BRAZILIAN FOREIGN EXCHANGE CONTROLS PERTAINING TO INTERNATIONAL TRADE

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1. INTRODUCTION

> *"(...) we have considered a more general solution, the purpose of which would be to secure a general equilibrium in the Brazilian balance of payments which would permit a lifting of the exchange control. Such a solution would require:*
>
> *(1) Favorable external conditions for Brazilian exports (...).*
> *(2) A rate of exchange which would stimulate exports and discourage imports.*
> *(3) The pursuit by Brazil of an appropriate financial and economic policy designed to limit expenditures, especially foreign, and to avoid domestic inflation."*

The quoted words above might seem quite adequate to address the current economic conditions in Brazil. They relate to issues that are extremely relevant in the contemporary scenario: trade balance surpluses, fiscal responsibility, equilibrium in the balance of payments, and monetary stability.

These words, however, were written seventy years ago by Mr. John H. Williams, Special Representative of the U.S. Department of State, in his report entitled “American Foreign Exchange Problems in Brazil, Argentina, Chile and Uruguay,” dated September 4th, 1934. Since then the Brazilian economy has experienced peaks and droughts, the country has been ruled by different governments which span a wide political spectrum, and the economic agents have always had to deal with a particular matter prescribed by the Brazilian legislation: foreign exchange controls.

With different dosages over time, this was (and still is) the remedy for a chronic shortage (or fear of shortage) of foreign exchange reserves.

This paper focuses on Brazilian foreign exchange controls pertaining to import and export operations. Following this introduction, Section 2 will describe the evolution of the corresponding regulations, beginning in the early 1930s. Next, Section 3 will present the current framework of the related rules and control mechanisms. Section 4 will provide a short survey of different arrangements adopted by other developing countries. Then Section 5 will discuss some relevant aspects of exchange controls, leading to the final remarks in Section 6.

2. THE EVOLUTION OF REGULATIONS

2.1. After the Crash (1930-1945)

The late 1920s and early 1930s brought definite transformations in the world and in Brazil. Domestically, the Revolution of 1930 led Getulio Vargas to power. Internationally, the 1929 crash of the New York Stock Exchange caused coffee prices to plummet. The consequences for the Brazilian economy were drastic, since coffee was by large the country's main export. As a response to the increasing pressure on the balance of payments and to the international instability, a series of decrees imposed several restrictions on the Brazilian foreign exchange regime, based on: (i) centralization of foreign exchange operations in the Bank of Brazil; (ii) restrictions on foreign currency accounts; (iii) export proceeds surrender requirements; (iv) mandatory use of national currency as legal tender for payments.

Exactly one week after the sterling devaluation of 1931, the Brazilian government issued the Decree 20541, of September 28, which, after explicitly recognizing the "abnormality of the

situation" and the "need to centralize the foreign exchange operations in order to avoid speculations harmful to the country's interests," established the **monopoly of the Bank of Brazil** to purchase export letters of exchange and foreign exchange values. It also set the priorities in the distribution of the foreign exchange: first, the needs of the public sector; second, the payment of imports; and third, other necessities. In 28 Oct 1931, Decree 20572 allowed the Bank of Brazil, if considered convenient and under approval of the Minister of Finance, to renounce its monopoly.

Reinforcing the control, Decree 21316, of 25 April 1932, prohibited the opening of foreign currency accounts in national banks. The existing ones were converted to the national currency (*mil-reis*) at the rate of the date of the Decree's publication.

The exchange controls were further extended by means of Decree 23258, of 19 Oct 1933, which is still in force and requires the **surrender of export proceeds.** Its preamble refers to Decree 20541 and to the government decision to centralize the foreign exchange operations in the Bank of Brazil aiming at distributing the available resources equitably. But it symptomatically also recognizes that the legal prescriptions "have been being infringed with the practice of operations harmful to the national interests by entities domiciled in the country."

Article 3 establishes that the lack of "coverage of export exchange values" is liable to penalty, as well as the overinvoicing of imports. It means that Brazilian exporters were henceforth obliged to surrender the proceeds originating from export operations to a Brazilian bank. The penalty for infringing these rules is a fine that can reach twofold the amount of the irregular operation (Article 6). It also qualifies as illegitimate any operation between entities established in Brazil and entities established abroad, when such operation is not performed through an authorized

bank (Article 1), as well as payments in national currency made in Brazil by Brazilian entities on behalf of non-resident entities (Article 2).

Another important piece of legislation was Decree 23501, of 27 Nov 1933, which declared null any contractual clause that stipulated payments in gold or foreign currencies, and established the mandatory use of the national currency as legal tender for payments. Although the text was peremptory and made no exceptions, it was clear that international trade operations and foreign loans could not be embraced by the Decree, as it was later recognized by Law 35, of 15 Feb 1935, and by Decree-Law 6650, of 29 June 1944. The provisions of Decree 23501 ended up as a definite rule under later legislations, the most important of which are Decree-Law 857, of 11 Sep 1969, and article 318 of the current Civil Code (Law 10406 of 2002).

As Brazil's balance of payment position improved, in 19 May 1934 Decree 24268 eased the exchange controls. Although maintaining the monopoly of the Bank of Brazil over the purchase of export exchange values, it stated the "necessity and convenience" of allowing other foreign exchange operations, not related to exports, to be performed by rates established by "supply and demand." In practice it created two exchange markets. In the "official market," the export exchange values purchased by the Bank of Brazil would be used for international trade and government payments; the remittance of profits, interests and dividends depended upon a previous approval of the banking authorities. Other operations not related to exports could be performed freely by authorized "banks, companies, societies, individual or corporate firms," in the "free market."

In September 1934, further liberalization occurred: the official market would now be fed by coffee export proceeds up to the limit of 155 French francs per bag; the exceeding proceeds as

well as those resulting from other merchandise exports could be negotiated in the free market. The Bank of Brazil would sell, at the official rate, 60% of the exchange required by approved imports, and the balance would be supplied by the free market[1].

This arrangement was in effect until after the Second World War with adjustments being made according to the situation of the balance of payments. When it was necessary to intensify the controls, the percentage of export proceeds that should be sold to the Bank of Brazil in the "official market" was increased to guarantee the payment of priority obligations, and less exchange would be available in the free market. The years of tight control went from late 1937 to 1939, under Decree-Law 97, of 23 Dec 1937, that returned to the Bank of Brazil the monopoly of purchasing foreign exchange. An agreement with United States, largely motivated by geopolitical reasons, resulted in a loan extended by Eximbank to solve commercial and financial arrears owned by Americans, and Brazil committed itself to the liberalization of exchange controls and to the resumption of foreign debt payments.

This explains Decree-Law 1201, of 8 April 1939, which in its first article reestablishes "the freedom for foreign exchange operations." The freedom was relative though. According to the new rules, export proceeds could be sold to any bank, but 30% of the exchange values should be delivered to the Bank of Brazil at the official rate. All imports were to be paid at the free market rate, but payments not related to imports could only be conducted through the Bank of Brazil.

[1] Coffee represented the largest amount of Brazilian exports, and the foreign exchange regime considered that non-traditional exports should not be penalized by the overvalued exchange, since, except for coffee, Brazil was a small supplier and thus a price taker in world markets. In 1935 non-traditional exporters could sell 100% of their proceeds at the free-market, while coffee exporters should sell 35% to the Bank of Brazil at the official rate.

In 02 Feb 1945, Decree-Law 7923 created the Superintendence of Currency and Credit (SUMOC), the embryo of the future Central Bank. Among its attributions, the new Superintendence became responsible for the foreign exchange regulations.

2.2. After World War II (1946-1955)

After WWII the new government of Eurico Gaspar Dutra issued Decree-Law 9025, of 27 Feb 1946, establishing additional regulations over foreign exchange operations. SUMOC was given power to reduce or suppress the percentage of exchange values that banks were obligated to sell to the Bank of Brazil according to Decree-Law 1201 of 1939[2]. Article 10 of the Decree prohibited the private compensation of credits, and this particular provision is in effect still today, as another important pillar of the foreign exchange controls. It means that if a Brazilian entity has receivables and liabilities with foreign entities, they cannot be settled by the net balance. Instead, there must be full remittances from and to abroad. The rationale behind the rule is that, should there be a scarcity of exchange and should some priority scale be set for allowing remittances, it would be contradictory to permit foreign exchange proceeds belonging to a Brazilian entity to be used for the payment of a non-priority obligation.

In 20 July 1946, Instruction 17 of SUMOC extinguished the official market and transferred all exchange operations to the free market. In mid-1947, after a brief period in which a more liberal approach prevailed, controls were tightened as a result of the deterioration on the balance of payments[3]. Once again, banks were obliged to sell to the Bank of Brazil, at the official rate, a

[2] The percentage was indeed reduced to 20% by Instruction 13 of SUMOC in 28.02.1946.

[3] Most of the international reserves that Brazil had accumulated during the war were expressed in European inconvertible currencies and gold. By the end of 1946, the reserves added up to US$ 730 million, but only US$ 92 million were available in convertible currencies. As a matter of fact, Brazil had a deficit in its commerce balance with the countries of convertible currencies (especially the United States), and a surplus with the inconvertible

percentage of the exchange values they purchased (30% according to Instruction 25 and 75% according to Instruction 26 of SUMOC).

In the first quarter of 1948, a new policy of import constriction was introduced by Law 262, of 23 Feb 1948, regulated by Decree 24697-A, of 23 March 1948, which created a system of **import licenses** according to priorities established by the government. The law itself set its final term at 30 June 1949, but was successively prorogated until 1953. In March 1949, Instruction 28 of SUMOC introduced the foreign exchange budget.

The overvaluation of the national currency made Brazilian exports less competitive. That was not really a problem for coffee exports, since the product proved to be inelastic with regard to prices (at least in the short run). However, some other products had no chance of being commercialized in the international market, since their international price was lower than the production costs at the official exchange rate. In order to overcome the problem, the government allowed the exporters of these so-called "burdensome products" (*produtos gravosos*) to sell their proceeds to importers at a higher exchange rate, regardless of the concession of import licenses. The Bank of Brazil acted like a broker in these so-called "tied operations" (*operações vinculadas*), that at some point comprised 25% of the amount of letters of exchange negotiated.

As time went by, the import licensing system, initially motivated by a shortage of convertible currencies, became an instrument of development policy based on import substitution. This assertive finds support, for instance, in the language used in Law 842, of 4 Oct 1949 (one of the laws that prorogated Law 262 of 1948), which mentions in its Article 2, as a limitation for the

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currency area. Besides, many of the products that had been exported by Brazil during the war were facing the competition of the former international suppliers.

concession of import licenses, “the possibility of [the goods] being produced in the country, with equal technologic characteristics and satisfactory price conditions.”

With Getulio Vargas back in power since 1950, Law 1807, of 7 Jan 1953, introduced new rules for the exchange market. According to the Law and to Decree 32285, of 19 Feb 1953, which regulated it, two foreign exchange markets were established, the official and the free market. As a general rule, the official market included exports, imports and related operations (insurance, freight, bank fees); government payments, including those from government-owned companies; registered loans, financing and foreign capital revenues related to sectors of “indubitable interest for the national economy” (energy, communications and transportation). The other exchange operations could be performed in the free market.

The licensing system for imports was maintained and SUMOC was given power to list products that should be imported at the free rate, which was supposed to diminish the demand for imports of non-essential products. For some products, the corresponding export proceeds could be sold totally or partially in the free market. It solved the problem of the “burdensome products,” whose costs structure made them unfeasible to be exported at the official exchange rate. As a result, different effective exchange rates applied, according to the percentage of proceeds that could be sold in the free market (15, 30 or 50%). The law abolished the system of “tied operations” that was in effect since 1948, about which many rumors of corruption arose against Bank of Brazil's officials.

Despite the new regulations and the reduction in imports, the situation of the external accounts continued to deteriorate. Exports did not react, and commercial arrears increased. To face the situation, two measures were adopted in June 1953. First, modifications in the former rules

allowed the sale of 50% of the proceeds of all exports, except coffee, in the free exchange market. Second, for some products (coffee, cocoa and cotton among them) exporters were allowed to sell, in the free market, the proceeds that exceeded a minimum price.

