Statement by Yahya A. Alyahya  
Date of Meeting: March 30, 2000

BRAZIL: Country Assistance Strategy; Fiscal and Administrative Reform  
Special Sector Adjustment Loan; and Social Security Special Sector Adjustment Loan

I welcome the discussion of this CAS for Brazil. The report is very informative, perhaps too much so. I also welcome the frank discussion of the issues and the challenges facing the country in the CAS, as well as in the accompanying two operations.

The Government’s determination and success in sailing safely through the turbulent international financial crisis of recent years deserve our commendation. This should also give us greater confidence in the Government’s commitment to continue implementing the challenging reform agenda, in spite of the obstacles that it could meet from internal opposition to reform. The Government’s proven willingness and ability to find alternative solutions, when faced with setbacks, in order to remain on track with reform, augur well for the successful implementation of its reform agenda. With these words, I can support the main thrust of the CAS and the two accompanying operations.

Let me now turn to more specific comments on the CAS:

I am pleased to note that the Bank’s assistance strategy uses the Government’s development strategy – PPA 2000/3 – as its main reference. This should strengthen ownership and improve the prospects for successful implementation of the CAS. I am also pleased that both the CAS and the Government’s development strategy focus on achieving sustainable reduction in poverty. In this context, while I find the analysis of institution building and the environment, and their link to growth and poverty interesting, I will focus my comments on the sections on poverty and economic development and growth.

Regarding the analysis of poverty in the text and in Annex 4, I have the following comments.
First, it seems to me that by using a food-only poverty line, as mentioned in footnote 2 page 4, the headcount poverty rate of 22 percent in 1998 could be substantially underestimated.

Second, the poverty profile provides a good basis for targeting the poor more effectively. From the analysis, it appears that the Bank and the Government are right in targeting the Northeast. However, it would have been useful to show whether the profile changes as the poverty line is shifted upwards or downwards, and to provide other measures (such as the Foster, Grear and Thorbeck poverty index) to give a sense of the depth of poverty across the profile categories. This latter measure of poverty would also indicate which policies – growth policies or redistribution policies -- would be more effective in reducing poverty in the country. My first impression is that, given that the income distribution in Brazil is significantly skewed, redistribution policies could be more effective.

To some extent, this impression is supported by the discussion in paragraphs 30 and 31 of the report. Figure 1 and the analysis show that to reduce poverty by half by 2015, and given the income effects of educational achievements, the economy would have to grow by an annual rate of 6 percent. With lower growth rates, the shortfall would have to be made up by structural social policies and improved social protection. As indicated in paragraph 30, these policies tend to contain a significant element of income redistribution. It is this aspect of the reform agenda, which generates so much resistance and the biggest challenge to the Government’s reform agenda.

Regarding Economic Development and Growth, it is clear from the report that in spite of improvements, the private sector is unable to play its role to the extend it could. The reasons are mentioned in the report and include large public financing requirements, which crowd out private investment; the persistent high interest rates; and infrastructure bottlenecks, especially in transport and power.

In this context, two aspects are important for growth and poverty reduction. First, is the need to develop and support small and medium enterprises, which has been identified as a concern for the private sector. Such enterprises are more likely, than large enterprises, to translate growth into employment and poverty reduction. I am, therefore, pleased to note that the Bank would be contributing to a study on the pattern of growth and poverty reduction. I look forward to reviewing this study.

The second aspect, which is important for growth, is to further stimulate growth of export. The CAS, as the trade paper for the Development Committee, rightly emphasizes the need to develop trade-related infrastructure and to invest in human capital. I am particularly pleased to note that the Bank Group is supporting these important sectors.

Turning now to the lending program, I can support the levels indicated for the three-year 2000-2002, as well as the composition between adjustment and investment lending. I believe the temporary shift to relatively more adjustment operations is warranted under the circumstances, so is the planned shift from lending to the states to lending more to the federal government. In this context, I have noted that a high-case lending scenario has not been developed, but the
possible triggers are mentioned in footnote 32. It would be helpful if staff could give some indication on the level and composition of increased lending under such a scenario.

Let me now turn to the two operations accompanying the CAS. Both the Fiscal and Administrative Reform, and the Second Social Security operations aim at achieving fiscal sustainability, which is the key to lowering interest rates, accelerating growth and reducing poverty. I have the following comments on each of these operations.

On Fiscal and Administrative Reform, I have noted the relationship between personnel expenditures, the level of indebtedness and the primary deficit described in paragraph 31. More specifically, higher personnel expenditures contribute to higher indebtedness, and the two are the main causes of fiscal distress. With debt agreements having been reached between the federal government and the state governments and becoming more binding, the states are expected to be forced to take measures to reduce personnel expenditures or increase revenues. Personnel expenditures consist of wages and social security benefits. The latter will be addressed by the Second Social Security operation, which should yield longer-term results. As for reducing the wage bill, it is clear that the envisaged measures can be reversed. It is also possible that the coming municipal election could make implementation of the needed measures more difficult, at least in the short run.

On the Second Social Security operation I just have the following question:

Consistent application of the new benefit formula, mentioned in paragraph 30, is crucial for reducing the fiscal burden. In this context, it would be useful to know how the actuarial coefficient is determined, and whether this could lead to an abuse of the formula. Are there other proposals that the Bank and the Government may have considered that could avoid such a possibility?

Finally, I wish the authorities every success.