reproduced in that table are reasonably accurate for this period.
- 41/ Banco Central do Brasil, Relatório Anual - 1979, p. 132; Relatório Anual - 1983, p. 83.
- 42/ Banco Central do Brasil. Brazil - Economic Program: Internal and External Adjustment, vol. 4 (August 1984), p. 53.
- 43/ The "net interbank debt" of Brazilian banks abroad is defined as the difference between their credits outstanding to Brazilian residents and their total interbank liabilities. The latter were officially estimated at US\$10 billion in November 1982. Carlos Geraldo Langoni, "The Brazilian Strategy in the Recent Financial Crisis", mimeo., speech given in New York, on December 20, 1982, at a meeting with Brazil's major bank creditors, p. 4.
- 44/ Ruben Almonacid and Maria Cristina R. Pinotti, "A Inflação Internacional Distorce os Dados do Balanço de Pagamentos do Brasil," Conjuntura Econômica, vol. 34, no. 1 (January 1980), pp. 80-84.
- 45/ In fact, net imports of goods and nonfactor services in current prices declined from 2.8 percent of GDP in 1974-78 to 1.3 percent GDP in 1979-82, whereas net factor payments rose from 1.5 percent to 3.7 percent of GDP on the average in the same period. Conjuntura Econômica, vol. 38, no. 6 (June 1984), pp. 89 and 93.

- 46/ From 1978 to 1982, the ratio of GNP to GDP at current market prices fell from 97.8 percent to 94.9 percent, and the ratio of gross domestic income to GDP in constant 1970 prices declined from 99.8 percent to 96.5 percent. Ibid., pp. 89, 94, 99.
- 47/ The decline in the ratio of fixed capital formation to GDP seems to have been associated not only with the sharp reduction in the net absorption of resources from abroad, but also with an increase in the ratio of consumption to GDP, from 72.8 percent in 1974-78 to 73.4 percent in 1979-80 (Table 24).
- 48/ The average rate of growth of export volume rose from 5.1 percent per year in 1974-78 to 11.1 percent in 1979-83 (Appendix B, Table 32).
- 49/ It should be noted, however, that because of an unrealistic prefixation of the exchange rate in 1980 and of the strong appreciation of the U.S. dollar against other major currencies in 1981-82, the cruzeiro suffered a substantial real appreciation during 1980-82, a fact that is clearly reflected in the disappointing performance of Brazilian exports in 1982. Paulo Nogueira Batista, Jr., "Política Cambial Brasileira: A Variação Efetiva de Taxa de Câmbio do Cruzeiro, 1979-1982" in Mito e Realidade, pp. 156-172. The substantial reduction in the ratio of imports to GDP seems to have resulted not only from the significant effective devaluation of the cruzeiro, but also from the lagged effects of the large import substitution projects initiated in the 1970s and from a substantial reduction in the share of imports in the apparent consumption of oil. The latter fell from 85 percent in 1978 to 68 percent in 1983. Banco Central do Brasil, Relatório Anual - 1983, p. 81.
- 50/ By the end of the year, gross reserves had fallen to US\$4 billion (Table 21). But it must be mentioned that official data on gross reserves did not provide an adequate indication of the effective amount of international liquidity of the Brazilian monetary authorities. A sizeable share of gross reserves seems to have been composed of illiquid assets. Moreover, as a consequence of the large increase in the short-term liabilities of the monetary authorities, by December 1982 net reserves had already fallen to a negative level of US\$2.3 billion (Table 21). For a discussion of the inadequacy of official reserve statistics in this period see Nogueira Batista, Jr., Mito e Realidade, pp. 20-23, 70-73, 202-4.
- 51/ Banco Central do Brasil, Informativo Mensal, January 1983, pp. 8 and 9. Spreads charged in projects I and II were extremely high - 2 1/8 percent over LIBOR or 1 7/8 percent over the U.S. prime rate - grace and final amortization periods were established at 2 1/2 and 8 years respectively. Affonso Celso Pastore, "Depoimento perante a Comissão Parlamentar de Inquérito da Dívida Externa Brasileira e do Acordo, FMI/Brasil em 02/05/84" (processed), p. 36.
- 52/ Banco Central do Brasil, Relatório Anual - 1983, p. 74.