The use of multiple exchange rates to discriminate foreign transactions in general, and in particular imports and exports based on the product being traded, was explicitly in effect under different forms until 1966, and implicitly even further, if the use of "contribution quotas," taxes and benefits is considered.

A major modification in the foreign exchange rules took place with Instruction SUMOC 70, issued at October 1953. Once again, export proceeds should be directly sold or transferred to the Bank of Brazil by the other banks. With regard to exports, instead of the mixed rates of the previous system, the new Instruction established a bonus over the official rate: Cr$ 5.00 per U.S. dollar for coffee exports, and Cr$ 10.00 per U.S. dollar for the other products. In practice, it was equivalent to an increase in the rate for coffee exports, while maintaining the rate already in use for the other products with the previous half-to-half mixing of official and free rates.

Relating to imports, a system of **exchange auctions** was introduced. It consisted in the auction sale of a paper called "promise to sell foreign exchange" that gave importers the right to buy a certain amount of foreign exchange in a certain currency. For the auctions, the imports were classified in five categories according to the essentiality of the goods. Authorities allocated the supply of exchange for each category. About 80% of total allocated exchange was reserved to categories I to III and only 3% to category V of luxury goods. The official rate applied to certain goods such as newsprint and wheat, while oil imports and goods imported directly by the government and its companies should be paid with a surtax on the official rate.

The consequence of the auction system was not only a regime of multiple rates that in practice was equivalent to an exchange devaluation, but the premiums paid by the importers became a significant source of income for the government.

In 29 Dec 1953, Law 2145 extinguished the Desk of Export and Import (CEXIM) of the Bank of Brazil and created the Desk of International Trade (CACEX - *Carteira de Comércio Exterior*).

2.3. From 1956 to 1964

In 14 Aug 1957, Law 3244 introduced an *ad-valorem* tariff system, under Juscelino Kubitscheck government. In order to regulate the foreign exchange provisions, Decree 42820 was issued in 16 Dec 1957, maintaining the basic structure of the system with two exchange markets and exchange auctions. However, the five categories of imported goods introduced by Instruction SUMOC 70 were reduced to two, called general and special categories (the latter for goods considered less essential), plus a preferential category - including newsprint, oil, wheat, fertilizers and priority investment equipment - that was not subject to the auctions.

The tariffs and the classification of goods were used as an instrument for the import substitution of capital goods, going beyond the first stages of substitution of consumption goods and reflecting the higher level of industrialization that the country had achieved.

Regarding exports, the bonus system was also maintained, but from 1957 to 1961 several Instructions issued by SUMOC gradually transferred the surrender of export proceeds from the official to the free market. Therefore, by December of 1960 only the proceeds from coffee, cocoa, crude mineral oil and castor beans exports remained in the official market.

As of 17 March 1958, mining companies were permitted to retain abroad a percentage of their export proceeds to service registered loans and for payments of goods and services to develop their industry (IMF, 1959).

The development policy put into effect in Kubitscheck government achieved an average GDP growth of 8.1% per year from 1956 to 1960, but the macroeconomic scenario inherited by his successor was characterized by high inflation, fiscal imbalance and deficit in the balance of payments.

Janio Quadros began his term of office with an orthodox economic policy. Instruction SUMOC 204, of 14 March 1961, modified the exchange regulations with the purpose of unifying the multiple existing exchange rates. The exchange rate applied to preferential imports was devalued by 100%. The general category of imports was transferred to the free rate market and still required a certificate of exchange cover (which implied a **prior foreign exchange contract**). The Instruction also forced importers, in addition to paying for the exchange, to **buy 150-day bills issued by the Bank of Brazil** in local currency, bearing interests at 6% per year, in the value equivalent to the import on a f.o.b. basis. **Import license auctions** on the basis of global quotas were established for the special category. Furthermore, importers could not acquire more than US$ 20,000.00 weekly (this limit did not apply to imports in the special category and was changed several times until the restriction was abolished in 1966).

In 7 April 1961, banks were instructed to require advance deposits from importers in the same value of the transaction involved and to forward these deposits to the Bank of Brazil. These **guarantee deposits** were returnable upon maturity of the contract and could be used to pay for

the foreign exchange. In May 23 the percentage was reduced to 10% and sales on terms not exceeding 30 days became exempt.

Instruction SUMOC 205, of 12 May 1961, allowed coffee export proceeds to be sold in the free market and created a "contribution quota" that should be surrendered to SUMOC without compensation. In July 1st, Instruction SUMOC 208 transferred the preferential category of imports to the free rate market.

The policy adopted by the government tried to eliminate the distortions caused by the multiple exchange rate system and by the overvaluation of the national currency. As a consequence, however, the prices of imported products rose and the government lost the revenues from the auctions system. Nonetheless, the measures seem to have pleased international creditors, and the government was able to obtain new loans and renegotiate the payments of the external debt.

After the resignation of Janio Quadros in August 1961, some temporary constrictions were imposed to imports in October through the increase to 150% in the percentage of compulsory purchase of Import Bills. The same rule was applied to financial remittances, with a percentage of 50%. This advance deposit requirement remained in effect under different formats and different percentages until 1965[4].

The next significant legislative modification pertaining to foreign exchange was Law 4131, of 3 Sep 1962, which still regulates foreign capital in Brazil. According to the Law, the registration of foreign investments and loans in the Central Bank (previously in the SUMOC) is a condition for the remittance of interests, royalties, technical assistance, profits and dividends. In its original

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[4] By December 1962, for instance, importers should make a deposit of 80% of the transaction value for 150 days, bearing no interest, or could alternatively purchase 1-year Treasury Bills at an interest rate of 8% per year.

version, the Law imposed limits on the remittances of profits and repatriation of capital, including the prohibition of the remittance of profits resulting from reinvestments (articles 31, 32 and 33), which caused some friction in the relationship with the United States.

Article 23 of Law 4131/1962, still in effect, is of utmost importance for the enforcement of the exchange controls. Its *caput* states that foreign exchange operations must be performed solely in authorized dealers; then its paragraphs establish pecuniary penalties for several illicit acts related to foreign exchange contracts, nominally false identification, false declarations, and misclassification of the contracts.

Some other articles deserve to be mentioned. Article 27 allows the authorities to segregate the payments of capital from those related to international trade (exports and imports) in distinct foreign exchange markets. Article 28, by its turn, states that in cases of serious disequilibria in the balance of payments (actual or forecasted), the authorities may impose temporary restrictions to imports and remittances of revenues of foreign capital. For this purpose they may centralize partially or totally the foreign exchange operations in the Bank of Brazil. The restrictions can be extended to payments of royalties, technical, administrative assistance and alike, as well as to expenses for international travels, but cannot reach the payment of interest and principal of registered loans. The concerns of the government about the impact of the Law on the flow of foreign capital are reflected by the fact that only in 20 Jan 1964 it was regulated (Decree 53451).

The deterioration of the balance of payments led the government to constrain imports even more by means of measures like financing requirements for capital goods (28 June 1963) and 200% advance deposit requirements (20 Oct 1963), with some exemptions for exporters of manufactured goods.

2.4. The first military governments and the "economic miracle" (1964-1973)

The first years of the military government inaugurated by the *coup d'etat* of March 1964 were dedicated, with respect to economic policy, to stabilization. In order to attract foreign capital, Law 4390, of 29 Aug 1964, introduced major modifications to Law 4131/1962, and the limits imposed to returns of capital and remittances of profits (including the prohibition of remittance of profits resulting from reinvestments) were revoked (arts. 31, 32 and 33).

In 31 Dec 1964, Law 4595 radically changed the financial system organization by extinguishing SUMOC and creating the National Monetary Council and the Central Bank of Brazil. The latter began operation in April 1st, 1965.

As part of the government industrial policy, firms exporting designated manufactured products were given the right to use up to 50% of the foreign exchange proceeds to cover their own imports or financial foreign obligations, without making advance deposits or paying the financial charge (Instruction SUMOC 279, of 10 Sep 1964). Industrial firms which committed themselves with maintaining stable prices (Interministerial Provision GB-71, of 23 Mar 1965) could use up to 100% of their exchange proceeds for the same purposes, with the same benefits (Instruction SUMOC 293, of 29 Mar 1965).

During 1965 and 1966 import restrictions in the form of quantitative limits for purchase of foreign exchange, advance deposits, guarantee deposits for forward import foreign exchange contracts and financial charges, were gradually lifted, and the system of multiple foreign exchange rates for industrial goods was slowly replaced by a system nominally based on a single rate.

Resolution 35, of 17 Sep 1966, abolished the requirement of prior foreign exchange contracts for the issuance of import licenses, although the goods could only be cleared by customs after the corresponding foreign exchange contract had been arranged. In 22 Nov 1966, Resolution 41 completed the unification of import categories, by determining that imports of goods classified in the special category would follow the same rules of the general category.

Indirect taxes on exports were eliminated and other incentives were introduced, like the drawback regime that, roughly speaking, allows the import of goods without duties as long as they are used in the production of other goods to be exported (Decree-Law 37/1966). Coffee exports still paid a contribution quota of 53-57% in 1964-1967.

After 1967, the focus of the economic policy shifted from stabilization to growth. It was the beginning of the "Brazilian economic miracle." Regarding the external sector, several incentives were given to exporters: tax exemptions and rebates; credit expansion; a more flexible crawling peg exchange rate regime that lasted from August 1968 until 1979; and other indirect measures, such as improvements in red-tape bureaucracy, promotion of export products abroad, better transport and commercialization infrastructure.

During 1968 a series of Resolutions established general rules for import payments. Resolution 82, of 03 Jan 1968, revoked the requirement of prior foreign exchange contracts for the customs clearance, but stipulated that the contract was conditional upon the presentation of the import certificate, license or declaration, according to the case. Communication GECAM 42 of the same date established that import forward exchange contracts for up to 180 days could henceforth be closed only when a letter of credit was being opened, or to pay for goods already shipped. Previously it was possible to enter into forward contracts without proving that a genuine

import transaction was involved. This measure together with Resolutions 82 and 83 (the latter prohibiting forward exchange contracts related with loans under Instruction SUMOC 289/1965) aimed at preventing purely speculative exchange operations. Letters of credit should be opened within five working days of the date of the foreign exchange contract. Commercial banks ordinarily required a guarantee deposit for their own protection for forward exchange contracts. The amount of the deposit depended on the credit attributed to the client, and could be used for payment of the contract when it was settled, interests being charged on the position of the forward contract not covered by the deposit.

As per Resolution 91, of 21 May 1968, imports should be paid in no longer than 180 days after shipment, but this period could be extended to 360 days in exceptional circumstances at the discretion of the Central Bank (later this attribution was passed to CACEX); imports with external financing with terms in excess of 360 days should be registered with the Central Bank.

Different conditions were valid for some products. Resolution 121, of 18 Aug 1968, required prior foreign exchange contracts for the import of products listed in Decree-Law 398/1968 and of automobiles, light utility trucks and station wagons. This provision was intended to discourage the use of foreign commercial credits for the financing of imports that were considered less essential, and was in effect until 18 Aug 1970, when Resolution 151 revoked it. Restrictions on imports were put into effect by means of surcharges on tariffs as well.

With regard to exports, Circular 111, of 3 Jan 1968, regulated the extension of advances on export foreign exchange contracts, limiting its value to 80% of the amount of the contract and its term to 90 days. Later, in 30 April 1971, Circular Letter GECAM 111 permitted that the full

amount of the contract was advanced, and the term was extended to 180 days. These operations were exempted from the financial tax by Resolution 253/1973.

In 4 Feb 1970, Decree 66175 abolished the requirement of consular visas on import invoices, which had been in effect under different shapes since at least the 19th century.

In 1972 the government introduced new incentives aimed at attracting investments for the increase of capacity of production geared toward exports and for the creation of trading companies. The new set of incentives was managed by the Commission for the Concession of Fiscal Benefits and Special Export Programs, that came to be known as BEFIEX (Decree-Law 1219 of 15 May 1972).

