

International Bank for Reconstruction and Development  
International Development Association  
International Finance Corporation  
Multilateral Investment Guarantee Agency

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EDS2000-47  
March 29, 2000  
02:04:36 PM

Statement by Murilo Portugal  
Date of Meeting: March 30, 2000

**Brazil CAS**

1. I wish to commend Bank, IFC and MIGA staff for yet another CAS of excellent quality for Brazil, both in terms of the contents of document and the process of its preparation. The CAS contains a comprehensive presentation of the macro-economic situation, the most important government policies in the areas relevant to the World Bank Group' priorities, and proposes a carefully designed strategy for the next three years. My authorities broadly concur with the proposed strategy. The CAS was prepared in close consultation with the Brazilian Government. The Bank and IFC have also undertaken a process of consultation of around 70 people in Congress, sub-national governments, academics, civil society organizations, and representatives of the private sector and conducted a survey of the views of 632 poor individuals, as described in the document.

**Recent macroeconomic developments and prospects**

2. Despite the exchange rate crisis experienced by Brazil in late 1998 and early 1999, economic performance last year has been significantly better than expected. GDP growth was 0.8 per cent compared to a decline of 4 per cent originally expected. Employment rose by more than 2.5 per cent allowing for a slight decline in the unemployment rate, despite the significant increase in the labor force. Consumer price inflation was 8.8 per cent, despite a nominal depreciation of the *Real* of almost 50 per cent and major increases in oil prices that were necessary to adjust domestic prices with the international price hike. Inflation remained within the inflation target band of 6 to 10 per cent established by the government.

3. The trade deficit declined from US\$ 6.6 billion in 1998 to US\$ 1.2 billion last year, helped by a process of efficient import substitution, despite the decline of 13 per cent in the terms of trade caused by higher oil prices and lower agricultural commodity prices. Import volumes declined by about 15 per cent, while output growth was positive. Export performance also improved gradually during 1999 and during the last quarter export volumes rose by 23%

year-on-year. The current account deficit narrowed by over US\$ 9 billion to US\$ 24 billion, and was more than fully financed by FDI net flows that reached nearly US\$ 30 billion in 1999. Net international reserves stood at US\$ 24 billion at year-end. Gross reserves, which include the financial assistance of the IMF and of the countries participating in the support package, were US\$ 39 billion. Brazil has already repaid to the IMF and these creditors US\$ 8 billion. Market confidence was restored and the international capital markets reopened for Brazil as early as April of last year. Despite the inhospitable environment for emerging countries that prevailed last year in those markets, Brazilian medium and long-term issues, both by the public and private sectors, reached US\$ 17 billion, even though spreads have remained much higher than those prevailing before the Asian crisis.

4. During the last quarter of 1999 the economy was growing at an annualized rate of 5.8%. The Government expects growth of 4 percent this year. The inflation target for end-2000 is 6 per cent, within a tolerance band of 4 to 8 per cent. The trade balance is expected to continue its improvement and to post a surplus. The current account deficit is expected to decline further to 3.5 per cent of GDP and, again, to be fully financed by FDI. The overall balance of payments is projected to post a surplus leading to an additional increase in international reserves. Brazil sovereign debt issues in the first quarter of this year amounted to US\$ 2.7 billion.

### **Policy and reform implementation**

5. These positive macroeconomic developments and prospects show how much determined policy implementation and international cooperation can achieve even in a very difficult environment as the one posed by international financial turmoil of the last 3 years. On behalf of my Brazilian authorities and on my own name, I wish to thank the Bank and the countries that participated in the international financial package for their support.

6. There was a fiscal turnaround last year. The primary surplus of the consolidated public sector (central government, states, municipalities and public enterprises) was about 3.1 per cent of GDP, compared to an equilibrium position in 1998. This allowed the public sector net debt to be reduced below the IMF program target for last year of nearly 51 per cent. These results were achieved both through increase in tax revenues and expenditure control, while protecting spending on education, health and other target social programs. Worthwhile of notice has been the improvement in the primary balance of the states that shifted from a deficit of 0.4 per cent of GDP in 1998 to a surplus of 0.15 per cent last year.