- 53/ Paulo Nogueira Batista Jr., "Países Devedores e Bancos Comerciais em Face da Crise Financeira Internacional", Fundação Getúlio Vargas, IBRE/CEMEI, (September 1984, processed, pp. 48-52).
- 54/ Conjuntura Econômica, vol. 38, no. 6 (June 1984), p. 89. The annual increase in the GDP implicit price deflator rose from an average of 96.3 percent in 1980-82 to 146 percent in 1983. Ibid.
- 55/ Pastore, "Depoimento perante," pp. 35-41. However, spreads were reduced only slightly from 2 1/8 percent to 2 percent over LIBOR and from 1 7/8 percent to 1 3/4 percent over the U.S. prime rate. Ibid., p. 36.
- 56/ Banco Central do Brasil, Brazil - Economic Program: Internal and External Adjustment, vol. 2, (March 1984), pp. 71-73.
- 57/ Banco Central do Brasil, Relatório Anual - 1984, pp. 76, 84. In the absence of sufficiently detailed information, it is assumed that the deficit on account of nonfactor services is equal to the difference between the total deficit in services and net payments in the form of interest, profits and dividends.
- 58/ Paulo Nogueira Batista, Jr., "International Debt Rescheduling Since mid-1982: Rescue Operations and Their Implications for Commercial Banks and Debtor Countries", paper prepared for the Intergovernmental Group of Twenty-Four on International Monetary Affairs, September 1984 (processed), pp. 2-12, pp. 34-51.
- 59/ "Relative exposure" is defined as the ratio of outstanding credits to banks' capital and reserves. In June 1982, claims held by the nine largest U.S. banks on thirteen developing and Eastern European countries experiencing debt-servicing disruption in 1982-83 made up the equivalent of as much as 193 percent of their total capital. Ibid., pp. 18, 21.
- 60/ A. W. Clausen, "Priority Issues for 1984", remarks before the Davos Symposium, Davos, Switzerland, 26 January 1984, p.7
- 61/ Bank for International Settlements, "The maturity distribution of international bank lending", Monetary and Economic Department, Basle, processed, various numbers. The BIS provides figures on the aggregated external positions of banks located in Group of Ten countries, Switzerland, Austria, Denmark and Ireland, and of a number of their affiliates domiciled in other countries, vis à vis countries outside the reporting area.
- 62/ Banco Central do Brasil, Boletim, various numbers.
- 63/ The figures for assets of banks with head offices in the United States are consolidated to include the positions of all their foreign affiliates. For banks with head offices in the other reporting countries the figures include, with some exceptions, the positions of affiliates located in offshore banking centers outside the reporting area, where these exist (the Bahamas, Barbados, Bahrain, Bermuda, Cayman Islands, Hong Kong, Lebanon, Liberia, Netherlands Overseas Territories, Panama, Singapore, Vanuatu, other British West Indies). Moreover, not

all banks that engage in international lending from the reporting countries are included. Bank for International Settlements, "The maturity distribution of international bank lending - second half 1983 developments" (Basle: Monetary and Economic Department, July 1984, processed), annex: Technical note on the coverage of the data, pp. 1-2.

64/ On the other hand, in the case of Italian banks no maturity distribution of external assets is available. Since Italian banks are in general not permitted to lend for long-term periods, the BIS includes all their external assets under the item "up to and including one year." For banks in France the only breakdown available is for initial maturities up to one year and over one year. The BIS includes positions over one year in the unallocated item.

65/ In 1981-83, commercial banks held on average 96.1 percent of Brazilian debt in the form of currency loans and 63.9 percent of debt in the form of import financing from private sources. Banco Central do Brasil, Brazil - Economic Program: Internal and External Adjustment, vol. 4 (August 1984), p. 54.



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