From 1968 to 1973, real GDP grew at an average rate of 11.2% per year. Exports increased from US$ 1,741 million in 1966 to US$ 6,199 million in 1973, with more diversified products and destinations. In the same period imports increased from US$ 1,441 million to US$ 6,192 million. Inflow of foreign direct investment recovered and its stock increased from US$ 1.6 billion in 1967 to US$ 4.6 billion in 1973, according to Central Bank data. The Brazilian market had become quite attractive as a consequence of export and selected import subsidies, together with high levels of protection against imports of goods produced domestically. Inflation, however, was a non-solved problem, and the external debt would become a constraint in the years ahead.

2.5. From the oil-shocks to the end of the military regime (1974-1984)

At the end of 1973 oil prices increased four-fold, which took the world economy into recession. The accelerated growth of the Brazilian economy in the previous years carried inflationary pressures and the loss of control of monetary policy into the new government headed by General

Ernesto Geisel. However, there was no consensus inside the government with respect to a stabilization program. Despite trying some short-term measures to contain inflation, the prevalent decision was to keep the development policy. Authorities propagated the idea that Brazil could be “an island of prosperity” amidst world economic turmoil. Increasing external debt financed balance of payments deficits, as the government believed that dollar real interest rates would remain negative or low, which proved to be a wrong assumption.

The international trade policy basically aimed at curtailing imports, moving on with the import substitution program, while keeping the incentives for exports. To accomplish these goals, the government started to use an arsenal of measures, beginning with duty increases for a wide range of goods.

Stringent exchange controls were put into effect. Resolution 289, of 24 June 1974, required **at-sight payment** for imports of products with tariffs equal to or greater than 55% (i.e., the import foreign exchange contract should be settled before the customs clearance). In 28 Feb 1975, Resolution 319 extended this requirement to products with tariffs equal to or greater than 37% and to other specified products regardless of the tariff, with some exceptions such as industrial and farming machines and equipment, goods related to drawback operations or with medium and long-term external financing.

In 16 July 1975, Resolution 331 revoked the at-sight payment requirement and in its place introduced a 100% **advance deposit requirement** affecting approximately 20% of total 1974 imports, meaning that the issuance of the import certificate was conditional upon the prior deposit of the total value in national currency for 180 days bearing no interest.

In 9 Oct 1975, measures to restore economic stability and improve the balance of payments were announced: 15% reduction in public sector imports in 1976, preference to domestic products in government procurement, increase in import duties for a wide range of products, and expansion of export financing mechanisms at low interest rates. Some of these announcements were implemented in 2 Dec 1975 by means of four Resolutions. Resolutions 352 and 353 dealt with export financing. Resolution 354 extended even more the advance deposit requirement for imports by eliminating the reference to the 37%-tariff limit, and increased the deposit term to 360 days, which implied a financial cost of about 40% for importers. Resolution 355 made the approval of external financing for imports in excess of one year conditional upon a declaration of CACEX with respect to the nonexistence of domestic similar goods or insufficiency of national production. Furthermore, in 6 Feb 1976, CACEX suspended the issuance of import licenses for a large number of "superfluous" imports. This list would be altered many times but the ban on many imports would last until the early 1990s.

Still dealing with advance deposits requirements, Communication GECAM 312, of 4 July 1976, prescribed a deposit equivalent to 100% of the value of the exchange transaction in the case of forward foreign exchange transactions for the opening of import letters of credit, with some exceptions. The deposit would be released on the date of settlement or cancellation of the contract.

In 1st Nov 1976, Resolution 391 stated that export foreign exchange contracts could be settled only after the receipt of foreign exchange through an account maintained abroad by an authorized bank. Contracts could be settled also by delivery of export documents assuring to the bank the right of receiving the proceeds, and in special cases by the receipt of foreign banknotes or traveler's checks. For goods subject to a contribution quota, the bank was responsible for the

collection of the corresponding amount. Communication GECAM 331 of the same date detailed the administrative procedures to be followed regarding export foreign exchange contracts. Both Resolution and Communication stayed in effect until 1992, incorporating successive modifications in between.

The second oil-shock came in the end of 1978, when the oil price went from US$ 12.00 to US$ 23.00 a barrel, and was soon accompanied by the increase of international interest rates. In March 1979, General Figueiredo government began. Despite the worsening in the international scenario, in a few months the prevalent view inside the government was, once again, in favor of economic growth in detriment of fiscal equilibrium and stabilization.

In 21 June 1979 Resolution 552 complemented the rules related to export proceeds: (i) foreign exchange contracts should be closed prior to the shipment or, for traditional exporters, within 10 days after that date; (ii) the proceeds should be received through an account of an authorized bank abroad, and the direct receipt by exporters was prohibited; (iii) the issue of the export certificate could be made conditional on the existence of a previously arranged foreign exchange contract; (iv) the 10-day limit could be waived by the Central Bank in the case of deferred payments. Later regulations set similar provisions[5].

In 7 Dec 1979 a 30% maxi-devaluation of the national currency was announced, together with a series of measures. Amid them, Resolution 584 lifted the advance deposit requirements for

[5] Resolution 667, of 17 Dec 1980, was explicit in saying that the requirement of prior foreign exchange contracts should apply to exporters involved in irregular foreign trade operations or which had failed to comply with the 10-day term. Resolution 1549, of 22 Dec 1988, included the existence of export certificates and exchange contracts not properly linked to each other as one of the situations that could motivate such requirement. Resolution 1964, of 28 Sep 1992, essentially maintained the same rules and is still in effect. The 10-day term was changed in several occasions until being set at 180 days limited to 20 days after the receipt of the proceeds (Circular 2486, of 30 Sep 1994).

imports, and other Resolutions did the same with respect to other compulsory and voluntary deposits on external loans and even on the issuance of passports.

In 18 April 1980, the financial tax (IOF) was extended to purchases of foreign exchange for imports of goods and services, with the exception of those related to the Itaipu project (Resolution 610). The percentage was initially set at 15%, and was supposed to be reduced to 10% by the end of the year.

The measures adopted by the government were not successful. Foreign loans declined in 1980, deficits in the current account escalated, the balance of payments was negative in 1979 and 1980, and international reserves fell. Inflation had reached a rate of around 100% per year. Effective October 1980, the economic policy definitely changed towards the control of domestic absorption by means of restrictive monetary policies. The goal was to restrain imports even more, make exports more attractive and thus reduce the need of foreign financing for the balance of payments.

In 31 Dec 1980, the financial tax (IOF) on import foreign exchange contracts, that was supposed to decrease, was instead increased to 25% and extended to imports of the Manaus Free Trade Zone (previously exempt) at a 15% rate. In January 1981, a new import licensing system was introduced: importers should submit to CACEX an annual import program as a basis for requesting import licenses. A tax credit program for exporters was reintroduced in April.

By the end of 1981, the trade balance showed a surplus of US$ 1.2 billion, but the rise in international interest rates increased debt service by US$ 3 billion. Nonetheless, the overall inflow of capital allowed an increase in reserves. The adjustment in the trade balance was accompanied by a 3.1% fall in GDP, the first since World War II.

Financing requirements for imports were introduced in 6 Oct 1982 by Resolution 767, which established minimum payment terms for many goods. Machines, equipment, instruments, vehicles, vessels and airplanes worth more than US$ 100,000.00 should have minimum payment terms of 3, 5 or 8 years, depending on the value of the import; parts and manufactured products for long-term consumption should be paid in no less than one year; all other goods, in no less than 180 days. Each importer was granted a US$ 100,000.00 yearly exemption within which imports could be made without payment terms requirements. The Resolution listed many cases for which the requirements didn't apply, such as imports for the Itaipu project, imports under the drawback regime, parts and products for airplanes manufacturing, medical equipment, etc. The scheme was in effect until 1991, with modifications along the way[6].

Soon after Mexican *moratorium* in 1982 it was clear that voluntary lending would not be enough to finance Brazil's current account deficit. While negotiating with the IMF, in 21 Feb 1983 the government devalued the national currency in 30%, taking the real exchange rate back to the same level of December 1979. During 1983, payment arrears emerged. In 29 July 1983, Resolution 851 centralized the foreign exchange operations in the Central Bank, meaning that banks selling foreign exchange should make deposits in foreign currency with the Central Bank instead of transferring funds abroad. Further instructions were issued by Circular 804 of the same date, which stated that the external payments would be made in dates to be indicated in each case by the Central Bank, according to a list of priorities. Resolution 898 lifted the centralization in

[6] Resolutions 911 and 953, of 5 Apr 1984 and 12 Sep 1984, permitted the requirements to be waived in some cases, like those involving financing or guarantees by foreign governments, bi and multilateral agencies. During 1986, several products whose importation was needed to complement the domestic supply became exempt of the financing requirements. Resolutions 1485 and 1534, of 25 May 1988 and 30 Nov 1988, eased the financing conditions (values and terms), and Resolution 1751, of 21 Sep 1990, suspended the requirements, that were finally abolished by Resolution 1798, of 27 Feb 1991.

14 March 1984, although imports with payment terms in excess of 360 days remained subject to deposit as long as they were included in the agreements with the Paris Club.

During 1984 arrears were eliminated. Some direct controls on imports were relaxed and the number of products in the negative list was reduced. Inflation had reached 215% (IPCA).

2.5. The New Republic (1985-1989)

In 1985, the Congress elected Tancredo Neves as the first civilian president since 1964. However, he died before beginning his term, and vice-president elected Jose Sarney was sworn into office. The years from 1985 to 1989 were full of heterodox attempts to control inflation, by means of the economic plans called Cruzado (February 1986), Cruzado II (November 1986), Bresser (June 1987) and Summer (January 1989). In the external sector, the economic policy adopted during 1986 had the effect of worsening the trade balance, as a consequence of the increase in domestic demand. The surplus of US$ 7 billion in 1984 gave place to a deficit of US$ 3.8 billion in 1986.

During this period the use of foreign currency accounts was permitted to some companies. Beginning 31 Oct 1986, exporters, importers of goods with external financing and national companies with foreign capital participation were authorized to open foreign currency accounts in U.S. dollars at the Central Bank, under certain conditions for withdrawals (Resolutions 1208 and 1209). These deposits can be viewed as instruments of monetary policy that additionally provided hedge to firms acting in the international market. The system was gradually discontinued as of 29 June 1988 by Resolution 1492, and the accounts were abolished in February 1989.

In January 1987 the prohibited import list was enlarged, and in February 1987 Brazil suspended the payments of interests to nonresident commercial banks (Resolution 1263). The suspension was revoked in September 1988 (Resolution 1516), but during 1989 financial external payments were again made subject to retention in Central Bank, and a preliminary agreement with nonresident creditor banks was reached only in April 1991.

As an incentive to exports, in 30 Mar 1987 producers of manufactured goods were entitled to exemptions from the import tax on imports of intermediate and capital goods worth no more than 10% of the growth of the company exports over the previous year. Restrictions on imports remained based on the mechanisms already in effect.

As of April 1988 (Resolution 1453), all foreign exchange operations started to be registered in the SISBACEN/CAMBIO[7], an electronic system that had been being developed in the previous years and that resulted in a huge improvement for data collection and exchange controls (Ornelas, 1999).

In 16 Nov 1989, export and import companies were allowed again to make voluntary foreign currency deposits with banks authorized to operate with foreign exchange, but funds on these accounts should be transferred to the Central Bank (Resolution 1662). These short-lived provisions were revoked in March 1990.

One of the most important moves towards the liberalization of the foreign exchange regulations was the creation of the "floating rate exchange market" by Resolution 1542 of 1st Dec 1988[8], initially encompassing only manual exchange for travelers, with an allowance of US$ 4,000.00.

[7] SISBACEN stands for "*Sistema de Informações Banco Central*" (Central Bank Information System), and CAMBIO means exchange.

[8] Replaced in the sequence by Resolution 1552, of 22 Dec 1988, later amended with additional regulation.

With time, more operations, thus far restricted by regulations, were gradually admitted into the floating rate market (e.g. health treatment, payment of services and unilateral transfers). Hence, transactions that fed the black market could now be carried out through a legal channel. Further details about the creation of the "floating rate exchange market" are given by Muniz (1998).