7. A new inflation-targeting framework for monetary policy was successfully established. Interest rates that started the year above 45 per cent were gradually brought down to 18.5 per cent.

8. Structural reforms continued to be gradually but steadily implemented and consolidated through a laborious consensus building process within political system that, while time consuming, should produce lasting results.

9. The Loans under consideration today for social security and administrative reform are important building blocks in this process. The government has secured congressional approval for the administrative reform and for introducing principles of actuarial balance within the current pay-as-you go system of the private sector workers. Bills regulating both private and public pension funds will allow these complementary pension mechanisms to grow in importance over time.

10. A Fiscal Responsibility Law has been cleared by the House of Representatives after extensive public and congressional debate and is now being considered by the Senate. The bill should allow for a major overhaul in the country's fiscal federalism. It will establish a comprehensive framework for prudent fiscal administration, encompassing the Executive, Legislative and Judiciary branches at federal, state and municipal levels and their respective publicly controlled enterprises. The law establishes directives for fiscal management, planning, budget execution, fiscal accountability and transparency. Fiscal accountability is to be enhanced by bimonthly publication of follow-up reports and by quarterly compliance checks. In parallel to the Fiscal Responsibility Law, Congress is considering a Fiscal Crimes Law to hold public officials accountable in their personal capacity.

### **Poverty Alleviation**

11. Reducing poverty and inequity of opportunities remains a great and yet unresolved challenge to governments and societies around the world, especially in developing countries, and it is no different in Brazil.

12. Brazil is fully committed to reduce poverty by half by 2015. A necessary, though not sufficient condition, to alleviate poverty is to maintain a stable macro-economic framework with low inflation and external financing viability, capable of ensuring per capita growth larger than population growth on a sustainable basis. This has been the highest priority of the Cardoso Administration since 1994. However, there are deep rooted historical and structural causes for poverty that are cannot be overcome in the short-term.

13. International financial crises from 1997 onwards culminating with our own exchange rate crisis in late 1998 and early 1999 have also had the unfortunate results of reducing growth and producing a temporary halt in the substantial gains in terms of poverty reduction brought about by the Real Plan. As inflation resumes a downward trend and growth picks up, absent new external shocks, income poverty indicators should improve over the coming years. As the poverty rate in Brazil is lower than the developing countries average and as marginal improvements are typically harder to make, one could expect that growth in Brazil would have a lower poverty reduction elasticity when compared to the developing countries average.

14. My authorities agree with the Bank analysis that fiscal reforms are by far the highest priority for pro-poor economic growth. Equally important are measures designed to lower the cost of capital, to increase labor productivity and to reduce regional disparities. Simplistic estimates of the amount of resources that would be required to close the aggregate policy gap through income transfers do not convey the appropriate policy message.

15. I would like to clarify that in Brazil there are no legal limitations to the participation of the poor in decision-making processes of relevance to them. The poor have the same political rights and representation as any other citizen. Poverty issues stand high in the Congressional agenda and in the national political debate. There is also strong participation of community associations and civil society groups that claim to represent the poor in several decision-making processes.

16. There is a very strong commitment by Brazilian government to expand access and improving quality of the public services as a way to increase equity in opportunities, thereby helping the poor to take advantage of economic growth. Expenditure on education in Brazil corresponds to 4.8% of GDP, in line with the OECD average of 4.9%. However, these resources are not well targeted, as expenditure per student at tertiary education is 12.8 times higher than at primary education and 9.9 times that of the secondary level, compared to the average 2.3 and 1.8, respectively, in the OECD countries. The Federal Government elected basic education as its highest priority since 1994, complementing the efforts and actions of states and municipal governments under whose responsibility primary education lies. Secondary education, also under the responsibility of subnational governments, has been receiving increased federal attention as well. Beyond the objective of expanding access to schools to all children, educational programs encompass training teachers and raising their qualifications in poorer areas, improving school management and monitoring and evaluation of quality standards.

17. The policies adopted since 1994 have already yielded concrete results. The share of seven to fourteen-year-olds in school increased from 89% in 1994 to 96.6 % of the population in that age group in 1999. The number of students completing primary and secondary education increased by 50% and 67.8% respectively, in the same time period.

