Board Meeting of June 12, 1997
Statement by Julio J. Nogués

Brazil: Country Assistance Strategy

I want to start by congratulating staff and management of the World Bank Group (WBG) for this comprehensive and focused CAS which our Chair endorses with enthusiasm. The proposal to increase lending to Brazil is welcomed but in its attempt to achieve this goal, the WBG will face a stringent market test. This is so because an all inclusive estimation could reveal that the costs of doing business with the Bank might not be much lower than the cost at which the Government of Brazil (GoB) is obtaining money from the international bond markets. Under these conditions, the Bank’s efficiency will be tested and we are confident that management will be successful.

The following are some specific comments.

Basic education

My reaction when reading the document was to feel very enthusiastic about the prominent supportive role that IBRD will play over the medium run in the area of basic education. Most of the times the WBG is called upon to play a supportive role over a wide spectrum of economic, social and environmental issues, but on a few occasions have we ventured to set our medium-run priorities. This CAS for Brazil stands as an exception which might be worth replicating in other countries. Because I believe that the Government’s goal of achieving universal primary education by 2007 is of fundamental importance, I fully support the selection of the sector where the Bank plans to remain engaged beyond the times of this CAS. Furthermore, given the unequal distribution of income that characterizes the LAC region and the central role that only basic education can play in reducing this inequality, I urge Management to engage in this sector in the region as much as it is engaging in Brazil. In fact I believe that in the upcoming years, basic education has the potential of becoming the centerpiece of the Bank’s assistance strategy to the region.

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Progress of the Real Plan

The progress achieved by the GoB in stabilizing and restructuring its economy are impressive. This progress provides the Bank with a unique opportunity of assisting in the massive transformation of this economy that still lies ahead. Clearly, the remaining fiscal deficit and the slowly growing current account deficit forecasted in the CAS, are matters of concern. In this regard, we agree with the document that the sooner the Government introduces the needed reform measures including the administrative reform, the social security reform, and the tax reform, the sooner will their effects show in the further consolidation of fiscal finances and therefore, in the continued decline in the cost of capital and growth of productivity.

Stabilization, poverty and unemployment

We agree with the CAS assessment that it is the progress in the Real Plan which underlies the reduction in poverty indicators recorded in recent years. Nevertheless, we have to remain alert because major structural transformations have yet to be implemented. Although I agree that labor market flexibility is higher in Brazil than in other countries in the region and therefore that it is more unlikely that unemployment will grow importantly, it would be imprudent not to be prepared for the event that this occurs. Furthermore, the own dynamics of the labor market forecast an increasing female labor force participation. The experience of other countries in the region suggests that in order to protect the poorest and less educated as well as the reform program, we have to remain alert and be prepared in case negative labor market developments occur.

Financial sector

We share the importance stressed in the document on the need to strengthen the financial sector in general, and the banking sector in particular. In this regard, we believe that the bank consolidation process that has taken place in recent years and the soon to be launched privatization of several state banks are important steps in the right direction. Nevertheless, further negative developments could appear and we have to keep in mind that there is still an important room for introducing additional measures that will help to strengthen the financial sector and thereby, to induce greater confidence and savings.

Private sector development and IFC

The different roles of IBRD and IFC in furthering the development of Brazil’s private sector are well explained in the CAS and I’m impressed by the important role that the Corporation is already playing. Brazil has one of the highest exposure ratios but as long as good economic and social policies prevail, I do not believe that this should be an obstacle to higher levels of IFC lending. The Government needs the support of the private sector which will be
forthcoming if it is able to adjust to the shift of economic policies. For this it needs low cost financing and knowledge both of which can be provided by IFC.

**Private sector development and MIGA**

The CAS document also highlights the catalytic role that MIGA will play but here I would have liked to see more candor. Brazil has nearly hit the current country limit guideline set by MIGA and therefore, there is practically no room left for additional operations. This contrast with the tremendous needs that Brazil has for MIGA’s guarantees at the present transitional stage of its reform program. This is a clear example of how costly it can be to a country our lack of agreement to capitalize MIGA and/or provide it with additional operating resources.

**Infrastructure needs and IBRD’s guarantees**

The infrastructure investment needs of Brazil are quite impressive and by one estimate, they stand at $20 billion per year (paragraph 15). IBRD loans will be playing a role in sectors where the Government plans to remain an important player but given the fiscal constraints, only a massive privatization drive will be able to attract significant private funds to this sector. Although I recognize that these funds could also be attracted with IBRD guarantees, we are concerned with the CAS statement that “...the goal of bringing to the Board a guarantee operation in FY97 was not met...” (paragraph 43). Given the prudent behavior of the GoB, it is our view that the Bank should not be seen as pushing the use of this instrument. Furthermore, as the document admits, “...progress is expected to remain slow...”. In short, the experience in Brazil shows the importance for IBRD to continue searching for alternative modalities of providing guarantees.

**Productivity, liberalization and deregulation**

The benefits of trade liberalization and deregulation of the economy have already started to show in growing productivity. Deepening these reforms will continue to support this trend which in turn and over time will show in improved export performance and employment creation. The appreciation of the Real induced by fiscal deficits and high real interest rates (paragraph 9) have resulted in balance of payments pressures and the introduction of some protective measures (paragraph 7). If these measures are left for a long time, they will retard the growth of total factor productivity and the benefits that this brings to the economy and in this regard, we are comforted by the assertion in the document that they are of a transitory nature (paragraph 7).
Economic and sector work

Page 2 of annex 2 lists the preliminary titles of the proposed Bank ESW output but I did not find a clear discussion of how it relates to different proposed projects or the crucial need for in-house knowledge that we have to acquire. Personally, I would have liked to see more work on MERCOSUR and more generally, on regional integration. For example, while I support the study on energy integration, other sectors including financial services and infrastructure projects are booming in the region. The Bank has also to prepare itself for the upcoming discussions on hemispheric integration.

I want to conclude my comments by reiterating my impression that this CAS document provides an excellent discussion of a well thought strategy. Finally, I wish the Government of Brazil complete success in the achievement of the economic and social goals they have set for their country.