2.6. Opening the economy (1990 -)

Another important change occurred when Resolution 1690, of 18 Mar 1990, created the "free exchange rate market," in the wake of the "Collor Plan" immediately after President Collor de Mello took office. It replaced the "official market" (technically called the "administered exchange rate market") by abolishing the rules according to which banks were obliged to sell to the Central Bank their foreign exchange long (bought) position above established limits, whereas the Central Bank guaranteed to cover the banks' short (sold) position. Despite being called "free," the Central Bank still intervened in the market to maintain the exchange rates at desired levels. By the same time, voluntary and compulsory deposits in foreign currency, or indexed by the exchange variation were abolished (Resolution 1691).

In the late 1980s, even in the presence of financial arrears, a gradual liberalization of exchange controls had been initiated, reflecting the efforts to open the Brazilian economy. Resolution 1289, of 20 March 1987, allowed a broader access to Brazilian capital markets by foreign investors; financing requirements for imports were relaxed in 1988 being finally extinguished in 1991; in 17 July 1988 the financial tax (IOF) on import foreign exchange contracts was abolished; the "floating rate exchange market" was created; the advance deposit requirement for import letters of credit, in effect since 1976 (although mitigated over time), was extinguished (Circular 1799, of 15 Aug 1990); exporters were allowed to receive advance payments from

external financial institutions (Circular 1803, of 16 Aug 1990); more options of investment were allowed to foreign investors, like stock and derivative markets; Circular-Letter 2223, of 4 Oct 1991, allowed 100% advance payment for imports; additional income tax on profit and dividends remittance abroad was abolished in 1992.

In 1990 the CACEX was extinguished and its functions were taken over by the Technical Coordinating Office for Trade (Coordenadoria Técnica de Intercâmbio Comercial - CTIC), an agency under the Ministry of Economy, Finance, and Planning[9]. Early in 1991, the government announced tariff reductions to be phased in over the 1991-94 period, the most expressive reductions in Brazilian trade protection in several decades.

In January 1993, the Foreign Trade Integrated System (SISCOMEX – Sistema Integrado de Comércio Exterior) began operation for exports. It is a computerized system that integrates the administrative procedures related to foreign trade operations and allows the government entities directly involved in the process (Secretariat of Foreign Trade, Secretariat of Federal Revenue and Central Bank of Brazil, respectively the Brazilian foreign trade, customs and foreign exchange authorities), as well as exporters, importers and other agents (like other government agencies, banks and carriers), to interact through an electronic platform inputting and retrieving data about the international trade operations, according to each one's role in the process. It completely changed the administrative treatment of foreign trade operations in Brazil, and not only made it agile and less bureaucratic, but also allowed controls to be implemented more efficiently. Circular 2231 had already been issued in 25 Sep 1992, adapting and consolidating the export foreign exchange rules for the new system.

[9] After some institutional reorganization, the foreign trade policy is presently carried out by the Secretariat of Foreign Trade (SECEX) under the Ministry of Development, Industry, and Foreign Trade.

In December 1992 the Senate voted the impeachment of Collor de Mello, and vice-president Itamar Franco was sworn into office. The inflow of capital had increased substantially, attracted by high interest rates and positives prospects for the economy. Balance of payments jumped from a deficit of US$ 369 million in 1991 to a surplus of US$ 14.7 billion in 1992, mostly due to an unprecedented portfolio investment. The government started to take measures to attenuate the monetary impact of the foreign sector and diminish short-term capital flows. Some measures were directly related to export and import foreign exchange operations. Therefore, Circular 2323, of 16 June 1993, reduced the maximum period for advance export payments from 360 to 180 days; Circular 2340, of 15 July 1993, increased the deadline for closing the export foreign exchange contract after the shipment of goods to 180 days, limited to five days (modified to 20 days in 09.30.1994 – Circular 2.486) after the receipt of the proceeds; and Circular 2341, of 15 July 1993, extended the maximum anticipation for contracting forward import foreign exchange transactions from 45 to 180 days in relation to the maturity of the liability abroad.

With the Real Plan, other measures were announced: advances on export foreign exchange contracts (ACCs) were prohibited from being transformed into advance export payments when it resulted in the postponement of the regulatory period for shipment of the goods, and the minimum period of amortization of advance export payments with basis on Circular 1979, of 27 June 1991, was increased from 360 to 720 days (Circulars 2434 and 2438, of 1st July 1994).

After the Real Plan went into effect, the new national currency appreciated due to the high inflow of capital, so other measures were taken to liberalize the outflow. Circular-Letter 2486, of 31 Aug 1994, abolished the limit of 20% for downpayments in imports financed with terms in excess of 360 days, and Circular 2105 of the same date allowed the advance payment of registered financed imports before the due date.

New restrictions on capital inflows were introduced in October 1994. The maximum period for ACC operations was reduced from 180 to 150 days in the case of small scale exporters with a total value of contracted operations equal to or less than US$ 10 million in the last 12 months; for medium and large scale exporters the maximum period was reduced to 90 days; products considered essential to domestic supply were given a maximum period of 30 days. The negotiation of export performances (by means of which a non-exporter can close an export foreign exchange contract and then buy the production of other companies to match the contract) was discouraged by earmarking export foreign exchange contracts to export registers, without permitting the change of the merchandise to be exported (Circular 2493, of 19 Oct 1994). This provision was in effect until 9 April 1996, when it was revoked by Circular 2719. Long-term export advance payments based on Circular 1979/1991 were suspended (Circular 2490, of 19 Oct 1994). A 15% reserve requirement on ACCs was established by Circular 2499, of 19 Oct 1994, and a 30% reserve requirement (later increased to 60%) was imposed on contracts involving assumption of importer's obligations (Circular 2498, of 19 Oct 1994, and Circular 2507, of 17 Nov 1994).

In January 1995, President Fernando Henrique Cardoso began his first term of office. Following the devaluation of the Mexican peso in December 1994 and the drop of international reserves, some of the previous measures were reversed. With respect to ACCs, the reserves requirements were lifted in 12 Jan 1995 (Circular 2534), and the maximum period went back to 180 days (with exception of some products – Circular 2539 of 25 Jan 1995). Long-term export advance payments were resumed with amortization periods greater than 360 days (Circular 2538, of 24 Jan 1995). In 20 Apr 1995, Circular 2561 limited import advance payments at 20% of the import value (this limitation was revoked by Circular 2693 in 20 June 1996).

In January 1997, the Siscomex import module began operation. At that time the overvaluation of the national currency and the high domestic interest rates were a big incentive to imports. Provisional Measure 1569, of 25 Mar 1997[10], established restrictions on short-term credit to finance imports, regulating the compliance with the maturity dates informed in the import declarations and bringing the costs of import financing to the same level of credit offered to domestic production. Basically, importers were required to close forward exchange contracts prior to the customs clearance for imports with payment terms up to 180 days, which was equivalent to make sight payments; for imports with payment terms between 181 and 360 days, the forward exchange contract should be closed within 180 days of the register of the import declaration (equivalent to the customs clearance). Imports financed for more than 360 days had to be registered in the Central Bank and were not subject to the forward exchange contract requirement. Fines were introduced in case of non-compliance, with some exemptions (e.g. operations under US$ 10,000.00, oil imports, imports from Mercosur, Chile and Bolivia). The main effect of these new rules was a significant increase in the volume of imports financed for more than one year, from 3% of total imports in 1996 to 37% in 1997.

Simplified procedures pertaining to foreign exchange contracts for exports up to US$ 10,000.00 were established by Circular 2836, of 8 Sep 1998, which also allowed the use of international credit cards in the payment of such exports and of international parcels. Similar simplified procedures for imports up to US$ 10,000.00 were introduced in 11 Feb 2000 by Circular 2967.

In 1997 and 1998 the Asian and Russian crises affected the market. In the second half of 1998 international reserves were drained by more than US$ 30 billion in a few months, an emergency loan was negotiated with the IMF, but in January 1999 it was not possible to sustain the crawling

[10] Reedited as Provisional Measures 1734/1999 and 1836/1999, finally converted into Law 9817 of 23 Aug 1999.

peg regime and exchange rates were allowed to float, completely modifying the foreign exchange policy. The exchange rate (per U.S. dollar) jumped from R$ 1.46 in 15 Jan 1999 to a peak of R$ 2.16 in 3 March 1999, but finished the year at R$ 1.79. The rates of the two exchange markets ("free" and "floating") were unified by Resolution 2588 of 25 Jan 1999, although the distinct regulations were maintained. A new structure for the monetary policy was also introduced with the adoption of the system of inflation targets.

With the Real Plan, inflation had been finally controlled, decreasing from 2,477% in 1993 to less than 2% in 1998 (IPCA). On the other hand, as a result of the overvalued currency and of high interest rates, the trade balance accumulated increasing deficits from 1995 to 1998, GDP grew at an average of 2.56% between 1994 and 1998, and public debt rocketed.

The currency devaluation in 1999 plus the increase in external financing costs followed by the fall of domestic interest rates along the year reduced the attractiveness of external import financing. Therefore, the requirement of prior foreign exchange contracting for imports could be lightened, and was maintained only for imports with payment terms up to 90 days (Circular 2876 of 17 March 1999). In 28 Oct 1999 this requirement was abolished by Circular 2948.

Regarding exports, Circular 2919 of 19 Aug 1999 increased the maximum period of advance export payments and ACCs to 360 days. In 6 Dec 2000, Circular 3016 permitted exports in consignment to be object of forward exchange contracts, so that they could benefit from ACCs.

In 2001 and 2002 the exchange market was put again under pressure by external factors (Argentinean crisis, terrorist attacks, accounting frauds in the U.S.) and by expectations regarding the presidential elections. Trade credit lines became scarce, and the Central Bank

introduced a scheme for auctioning reserves tied to the concession of export credits (Circulars 3145 and 3146, of 23 and 30 Aug 2002).

As a whole, the present foreign exchange regulations pertaining to imports and exports have been stable, with only minor modifications since 2000. After the adoption of the floating exchange regime, the trade balance recovered from a deficit of US$ 6.6 billion in 1998 to a surplus of US$ 13.1 billion in 2002. In 2003, the surplus from January to November exceeded US$ 22 billion.

3. EXISTING CONTROLS

Brazilian foreign exchange controls pertaining to international trade operations are based on data provided by Siscomex and Sisbacen. Ornelas (1999) presents a comprehensive description of both systems.

3.1. Exports

Exporters must register with the Secretariat of Foreign Trade (SECEX) in order to be entitled to carry out an export transaction. This is automatically done during the first export. As a general rule, the exporter must enter information about the transaction into Siscomex to obtain an Export Registration (RE - *Registro de Exportação*) prior to the shipping of the goods. Some operations (supply of fuel and goods to ships and airplanes in international routes, and sale of precious and semiprecious gems and metals to non-resident travelers, including jewels) can be registered after the shipping. Required data include type, quantity, classification and description of the goods, incoterm, price and conditions of payment. The shipment must be made within 60 days of the issuance of the RE, otherwise it will be automatically canceled (prorogation is admissible). For

some products (basically those negotiated in Commodities Exchanges), a Sales Registration (RV - *Registro de Venda*) is required prior to the RE.

The system scrutinizes the inputted data, taking into account possible restrictions imposed on the goods being exported or on the country of the importer (in accordance with UN sanctions). Prices, terms of payment and commission paid to the sales agent are also verified, using the international trade market as a guideline. In most cases the process is automatic, and the RE is issued immediately. In certain situations (e.g. products requiring acquiescence of an specific government agency, like dual-use items, exports without exchange cover and exports in consignment) an administrative analysis by government officials is necessary. If payment terms are in excess of 180 days from the shipment, the operation is considered a financed export, and a Register of Credit (RC - *Registro de Crédito*) is also necessary. The RC is subject to approval of SECEX and provides information about the schedule of payment and interests charged to the importer.

After the shipment of the goods and customs clearance, another electronic document, the Declaration of Export Clearance (DDE - *Declaração de Despacho de Exportação*), is issued. The DDE ascertains that the export was performed and informs the quantity of goods actually shipped (that can eventually differ from the quantity previously informed in the RE). One DDE may correspond to more than one RE.