18. The Federal Government has also given high priority to basic health care. From 1996 to 1999 resources allocated to basic health have increased by 208 percent. This new policy has a strong emphasis on prevention. Health agents hired at poor communities have the responsibility of visiting neighborhoods to provide guidance, identify problems and follow up health procedures. The number of such community Health Agents increased threefold between 1994 and 1999 to 111 thousand individuals. In parallel, a family health program was created, where teams of one doctor, a nurse and up to six health agents visit families on their homes to provide care. The number of teams increased fifteen-fold between 1994 and 1999. Another important program relates to free distribution of milk to children from 6 months to 2 years of age who face nutritional risks. Also, the Federal Governments undertake periodic national vaccine campaigns to children and the elderly (influenza), covering in many cases up to 95% of the targeted population.

19. Decentralization is an important feature of the basic health care strategy. The programs mentioned above are carried out with the help of states and particularly municipalities that receive transfers of resources from the Ministry of Health. Access to these resources is subject to criteria that include the constitution of local health councils, with the participation of community members. These bodies allow the communities to influence priority setting and to control of spending in those programs.

20. Under consideration by the Board today is a loan to support social security reform. The social security deficit and the distortions of this system, which the government is seeking to correct by this reform, are well known to Board members. What is less known, however, is that embedded in our social security system there is a large and well-functioning social safety net for the rural poor and the elderly. Of the 18,3 million Brazilians who receive social security benefits, 7.9 million are rural workers, elderly or disabled people who never contributed to the system.

21. As described in the CAS document, poverty in Brazil is substantially concentrated in rural areas, and one critical means of improving living conditions in those areas is through asset distribution by land reform. From 1995 to 1999 373 thousand families have been settled in some 13 million hectares of land. This is 70 per cent more families than what had been achieved in the previous 30 years, since land reform law was enacted in 1964. Most land reform has been implemented through paid expropriation of land. However, land expropriation can sometimes be costly and slow due to judicial litigation and requires a higher degree of centralization of decisions in Brasilia. The Federal Government decided to complement the land reform program with a market-based, decentralized, community-driven mechanism where by resources are lent directly to rural workers and poor farmers associations to negotiate and buy the land directly. This program has been piloted in nine states with the support of the Bank, with the Brazilian government financing land acquisition and the Bank financing productive investments, technical assistance, electrification, irrigation, and other inputs to the new farmers. Some 15,000 families are benefiting from the pilot experience while another 28,000 families await for its extension. Building on this promising pilot experience, the Government created a program (Banco da Terra) to meet the increasing demand for this land reform approach by communities in several states. In addition to land distribution, provision of infrastructure and technical assistance, a National Program of Education in the Land Reform in the settlements was launched in April 1999 to provide basic education for children and training on farm management for adults. The program is carried out with the help of operational NGOs and churches. So far 62.7 thousand people have benefited from this program in 616 municipalities in 21 states.

22. Another priority refers to elimination of child labor. This problem occurs more frequently in some rural regions and in particular industries such as charcoal, sisal and sugar production. The government has stepped in firmly since 1996. Last year the budget for this program had risen to R\$ 82.7 million to support 145,507 children with scholarships that allow them to abandon work and to attend school.

## **Environment**

23. There are a number of environmental programs under implementation in Brazil, some with the support of the Bank, some of which are described in the CAS. The main policy undertaken is finalizing the Brazilian Agenda 21, which are results of prior commitments made in the Rio Earth Summit in 1992. A Commission composed of high government officials and representatives from NGO's, think tanks, the private sector, help of different consortia of local institutions, and workshops around the country, has made "thematic documents" proposals in six areas: sustainable cities, sustainable agriculture, reducing social inequalities, infrastructure and

regional integration, natural resource management and science and technology for sustainable development. By the end of 2000 the process should be concluded and the final document adopted.

24. In parallel to this national process, states and cities throughout the country are expected to prepare their own local Agendas 21, which would then form part of the national Agenda. Also, five states have initiated similar agendas.