The exporter must surrender the export proceeds to an authorized bank, according to Decree 23258/1933. This is accomplished by means of an export foreign exchange contract electronically registered in Sisbacen. The contract can be signed before or after the shipment, and can be classified as follows:

a) Pre-payment (a.k.a. advance payment) - The export proceeds are advanced to the exporter by the importer itself or by a financial institution, at financing rates freely agreed upon by the parties; interests may be paid either by financial remittance or with merchandise. The advance payment is characterized by the fact that the settlement of the contract precedes the shipment of the goods. If the advance period exceeds 360 days from the shipment date, the exporter must submit a Register of Financial Operation (ROF - *Registro de Operação Financeira*) to the Central Bank.

b) Advance on foreign exchange contracts (ACC - *adiantamento de contrato de câmbio*) – The bank extends to the exporter a partial or total advance in local currency prior to the shipment, with the primary objective of financing the manufacturing and commercialization process of the goods to be exported. Shipment must occur within 360 days of the date of the contract, and the settlement must occur within 180 days of the shipment.

c) Advance on delivered letters (ACE - *adiantamento sobre cambiais entregues*) –The bank extends to the exporter a partial or total advance in local currency against presentation of shipping documents before the due date for the payment by the importer and the settlement of the contract. The maximum term of the advance is 180 days, since the contract must be settled within 180 days of the shipment.

d) Forward export exchange contract, without advance - The foreign exchange contract is closed for future settlement at a rate agreed upon by the parties, without any advance in local currency. This kind of contract is usually called "locked exchange contract" (*câmbio travado*).

e) Standard foreign exchange contract – The foreign exchange contract is closed after the importer has made the payment, for prompt settlement. Currently the export proceeds must be surrendered within 20 days of being received.

Every DDE corresponding to an export with exchange cover clause must be linked to a settled foreign exchange contract. The linkage is electronically made through Sisbacen by the bank with which the contract was closed. The bank must keep in its files the basic documents related to the export such as commercial invoices, bills of lading, letters of credit, swifts, etc. The main controls concerning exports are detailed below.

Lack of exchange cover

The lack of exchange cover for a given export is detected when the corresponding DDE becomes overdue without being linked to any exchange contract, or when the DDE is linked but the contract is not settled in the due date. Both cases mean that proceeds were not surrendered to an authorized bank within the time period assigned by the regulations, which potentially infringes Article 3 of Decree 23258/1933.

In any commercial activity, sellers are subject to delayed payments and default. In the case of exports, however, according to the Brazilian foreign exchange regulation, exporters and banks have the obligation to make every possible effort to receive the payment. This includes filing a suit against the debtor abroad. Only exports up to US$ 30,000.00 are exempt of these requirements, since the legal costs associated with the litigation may not pay off. Even if the importer was declared bankrupt, the exporter has to claim his credits in the bankruptcy proceedings.

In many cases, a sequence of shipments to the same allegedly delinquent importer may indicate non-compliance with the export regulations, especially when shipments continue after previous exports are overdue. This is frequently a sign that the exporter and importer are related to each other, or that the proceeds were received and were not surrendered to an authorized bank as required.

Settled export exchange contracts without link to DDEs

Settled export exchange contracts without link to an actual export are also object of attention, particularly when large sums are involved in the form of advance payments. It usually means that the payment sent from abroad had another destination, which has nothing to do with the export activity. This might happen when exchange controls related to the inflow of capital are in effect, as was the case during the mid-1990s. If export exchange contracts are identified and no export was ever performed, the alleged exporters may be liable for false declarations in exchange contracts, an infringement to Article 23, paragraph 3, of Law 4131/62.

It must be remarked that, in case of non-performance, advance payments for exports cannot be returned to the payer unless it is previously converted into a loan or an investment. This implies submitting a register of the operation to the Central Bank, as well as incurring financial costs associated with the "symbolic" exchange operations that are needed to characterize the new nature of the capital.

Unsettled export exchange contracts without link to DDEs

Another control activity deals with unsettled export exchange contracts not linked to DDEs. The exchange regulations state that overdue, unsettled export exchange contracts for which there was

no corresponding shipment of goods or supply of services, must be cancelled or written off within 20 days from the date scheduled for delivery of export documents.

Since the credit lines available to exporters through foreign exchange contracts (ACCs and ACEs) benefit from tax exemptions that make them cheaper, these funds are earmarked for export financing and must not be used for other purposes. In order to discourage speculative transactions (that can become a temptation in a scenario of high interest rates associated with stable exchange rates), a financial charge must be paid whenever an export exchange contract is cancelled or written off before the shipment of goods or supply of services (Law 7738, of 9 March 1989, and Law 9813, of 23 Aug 1999).

3.2. Imports

Since 1997, the entire import process is also conducted through Siscomex. There are two basic electronic documents related to the import process: the Import License (LI - *Licença de Importação*) and the Import Declaration (DI - *Declaração de Importação*).

The imports of some products and some import operations with particular characteristics require authorization of specific government agencies or are under control of SECEX. In such cases, the import falls into the category of non-automatic licensing and the importer must submit an Import License (usually prior to the shipment of the goods). The products and operations in this situation are listed in Communication DECEX 37 of 17 Dec 1997 (with later modifications), including: petrochemical, drugs, live animals and military products, as well as imports of used goods, imports without exchange cover and imports that benefit from special tax regimes. The license is issued usually within a five-day to two-week period. Importers do not need to submit a LI when the import falls into the category of automatic licensing, for which the license is automatically

granted when the Import Declaration is approved. The prices informed in LIs and DIs are checked in comparison with the international market, specialized publications and manufacturers' price lists.

The Import Declaration (DI) is the document that starts the customs clearance of the import and contains the information related to the importer, exporter, characteristics of the goods, transport, insurance, taxes and payment scheme (including value and currency), among others. The electronic register of the DI is usually made after the arrival of the goods, although in some situations it can be previously registered. The federal taxes and other duties related to antidumping, compensatory and safeguard measures are paid via automatic debt in a checking account informed by the importer in the DI.

After registering the DI, the importer or its agent must file the entry documents (original bill of lading or equivalent, commercial invoice, and any other papers required by specific legislation like certificates of origin) with the customs authorities. A verification of the import then takes place (in different levels according to the criteria established by the customs), and finally, if the clearance process concludes successfully, the importer will be allowed to withdraw the merchandise. At the end of the process, a final electronic document called Import Certificate (CI - *Certificado de Importação*) can be printed directly by the importer through Siscomex.

The exchange regulation classifies the payment of imports as follows:

a) Advance payments: Advance payments occur when imports are paid (1) prior to the shipment of the goods, in the case of final imports (including drawback operations) or

imports entering Free Trade Zones and "industrial bonded warehouses"[11]; or (2) prior to the nationalization of the goods, in the case of other customs regimes. The maximum allowed anticipation is 180 days, except for goods with a long production cycle. If the merchandise does not enter the country by the date informed in the import exchange contract, the importer must repatriate the advance payment.

b) At-sight payments: "At-sight" payments occur when the payment is processed through documentary sight collection or results from the negotiation of a letter of credit issued for payment against presentation of shipping documents, prior to the customs clearance of the goods or their entrance in "industrial bonded warehouses." It only applies for final imports (including drawback operations) or imports entering Free Trade Zones and "industrial bonded warehouses," and is not valid for other customs regimes.

c) Term payments: If the payment is made after the goods have been cleared by the customs or have entered an "industrial bonded warehouse," it is said to be a term payment.

As well, imports can be paid either in foreign or in national currency. In the first case, the payment should be performed through an import foreign exchange contract with an authorized bank; in the latter case, through a deposit of national currency in a non-resident account, an operation also registered in Sisbacen and known as international transfer in reais (TIR - *transferência internacional em reais*). In both cases, a link between the DI and the payment (either the exchange contract or the TIR) must be provided by the importer or by the bank.

[11] "*Entrepostos aduaneiros industriais"*: Customs regime which allows the suspension of taxes on imports of goods that will be industrialized for export purposes.

Imports with payment terms exceeding 360 days must be registered with Central Bank through Sisbacen by means of a Register of Financial Operation. Forward import foreign exchange contracts are admissible; the maximum term for settlement is 360 days from the exchange contract date, limited to the maturity of the import payment.

Government controls over imports have different reasons: (i) avoiding the entrance of undesired foreign goods either for its own nature (e.g. drugs and weapons) or for protection of the national economy; (ii) avoiding tax-evasion resulting from under invoicing; (iii) avoiding foreign exchange evasion resulting from over invoicing and illicit payments.

This section concerns solely with foreign exchange controls, which aim at making sure that each DI demanding exchange cover matches a corresponding payment and vice-versa. The most relevant situations are described below.

Settled payments with overdue term for linkage to a DI

After the time period assigned by the regulations, settled exchange contracts and TIRs related to import payments must be linked to a corresponding DI. The non-existence of such link may be seen as evidence that the payment was not due, which may characterize foreign exchange evasion. If the importer does not repatriate the money and is not able to present reasonable explanations (e.g. delays in the shipping, transport or clearance of the merchandise, errors in the DI or in the exchange contract), he might be liable for false declaration in foreign exchange contracts (Law 4131/1962, Article 23, paragraph 3).

Major concern is devoted to advance payments, notably when companies that are not traditional importers send large amounts of money abroad through import exchange contracts, which might be connected to criminal activities and money laundering.

Before the implementation of the import module of Siscomex in 1997, variants of this practice were the presentation of false import documents to support the remittances, and the multiple presentations of the same documents to different banks. Since at that time there was no electronic register of the import licenses and declarations, the controls depended heavily on procedures that should be followed by banks and brokers. Documents should be properly checked and should be stamped by the banks at each remittance, in order to attest that the corresponding amount had already been totally or partially paid. Procedures like these gave chance to many faults.

Currently the perpetration of these kinds of frauds is much more difficult, since every import must correspond to electronic registers subject to validation at several checkpoints by different government agencies. Furthermore, the access to Siscomex requires that companies and individuals periodically update their files with the Secretariat of Federal Revenue.

Overdue DIs without link to exchange contracts or TIRs

This controls deal with the opposite situation: goods were imported but there are no payments linked to the corresponding DIs. The legal basis for the Central Bank action is Law 9817/1999, which establishes that the importer is subject to a financial charge in the following situations:

I. foreign exchange contract closed after the term established by the Central Bank;
II. payment in national currency when the import was supposed to be paid in foreign currency;
III. delayed payment of imports registered for payment in national currency;

IV. lack of payment after 180 days after the first day of the month subsequent to the month scheduled for payment in the DI.

Some imports are exempt of the financial charge, such as imports worth less than US$ 10,000.00 (the full list of exemptions is given by Circular-Letter 2955 of 21 Feb 2001).

The rationale is that a DI without link to a proper payment can be seen as a sign either that the payment was performed without the intervention of an authorized bank (which is not allowed) or that the price informed in the DI is higher than the actual price charged by the exporter. In this latter situation, it is possible that the goods were imported by prices lower than those declared in the documents, in a *de facto* dumping practice. On the other hand, a delayed payment may suggest the practice of speculation with the arbitrage of domestic and international interest rates vis-à-vis the expected variation in the exchange rate.

In the case of delayed payments and contracts, Sisbacen automatically calculates the values of the financial charges and presents it to the respective bank (although the importer is liable for the charge, the bank is responsible for its collection to the Central Bank). The situation becomes more complex when there is no registered payment. In these circumstances, if the DI's remain unmatched to any payment without acceptable explanations, the importer may be compelled to pay the financial charge through an administrative process.

3.3. Enforcement of exchange regulation

The enforcement of the exchange controls by the CBB is based on specific regulations and on the possibility of demanding special procedures through Siscomex and Sisbacen. The most important tools of enforcement are detailed below.

Fines

The exchange controls are based on the data inputted in Sisbacen and Siscomex by a variety of agents (importers, exporters and their representatives, banks and brokers among others). The accuracy and the timely input of these data are of ultimate relevance for the achievement of the objectives pursued by the controls, as well as for the consistency of the statistics relating to foreign capital, exchange and international trade.

Since 2 March 1994, when Circular 2408 was issued, the register of incorrect or incomplete information on Sisbacen, the non presentation of a document required by regulation for a particular kind of foreign exchange operation, and the absence of link between a foreign exchange contract and the electronic registers concerning exports and imports (including foreign capital registers like the Registers of Financial Operations mentioned before), make banks subject to a R$ 150.00 fine[12].

In 1st Nov 2001, Circular 2408 was revoked and substituted by Resolution 2901, which extended the application of such fine to other situations.

In some cases (e.g. reclassification of foreign exchange operations) Sisbacen automatically applies the fines, and subsequently processes the notification and collection through the Brazilian Payment System.

Financial charges

As explained before, exporters and importers are liable for financial charges in case of: (1) cancellation or writing off of an export exchange contract prior to the shipping of goods or

supplying of service; and (2) delayed payments of imports, payment in national currency of imports licensed for payment in foreign currency, and lack of payment of imports. Sisbacen automatically calculates the financial charges whenever the corresponding event occurs and subsequently processes the notification and collection through the Brazilian Payment System (except in the case of lack of payment of imports, when an administrative process should be necessary).

Mandatory foreign exchange contracting prior to the export registration

According to Resolution 1964, of 25 Sep 1992, the export registration (RE) must be preceded by a corresponding export foreign exchange contract whenever the exporter: (1) is involved in abnormal operations or irregular practices related to foreign exchange or foreign trade; (2) does not arrange the proper export foreign exchange contracts in due term after performing exports; (3) does not arrange the proper links between export foreign exchange contracts and the respective registrations of the export transaction in Siscomex[13].

When an exporter is under such restriction, every export registration it submits through Siscomex will be pending approval until it is linked to an export foreign exchange contract, i.e. until an export foreign exchange contract is previously allocated to it. The exporter has three options in order to meet this requirement: (i) receiving an advance payment from the importer; (ii) arranging an advance on foreign exchange contract (ACC); or (iii) closing a forward foreign exchange contract (v. Section 3.1).

[12] Circular 2408/1994 initially set the fine at 200 UFIRs but the value was later fixed at R$ 150.00 by Circular 2615 of 14 Sep 1995 (currently circa US$ 51.00).
[13] Includes REs and DDEs.

After the foreign exchange contract is closed and linked to the pending export registration, Siscomex automatically authorizes the processing of the RE to move on.

This requirement is an efficient tool to enforce the regulations and to avoid the appearance of new exports with pending links. In general, the prior arrangement of a foreign exchange contract and the consequent participation of a bank in the operation reduce the probability of the exports not being paid or of the proceeds not being surrendered as required.

Mandatory submission of foreign exchange contracts for previous approval of the Central Bank

Regular import and export foreign exchange contracts do not need previous approval of the Central Bank to be performed and electronically registered. However, through Sisbacen the Central Bank can demand that operations of specific individuals and companies be conditional upon prior approval on a case-by-case basis, also via Sisbacen, before completing. This is typically the case when an exporter has received advance payments without performing the corresponding exports within the stipulated term, or when an importer has sent funds abroad without performing the corresponding imports within the allowed time.

Administrative processes

A punitive administrative process must be started whenever there is evidence that an illicit act characterized as so in the legislation has been committed and a penalty must be applied.

Concerning foreign trade exchange controls, processes are mostly related to the following irregularities:

- ? lack of exchange cover in exports (Decree 23258/1933) - penalty of up to 200% the value of the irregularity;
- ? false declarations in foreign exchange contracts (Law 4131/1962, Article 23, par. 3) - penalty of 5% to 100% of the value of the contract;
- ? false identification in foreign exchange contracts (Law 4131/1962, Article 23, par. 2) - penalty of 50% to 300% of the value of the contract;
- ? non payment of imports (Law 9817/1999) - penalties calculated according to Circular-Letter 2955/2001.

The process follows the rite prescribed by Resolution 1065/1985 and by Law 9784/1999. It starts with the notification of the defendant by means of a document that describes the charges against him and assigns the deadline for the presentation of his defense. The defense is analyzed and the case is judged by another authority that is not the one which decided to start the process. If the defendant is judged liable for the penalties, he can still appeal to the Council of Appeals of the National Financial System (CRSFN – *Conselho de Recursos do Sistema Financeiro Nacional*). Processes in which the charges are dismissed in the first degree of jurisdiction have to be submitted *ex officio* to the CRSFN. When a penalty decision becomes definitive and there is no voluntary payment (which is usual, given the high values of the penalties), the case goes to the courts for judicial collection.

The legislation on which these processes are based attributes liability to the entities that perform the irregular operations (exporters, importers and, in the case of false identification, also banks and brokers). In other words, unless the exporter, importer or client specified in the contract is a natural person, the process reaches only juridical persons. This circumstance impairs the

effectiveness of the processes, given the fact that very often such firms do not have traceable assets or, when they do, shareholders and administrators simply clear and close them out. This results in a large number of processes in the courts with low chances of success with respect to the judicial collection of the fines. The solution would be to make the firms' shareholders and/or administrators liable for the irregularities committed under their management.

Communication to the Secretariat of Federal Revenue and to the Federal Public Ministry

Whenever the facts under exam show evidence that tax or criminal laws may have been infringed, the Central Bank has to notify the Secretariat of Federal Revenue and the Federal Public Ministry respectively. Brazilian legislation defines as crimes several acts related to foreign exchange, such as the illegal remittance of foreign exchange by unauthorized means (foreign exchange evasion), the trade of foreign exchange by non-authorized dealers, false declarations and false identification in foreign exchange contracts (Law 7492/1986).

4. OTHER COUNTRIES' POLICIES

This section brings a comparison among different arrangements in effect in other developing countries regarding export and import foreign exchange controls. The material is based on the 2003 IMF Annual Report on Exchange Arrangements and Exchange Restrictions, with focus on the "Export and Export Proceeds" and "Import and Import Payments" sections. The following 32 developing countries have been selected:

i. in Latin America: Argentina, Bolivia, Chile, Colombia, Ecuador, Paraguay, Peru, Uruguay, Venezuela, Mexico, Costa Rica, El Salvador, Honduras, Nicaragua and Panama.

ii. in Eastern Europe: Czech Republic, Slovenia, Hungary, Poland, Lithuania, Ukraine, Romania and Russia.

iii. in Asia: India, China, South Korea, Thailand, Malaysia, Indonesia, Philippines, Turkey[14] and Vietnam.

4.1. Exports

The main aspects to be analyzed with respect to exports are the repatriation and surrender requirements, defined by the IMF as follows:

Repatriation requirements:	The obligation of exporters to repatriate export proceeds.
Surrender requirements:	Regulations requiring the recipient of repatriated export proceeds to sell any foreign exchange proceeds in return for local currency to the central banks, commercial banks, foreign exchange markets, or exchange dealers authorized for this purpose.

Considering all the 187 countries included in the IMF 2003 Annual Report, repatriation of export proceeds is required by 101 countries, out of which 79 also require the surrender of the proceeds.

Amid the selected countries, no repatriation of export proceeds is required by Bolivia, Chile, Peru, Paraguay, Uruguay, Mexico, Nicaragua, El Salvador, Panama, Indonesia, Philippines, Czech Republic, Hungary, Lithuania, Poland, Romania and Slovenia. This group includes some countries of Eastern Europe that will join European Union in 2004 and Romania (that abolished repatriation requirements in January, 2003, and is a candidate member for the E.U.); it also includes some Latin American countries in which the U.S. dollar is legal tender (Bolivia, El

✍ [14] Albeit geographically located in Asia, Turkey is a candidate member for joining European Union.

Salvador, Panama) or with highly dollarized economies such as Peru and Paraguay. In the case of Chile, exporters must report their receipts to the Central Bank, who has the power to impose, under certain conditions, repatriation and surrender requirements in order to secure the stability of the currency and of the balance of payments[15].

Three countries (Costa Rica, Vietnam and Bulgaria) require the repatriation of the export proceeds, but allow all exporters either to sell them in the exchange market or to maintain deposits in foreign currency accounts in authorized institutions. In Costa Rica special provisions apply to companies in Free Trade Zones, which may dispose freely of their proceeds.

In all the other selected countries there are repatriation and surrender requirements in different extents, meaning that exporters must surrender at least part of their proceeds. Percentages and special arrangements vary from country to country. In Colombia, for instance, exporters can hold foreign currency compensation accounts abroad, provided that these accounts are registered at the Banco de la Republica[16]. Malaysian exporters are allowed to retain their export proceeds in foreign currency accounts with designated banks with an overnight limit of between the equivalent of US$ 1 million and US$ 70 million, or any larger approved amount. In Thailand deposits in domestically held foreign currency accounts are allowed if the exporter has obligations to be paid abroad within three months of the deposit date. In Russia and India exporters may also keep a percentage of their proceeds in domestically held foreign currency accounts. In China all enterprises authorized to conduct current account transactions may retain foreign exchange equivalent to 20% of their current account foreign exchange earnings in the previous year.

[15] Ley Organica Constitucional del Banco Central de Chile, Articles 49 and 50
[16] Manual de Cambios Internacionales, section 9, External Circular DCIN-23/2002

As a matter of fact, among the selected countries only in Argentina the full surrender of export proceeds is required (with some exceptions due to the transition from the former full convertibility regime). Even in Venezuela, currently under foreign exchange centralization, exporters may keep up to 10% of their proceeds to cover costs resulting from their activities[17].

The table presented in the Appendix compiles the information about the selected countries.

4.2. Imports

The main exchange arrangements related to imports compiled in the IMF Annual Report are the existence of foreign exchange budget, financing requirements and documentation requirements, the latter including domiciliation requirement, preshipment inspection, obligation to use letters of credit as a form of payment, and the use of import licenses as exchange licenses.

Among the selected countries, IMF reports the existence of an import budget only for Vietnam, underlining that this budget is indicative and not binding. Still according to the IMF, most of the selected countries have no financing or documentation requirements (other than documentary evidence) for purchasing foreign exchange aimed at import payments. The reported restrictions are described below:

Argentina – By the end of 2002, restrictions applied to import payments, in the form of financing requirements and prohibitions for advance payments. Since then these restrictions have been lifted.

Colombia - Imports payable more than 6 months after the date of the transport document are considered financed imports and must be reported to the Banco de la Republica.

[17] Convenio Cambiario #1, Article 27, paragraph 1, and Providencia CADIVI #30, Article 7

Malaysia - Payments are freely allowed provided that they are in foreign currency. There are minimum financing requirements that vary for rice, fish and fishery products depending on the agreement between those involved. In accordance with a special agreement, sales of rice from Myanmar are subject to advance payments.

Philippines - Accounts overdue by more than 30 calendar days for which no request for extension of payment has been filed with the Central Bank, or no advice on nonpayment has been received from the creditor concerned, must be deemed to have been paid and are not eligible for servicing with foreign exchange purchased from the banking system.

Russia - Advance payments for imports of goods, services and intellectual property for periods in excess of 90 days need approval of Bank of Russia, with some exceptions. If the purchase of foreign currency is carried out before the import of commodities, it is necessary to make a 20% deposit in domestic currency in the executing bank, unless some conditions are fulfilled. To purchase foreign currency for import prepayments, the importer must present to the bank the foreign exchange purchase order approved by the Ministry of Finance.

Ukraine - For purchases exceeding US$ 10,000 a certificate from the State Tax Administration must be presented to the bank in addition to the import contract.

Venezuela - Effective February 2003, prior authorization of CADIVI (Foreign Exchange Administration Commission) is required for the purchase of foreign exchange. Authorization is granted on a discretionary basis and is subject to evidence of tax compliance and registration requirements. These provisions were issued on an emergency basis, given the foreign exchange crisis affecting that country.

5. ANALYSIS

5.1. Purposes of foreign exchange controls

According to Root (1984), exchange controls can be motivated by different reasons: (a) the suppression of balance of payments disequilibria; (b) the facilitation of national planning; (c) the protection of national industries; (d) and the creation of government revenues. All these objectives can be identified throughout Brazil's history, with different weights at each phase.

The main concern of exchange controls has always been the balance of payments and the scarcity of foreign exchange. This is explicit, for instance, in Decree 23258 of 1933, whose preamble attributes the centralization of operations in the Bank of Brazil to the purpose of distributing equitably the available foreign exchange values. As a rule, one can notice the recrudescence of the exchange controls whenever the balance of payments is under pressure, as happened in 1931, 1937, 1947, 1961, 1974 and 1979.