### **Role of the Bank**

25. As mentioned in the CAS, the role of the Bank in Brazil is small but not insignificant. Lending operations are correctly concentrated in a few high priority areas, but the policy dialogue evolves around a larger spectrum of themes. We agree with the priorities selected for this CAS and, therefore, have just a few observations with respect to the future role of the Bank in Brazil.

26. First, the Bank should strive to increase over the next few years the integration between its program and the Brazilian budgetary process, a move that has already started. This would guarantee both that the Bank finances the existing fiscal deficit rather than contribute increase such a deficit and would substantially increase the development effectiveness of the Bank's interventions. Brazil has a well-developed budgetary process that allows for long term development planning. The budgetary process is composed of three key instruments, namely a multi-year plan (PPA), an annual budgeting guidelines law (LDO), and the annual budget proper (LO). The PPA now under consideration by the Brazilian Congress is a four-year investment program covering 2000-2003, and encompassing 365 projects. It is both a budgetary and a development tool, comprising public and private investments in the areas of energy, telecommunications, social development, environment, information and knowledge in all regions of the country. The studies that supported the design of this program had the involvement of some two thousand professionals and its preparation was subject to extensive consultations with sub-national governments and civil society in all 27 states. A greater integration between the Bank's lending program, the PPA and the annual budget could improve management and lead to a new relationship between Brazil and the Bank in terms of defining priorities.

27. Second, in the current period of fiscal consolidation, my authorities believe that new Bank lending to the states should be limited to states that attain a primary surplus and display a debt-to-revenue ratio lower than the one envisaged in the debt rescheduling agreements, or for loans that have already been included into those agreements. These conditions should apply to all state lending, including strictly poverty-targeted projects. The future gradual replacement of current administrative controls for market discipline, proposed in the CAS document, is certainly desirable but would be possible only in relation to those lenders that are prepared to accept the market risks and to lend to the states without a federal guarantee.

28. Third, we agree with the Bank analysis that a comprehensive growth agenda that would favor pro-poor growth should include the provision of adequate infrastructure, especially in the transport area, and the removal of infrastructure bottlenecks for more vigorous export growth. Whenever possible, this should be done by the private sector or in conjunction with the private

sector. However, when this is not feasible, public investment would continue to play an important role and we would welcome the Bank giving a high priority for lending in these cases.

29. Fourth, as I have argued in other occasions, in coming years the Bank should focus more attention in the area of science and technology. Once the strategy for science and technology, now under preparation, is completed the Bank should scale up its support to help borrowing countries take advantage of the ongoing technological revolution and leapfrog obstacles to development and poverty alleviation. Again, Brazil would be in a good position to benefit from such undertaking as it already possesses a critical mass of human resources to absorb technology and use it effectively within its own circumstances.

30. Fifth, a more diverse and imaginative array of Bank instruments will be needed to tailor effective interventions. In this respect I would like to encourage Management to continue exploring possibilities of using programmatic loans for the purpose of supporting time-slice operations of the budget in countries that have well developed budgetary institutions, as well as a good system of internal controls and external auditing mechanisms in place.

31. Decentralization has helped the Bank to improve its understanding of the country's needs and concerns and its effectiveness on the field. I would like to thank Mr. Nankani and his team for the excellent and exemplary job they are doing in Brazil

### **Private sector development**

32. Brazil has a solid and vibrant private sector, including a sound financial sector, that has been the main engine of growth over many decades. At the same time there remains an important shortage in terms of long term financing, especially in second-tier companies. The CAS document rightly pointed out that low financial intermediation constitutes an impediment for greater private sector investment in Brazil. All I can say at this point is that the Government is very much aware of this situation and has established a high level commission, chaired by the Central Bank Governor, to look at ways to improve financial intermediation both in the banking sector and capital markets. IFC has an important role to complement to the domestic long term financing mechanisms for the private sector.

33. I also very much welcome the increased focus on high technology initiatives by IFC, such as the SoftBank Fund. Although Internet access per se, including free access, is growing rapidly in Brazil, the speed at which companies in general plug on to the network could be enhanced by the existence of specialized firms such as those envisaged in the IFC project. We would welcome other IFC initiatives in the high technology industries.