Exchange controls were also used as an instrument of development policy in the context of national planning. The most visible example of such strategy is the import substitution industrialization. In Brazil this policy was important well before 1930, but flourished between WWII and the 1970s. It was largely based on overvalued exchange rates and import controls: overvalued exchange rates allowed the import of inputs and capital goods at a lower cost, whereas limitations against imports of non-essential consumption goods and of domestically produced goods favored the building of a national industry devoted to their production.

In an opposite direction, the Real Plan initial effort to control inflation in the mid-1990's was largely based on an overvalued exchange rate and a more liberal approach to imports, which

allowed foreign products to supply domestic demand and keep prices at a low level through competition.

The use of exchange controls as a source of government revenues was particularly important in the years following the introduction of the auctioning system for imports (Instruction SUMOC 70 of 1953), as the premiums paid by importers (minus the bonuses paid to exporters) were used to finance government expenditures. The "contribution quotas" over some export products, and the taxes over import foreign exchange contracts (the latter functioning as an additional disincentive to imports) were also important sources of revenue.

5.2. Negative consequences of exchange controls

Negative consequences of exchange controls have been reported in the literature (Dunn and Mutti, 2001; Dunn, 2002). A brief survey of different views (pros and cons) about exchange controls and capital flight is provided by Pinheiro (1997). The following paragraphs focus on the issues directly connected with international trade in the Brazilian scenario.

Foreign exchange black market

Excessive restrictions on foreign exchange operations lead invariably to the growth of a black market for hard currencies, as a consequence of the basic law of supply and demand. A comprehensive study of the Brazilian case can be found in Pechman (1994), according to whom the combined daily turnover of the black market in Rio de Janeiro and Sao Paulo was estimated in US$ 10 million from 1980 to 1985, and US$ 20 million in the following years. Although these figures are insignificant when compared to the formal financial market, the high premium in the black market at that time was a clear sign that there was a strong demand for foreign exchange

that could not be channeled through the official market due to the stringent regulations. Part of this demand came from legitimate operations, such as international travel, medical treatment, maintenance of residents abroad and so on, for which narrow quantitative limits applied. This high premium served as a strong incentive for illegal operations whose purpose was purchasing exchange values at the "cheaper" official rate, as well as evading the surrender requirements by selling exchange values at the higher black-market rate. With this in mind it comes as no surprise that by the time when premium reached more than 160% in the late 1980s big frauds occurred in import foreign exchange contracts.

Underinvoicing of exports, transfer pricing and smuggling

The underinvoicing of exports is reported in the literature as a common practice to evade exchange controls. It is a means that exporters use to overcome surrender requirements and thus hold exchange values abroad, either as a reserve of value or to sell it at higher rates than could be obtained in the official market. Some studies try to determine the extent to which the practice takes place by comparing the export data from the country being considered and the import data from its partners. Nonetheless, the process is not accurate, since discrepancies arise from a variety of reasons such as[18]:

- methodological differences: trade coverage, definition of partner country, definition of statistical territory, different valuations in theory or practice, particularly the difference between f.o.b. and c.i.f. valuations;
- time lag: the same operation can be recorded under a different reference period because of transport times or also because of processing delays;

? statistical confidentiality: the same operation cannot be recorded in the trade of one of the two partners because of statistical confidentiality (or the procedures used to avoid disclosure may differ);

? different practices in the treatment of revisions;

? currency conversion.

Cuddington (1986) reproduces data according to which, between 1977-1983, exports were underinvoiced by an average of 19.6% in Argentina, 12.7% in Brazil, 12.8% in Chile, 33.6% in Mexico, and 27.8% in Uruguay[19]. He notices, however, that exports are reported by f.o.b. values, and imports by c.i.f. values. Estimating average insurance and freight at a crude 10% of f.o.b. value as he did, the Brazilian number falls to 2.7%.

Using data from 1967, Bhagwati (1978) concludes that exports reported by Brazilian statistics differed by 14.0% from imports reported by countries from OECD and by 4.1% from imports reported by the U.S. and Canada[20]. One must notice that the U.S. and Canada record their imports by f.o.b. values, whereas other OECD countries record theirs by c.i.f. values.

A report published by the International Trade Center[21] compares foreign trade data supplied by each country and its mirror partners' data for year 2001. It provides tables that show total and absolute average discrepancy measures. For the present discussion, the relevant figure is the total discrepancy measure for exports, defined as $â_{EXP} = 100 \times (M-T) / (T+M)$, where T is the total exports reported by the country under consideration, and M is the sum of imports from that

[18] "Statistics on the trading of goods - User guide", European Communities, 2002, available on-line in the site www.eurotrace.org.
[19] Percentages as a proportion of reported exports.
[20] Percentages as a proportion of reported exports.
[21] "Reliability of trade statistics - Indicators of consistency between trade figures reported by countries and their corresponding mirror estimates", available on-line in the site www.intracen.org.

country reported by its partners. The value of $\hat{a}_{EXP}$ varies from -100% to 100%. According to the report, since import statistics include freight and insurance costs, a positive value (close to 5%) is usually expected.

Country	$\hat{a}_{EXP}$ (%, year 2001)
Brazil	4.3
U.S.	8.0
Canada	1.5
Mexico	-1.4
Argentina	2.7
UK	-1.2
South Africa	30.6
Japan	6.8
Russia	9.7
China	22.7

Positive values mean that imports reported by partner countries are higher than exports registered by the country being considered, thus revealing the potential occurrence of underinvoicing in its exports. However, given the multiple sources of discrepancies, this method does not lead to definite conclusions with regard to it. One must notice that the purpose of the ITC report is to address the reliability of international trade statistics, not to make inferences about over or underinvoicing practices.

Of course the 4.3%-value attributed to Brazil does not mean that the practice of underinvoicing does not occur. It can take other forms that are not captured by the statistics comparison described above. This is the case of transfer pricing, when the price in an inter-company operation is manipulated with the purpose of allocating revenues in the most convenient way, not being equivalent to the price that would be in effect between unrelated parties (called the arm's length price).

For instance, if an exporter owns a trading subsidiary abroad, it may well export its products to that trading company by prices lower than the prices charged to the final buyer, holding the

balance overseas both for taxation purposes or to evade the export proceeds surrender requirements. Although Siscomex performs checks on minimum prices of the commodities being exported, for some products a wide range of prices may be accepted due to possible variations in specifications and quality. Brazilian legislation deals with the tax effects of transfer pricing in Laws 9430/1996 and 9959/2000, and in Normative Instructions of the Secretariat of Federal Revenue 243/2002 and 321/2003.

Additionally, one form to delay the surrender of export proceeds is to charge the related trading company with longer maturity drafts than those issued against the final buyer, maintaining the proceeds overseas for the period between.

In the extreme case, underinvoicing of exports take the form of smuggling goods out of the country. Pechman (1994) mentions that exporters may be one of the sources of dollars for the black market, and explicitly refers to the smuggling of soybeans and coffee from Brazil to Paraguay. Muniz (1998) shows evidence of smuggling of gold to Uruguay.

Overinvoicing of imports

Evasion of exchange controls may also occur through overinvoiced imports. In this case however importers face heavier duties, thus such practice would require complex tax planning within a strategy of transfer pricing, or would be motivated by expectations about possible currency devaluations and premiums in the black-market.

As a matter of fact, some studies based on past numbers reveal that the most common practice for the Brazilian case is the underinvoicing of imports (Nembhard 1996; Bhagwati 1978),

meaning that in general the import tax burden overcomes possible gains obtained from irregular remittances.

Repeating the same methodology used for exports, the table below shows discrepancies resulting from comparison between imports reported by some countries and the exports to such countries reported by its partners in 2001. Defining $\hat{a}_{IMP}$ = 100 x (M-T) / (T+M) as before, negative values mean that imports reported by the country under consideration are overvalued compared to the exports reported by its partners countries, thus revealing potential overinvoicing (taking into account that imports are usually based on c.i.f. values and exports on f.o.b. values, a negative difference of 5% should be expected):

Country	$\hat{a}_{IMP}$ (%, year 2001)
Brazil	-4.9
U.S. (*)	-5.5
Canada (*)	-6.1
Mexico	-21.8
Argentina	-7.8
UK	0.3
South Africa (*)	7.1
Japan	-11.2
Russia	19.7
China	-18.8

(*) imports f.o.b.; other countries imports c.i.f.

The same remarks made to the exports are valid here: the sources of discrepancies are many, and conclusions based on these figures must be circumspect. Furthermore, collusive transfer pricing is not captured in these comparisons.

Nonetheless, whereas overinvoicing of imports cannot be easily identified in the Brazilian case through foreign trade data, i.e. through imports that actually crossed the borders, there is record of faked invoices being used to purchase foreign exchange for payment of alleged imports that

never took place. The most noticeable cases were the frauds that occurred in the late 1980's, already mentioned.

5.3. Costs derived from exchange controls

The will of individuals and companies to circumvent exchange controls may be an incentive to the practice of the illegal actions mentioned above. As described in Section 3, Brazilian government developed electronic systems and a regulatory framework that allow an effective control and enforcement of rules related to the foreign trade operations. Illegal operations still occur, but since the liberalization initiated in the 1990s (especially with the creation of the "floating rate exchange market" and the subsequent diminishing of the black-market premiums) they are not simply motivated by exchange controls, being linked in many cases to tax evasion and money laundering.

No one can deny, however, that the compliance with the complex set of rules that regulate the foreign exchange operations in Brazil carries costs in many senses. These costs can be classified in two broad categories. The first is related to the flow of information needed to be supplied to the control systems (registering imports, exports, foreign exchange contracts, financial operations, and keeping the track of each transaction by means of the appropriate linkages) and to its monitoring. The second has to do with the substantive impositions and prohibitions embedded in the regulations.

With respect to the first category of costs, exporters, importers and banks often claim that information and documentation requirements demand an expensive back office structure. Some measures have been adopted in order to reduce these costs, such as the implementation of simplified procedures for operations up to US$ 10,000.00 and the recent release of RedeCec

(*Rede de Informações de Capitais Estrangeiros e Câmbio* - Foreign Capital and Exchange Information Network), a system that allows companies and individuals to access via internet their pending electronic registers. Further simplification is often requested by the parts involved, especially with respect to the custody of documents by the banks, and to the linkages between the foreign exchange contracts and the corresponding export or import registers. There are costs incurred by the public sector too, associated with the surveillance and enforcement activities.

The second category of costs is connected with capital controls in a wider sense, encompassing questions like export proceeds surrender requirements, private compensations, and withholding of foreign exchange values.

As a consequence of the surrender requirements and of the restrictions for foreign currency accounts in Brazil, companies willing to hold foreign exchange values have to seek strategies such as creating subsidiaries overseas or transfering funds by means of non-resident accounts. Even so, the export proceeds should be surrendered first, i.e. sold to a Brazilian bank by means of a foreign exchange contract, and then possibly bought again for remittance. The same applies if the exporter has payments to make abroad. The main costs that result from this framework are: (i) the transaction costs related to the banking operations; (ii) the spread between selling and buying exchange rates; and (iii) the cost of hedge strategies that could possibly be avoided if the company was allowed to hold its proceeds.

It is important to notice that the transfer of funds is not prohibited and can be legally made through the TIR mechanism. However such operations still have expressive transaction costs and demand some financial expertise; therefore they are not easily available to all companies, especially not to the small ones.

Consequently, Brazilian firms dealing with international businesses must face a financial cost that impacts their earnings and competitiveness. Trying to measure this impact goes far beyond the purpose of this paper, but this is an issue to have in mind in two dimensions: first, many Brazilian companies are global market players, and one decimal of percentage in their margins can decide their fate in a competitive arena; second, financial costs and exposure to exchange risk may be proportionally even more harmful to the small companies that try to enter the international market. As the country evolves from a closed to an open economy and so much importance is put in export performance as a means of reducing the dependency on volatile international capital flows, the ability of national firms to compete in foreign markets is crucial to a sustained development. Thus, reducing costs and improving the overall efficiency of the economy must be a commitment of government and private sector.

The point here is that exchange controls pertaining to international trade should be discussed first and foremost in the light of the costs they provoke vis-à-vis the purposes for which they were created - especially in what concerns the equilibrium in the balance of payments.

5.4. Balance of payments constraints: is liberalization possible?

Brazilian regulations have been gradually evolving towards a more flexible framework. In the late 1980s the floating exchange market was created and many quantitative limits on exchange transactions were removed; capital movements through the non-resident accounts were permitted; extensive paperwork necessary to conduct commercial operations or to register foreign capital were substituted by electronic systems; finally in 1999 the previous pegged exchange rate regime was substituted by a floating rate exchange regime, a rupture with the former foreign exchange policies that had been in place since the 1930s.

The successive devaluations of the real since 1999 helped to catapult exports and restrain imports, resulting in increasing trade balance surpluses since 2001. The Brazilian economy relies upon this trade flow to secure a stable balance of payments, as capital flows seem to be more reluctant to move into emerging markets than they were in the 1990s.

How would the relaxation of exchange controls affect this scenario? Different opinions emerge from very acknowledged economists. In a recent article the former president of Central Bank Persio Arida advocated the convertibility of the national currency as a further step in the path of economic stability. He clarifies that by convertibility he denotes the elimination of restrictions for the exchange of *reais* by foreign currencies and vice-versa, without any proposal to facilitate the use of foreign currencies as a means of payment in domestic transactions.

Attempting to control capital flights in a country with a chronic inflationary economy, he says, legislators tried to avoid that the dollar was used as reserve of value, and thus introduced several restrictions to the purchase and accumulation of foreign exchange. He considers that the current regulatory framework does not reflect the changes occurred since 1999, when the floating rate foreign exchange regime was adopted together with an economic policy based on primary budget surpluses and interest rates oriented to inflation targets. As an example, he mentions the maintenance of the two foreign exchange markets (the so-called "free" and "floating" markets) after their rates were unified. The distinct regulations for each market, despite being currently liberal, allow the Central Bank to reintroduce restrictive controls at any moment.

These controls are seen by potential investors as a disincentive to invest in Brazil, given the risks of changes in legislation that could impose restrictions in the outflow of capitals. This perception also results in higher premiums in the international market interest rates charged on Brazilian

borrowers, and consequently on higher domestic interest rates. As another advantage of full convertibility he points to the cut in the costs of transaction with the external market, which would bring efficiency gains to the economy as a whole. Such liberalization would not affect the flow of information to the Central Bank, as rules should demand that transactions be properly reported. Finally he recognizes that convertibility has been achieved to some extent, and that the process towards full convertibility should be implemented gradually.

A second former president of the Central Bank, Gustavo Loyola, has the same beliefs. He compares the Brazilian foreign exchange legislation to a patchwork and also thinks that many foreign investors see it as an additional source of risk, particularly Law 4131/1962.

Another former president of the Central Bank, Gustavo Franco, expressed a different opinion in an article published in 2001. He remarks that the basis of the foreign exchange legislation in Brazil are Decree 23258/1933 and Law 4131/1962, and that the current rules allow a *de facto* convertibility for the current account together with controls for the capital account, albeit some transactions have special treatment. He believes that revocation of the mentioned legislation would be equivalent to opening the capital account and that the full convertibility could result in significant outflows of capital.

6. FINAL REMARKS

As described in Section 2, the mechanisms of exchange control used in Brazil over its history embrace a large variety of instruments. A non exhaustive list should include export proceeds surrender requirements, dual markets and multiple exchange rates, rights granted to exporters to resell part of their proceeds at different rates, import licenses allocated by different criteria and

procedures, import financing requirements, advance deposits, rebates on import duties for exports, exchange auctions, and export and import subsidies.

With respect to international trade operations, the current exchange controls rely upon import and export registrations, export proceeds surrender requirements, prohibition of private compensation with non residents, and restrictions on foreign exchange accounts.

The pertinent question addressed by respected economists and policymakers is: given the current scenario, are these controls still justifiable?

Controls on exchange operations exist because foreign exchange is a scarce good whose price affects the economy as a whole. As long as there is not certainty that the supply (mainly export proceeds and capital inflow) will be enough to match the demand, there is a temptation to control both the supply (hence the proceeds surrender requirement) and the demand (hence the limits and controls on the purchase of foreign exchange and capital outflows). A market without restrictions may work properly when economic agents have the expectation that voluntary supply will clear the full demand at a reasonable price. This implies a stable economy with fiscal responsibility, equilibrium in the balance of payments and controlled inflation, conditions that are implicit in the words written by Mr. John H. Williams in 1934, quoted in Section 1.

This is the trail being tracked now. However, not only weaknesses like a high debt/GDP ratio and an overall budget unbalance may disturb the march, but also unexpected obstacles seem to be waiting at every moment, such as the Argentinean crisis, the Enron affair and the pre-electoral instability experienced in 2002. As long as the balance of payments is not immune to episodes of this nature and to the moods of international capital flows, some kind of control should be expected, even if it is latent in the legislation to be put in practice only when necessary. An

example of this tactic is given by the Central Bank of Chile Organic Law with regard to export proceeds surrender requirements, as reported in Section 4.1.

Any regulation must be viewed through two prisms: necessity and cost. Out of the many laws, decrees and decree-laws presented in Section 2, some old survivors still live in the present legislation, which has two possible and contradictory meanings: first, they are good pieces of legislation, since they have been being used for so long; second, they may look anachronistic given the evolution of information technology, the level of sophistication achieved by international businesses, and the changes in the Brazilian economic policy, especially in the foreign exchange regime. This paper has no intention of proposing regulatory modifications, but even assuming that no wider liberalization is feasible so far, there are at least some specific points related to international trade operations that deserve to be evaluated from the necessity-versus-cost point of view.

As seen before, many developing countries have been moving towards lighter proceeds surrender requirements, either by demanding simply that the receipt and destination of the proceeds are reported to the Central Bank, or by permitting that exporters keep at least part of the proceeds in foreign currency accounts, under certain rules. Two immediate benefits for the exporter can arise from this: a natural and inexpensive hedge for external liabilities and lower financial costs. Such an arrangement logically implies reviewing the issue of private compensations as well.

Regarding day-to-day aspects of controls, there is always space for improvement, as shows the recent release of the internet-based RedeCec. With the growth of international trade flows in the Brazilian economy and the resulting increase in the number and volume of corresponding

financial transactions, the use of information technology is the basis of surveillance and enforcement, plus being an efficient instrument, if well used, to simplify, speed up, and "debureaucratize" procedures. Whenever possible, *a priori* authorizations must give place to *a posteriori* effective controls, and as economic stability consolidates, controls should focus primarily on the legitimacy of the transactions.

Moreover, reinforcing what was stated in Section 3.3, no matter which exchange arrangements exist, legislation needs to evolve in order to make administrative sanctions more effective by reaching not only the juridical persons involved in illegal operations, but also their shareholders and/or directors.

Finally, one must have in mind that this paper deals with a living subject, as prove the words of the Deputy Governor for International Affairs of the Central Bank of Brazil, Alexandre Schwartsman, who said in his investiture speech (November 7th, 2003):

> *"There is today a perception, that I would not dare to call consensual, but, at least, widespread among the people who think the Brazilian foreign exchange system, about the necessity to move on with its evolution, keeping the tendency of reform that already comes from some time. The challenge in this realm is to design a reform that provides the country with modern exchange regulations appropriate to the floating exchange regime, safely and gradually, and that essentially simplify the system operation."*

APPENDIX – EXPORT FOREIGN EXCHANGE REGULATIONS FOR SELECTED COUNTRIES

Export foreign exchange regulations for selected countries		
Country	Repatriation requirements	Surrender requirements
Argentina	Yes	Effective March 2003 export proceeds must be sold in the foreign exchange market within 90 days after their due date.
Bolivia	No	No
Bulgaria	Yes	Proceeds may be retained in foreign currencies or sold in the exchange market.
Chile	Exporters must report the receipt and destination of proceeds received fom exports above US$ 10,000.00.	No. Regulations allow Central Bank to impose the repatriation and surrender of proceeds in exceptional circumstances (Ley Organica Constitucional del Banco Central de Chile, articles 49 and 50).
China	Yes	Effective October 15, 2002, all enterprises authorized to conduct current account transactions may retain foreign exchange equivalent to 20% of their current account foreign exchange earnings in the previous year, except for special purpose transactions; the remaining amounts must be surrendered to authorized banks.
Colombia	Yes	Proceeds must be surrendered to an authorized intermediary within six months or maintained in foreign accounts registered at the Banco de la Republica. Special provisions apply to coffee exports.
Costa Rica	Yes.	Exporters must report receipt from exports within 90 days after the end of the fiscal year.
Czech Republic	No	No
Ecuador	Yes	All proceeds must be surrendered to authorized financial entities. Exporters may retain up to 15% of their proceeds to cover costs abroad (30% in the case of marine products). Minimum references prices are established for some products.
El Salvador	No	No
Honduras	Yes	Exports earnings must be surrendered to banks or exchanges houses within 20 to 85 days. Commercial banks and exchange houses must sell all the purchased foreign exchange to the Central Bank. Exporters are allowed to retain up to 30% of their foreign exchange proceeds to finance their own imports and to pay authorized external obligations.
Hungary	No	No

Export foreign exchange regulations for selected countries		
Country	Repatriation requirements	Surrender requirements
India	Yes. Proceeds must be repatriated within six months of shipment unless otherwise specified by the Reserve Bank of India.	Exporters are permitted to retain up to 50% of foreign exchange receipts in foreign currency accounts with banks in India (up to 70% in the case of 100% export-oriented businesses, those in export processing zones, and those in hardware/software technology parks).
Indonesia	No	No
Lithuania	No	No
Malaysia	Proceeds from exports must be received and repatriated according to the payment schedule specified in the commercial contract, but no later than six months after the date of export.	Effective April 1, 2003, exporters are allowed to retain their export proceeds in foreign currency accounts with designated banks with an overnight limit of between the equivalent of US$ 1 million and US$ 70 million, or any larger approved amount.
Mexico	No	No
Nicaragua	No	No
Panama	No	No
Paraguay	No	No
Peru	No	No
Philippines	No	No
Poland	No	No
Romania	No (requirements abolished in January, 2003).	No
Russia	All proceeds from exports must be credited to their foreign exchange accounts opened with authorized banks. Proceeds are permitted to remain in accounts with banks outside the Russian Federation up to the amount necessary for execution of the obligations under credit agreements with nonresident organizations that are agents of government of OECD member states.	A surrender requirement of 50% is applied to proceeds from exports of goods, services, and intellectual property of residents, to be effected within seven days after being credited to the exporter's account at an authorized bank.
Slovenia	No	No
South Korea	Yes. Effective February 7, 2002, proceeds exceeding US$ 100,000.00 must be repatriated within 6 months of receipt (previously US$ 50,000.00). However, they may be held abroad and used for overseas transactions in accordance to regulation.	No

Export foreign exchange regulations for selected countries		
Country	**Repatriation requirements**	**Surrender requirements**
Thailand	Export proceeds exceeding the equivalent of B 500,000 (circa US$ 12,500) must be repatriated immediately after payment is received and within 120 days of shipment.	Proceeds must be surrendered to authorized banks within seven days of receipt. Deposit in foreign currency accounts are allowed if the payee has obligations to non residents abroad within three months of the deposit date.
Turkey	Yes	Proceeds must be surrendered within 180 days from the date of shipment to banks or special financial institutions. Exporters may retain foreign exchange receipts up to US$ 50,000. If at least 70% of the foreign exchange receipt is surrendered within 90 days following the date of shipment exporters are entitled to retain the remaining 30% which they may deposit in foreign exchange accounts with commercial banks, keep abroad, or dispose freely.
Ukraine	Exporters must repatriate all foreign exchange proceeds through domestic commercial banks within 90 days of shipment (authorization required for longer periods).	There is a 50% surrender requirement.
Uruguay	No	No
Venezuela	Yes	Effective February 2003 all export proceeds must be surrendered to the Central Bank. Oil exporters may retain 10% of their proceeds for export related expenses.
Vietnam	Yes. All receipts originating from current transactions must be repatriated immediately.	Effective May 1, 2002, resident enterprises must sell 30% (previously 50%) of their foreign exchange earnings to banks. On April 17, 2003, the surrender requirement was reduced from 30% to zero.

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