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President Wolfensohn - Briefings Books for Presidents Meetings - Meeting Material
Courtesy Call - Mr Pedro Malan - Minister of Finance - Brazil - November 26, 199

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A. CLASSIFICATION

- ☒ Meeting Material
- ☐ Trips
- ☐ Speeches

- ☐ Annual Meetings
- ☐ Corporate Management
- ☐ Communications with Staff

- ☐ Phone Logs
- ☐ Calendar
- ☐ Press Clippings/Photos

- ☐ JDW Transcripts
- ☐ Social Events
- ☐ Other

B. SUBJECT: (SHORT) COURTESY CALL: MR. PEDRO MALAN, MINISTER OF FINANCE, BRAZIL (N) (B)

VENUE: E1227 (OFFICE)

CONTACT: MARY LOU BENNETT @ 80086

IN ATTENDANCE: JDW, G. NANKANI, KOCH-WESER (OPTIONAL), HOMI KHARAS, HANY

DELEGATION ATTENDEES:

MINISTER PEDRO MALAN

MR. ROBERTO JAGUARIBE, SECRETARY FOR INTERNATIONAL AFFAIRS, MINISTRY OF PLANNING, BRAZIL

MR. MURILO PORTUGAL, ALTERNATE ED

(B) NANKANI, LACVP // DUE: FRIDAY, NOV. 22

(M) BY LACVP -- DUE FRIDAY, NOV. 29

EXC: HANY // ALI (11/21)

DATE: 12/17/96

C. VPU

Corporate

- ☐ CTR
- ☐ EXT
- ☐ LEG
- ☐ MPS
- ☐ OED
- ☐ SEC/Board
- ☐ TRE

Regional

- ☐ AFR
- ☐ EAP
- ☐ ECA
- ☒ LAC
- ☐ MNA
- ☐ SAS

Central

- ☐ CFS
- ☐ DEC
- ☐ ESD
- ☐ FPD
- ☐ FPR
- ☐ HRO

Affiliates

- ☐ GEF
- ☐ ICSID
- ☐ IFC
- ☐ Inspection Panel
- ☐ Kennedy Center
- ☐ MIGA

D. EXTERNAL PARTNER

- ☐ IMF
- ☐ UN
- ☐ MDB/Other IO
- ☐ NGO
- ☐ Private Sector

- ☐ Part I
- ☐ Part II
- ☐ Other

E. COMMENTS: THIS BRIEF INCLUDES THE FOLLOWING:

- BIO
- MACROECONOMIC DEVELOPMENTS
- FIGURES

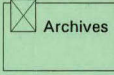
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12/17/96

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OFFICE MEMORANDUM

DATE: November 25, 1996

TO: Mr. James D. Wolfensohn

FROM: Caio K. Koch-Weser, EXC

EXTENSION: 35250

SUBJECT: **BRAZIL - Meeting with Mr. Malan**

Attached is the Region's briefing for your meeting with Mr. Malan. The Operations Committee has reviewed the State Reform operations carefully. They are an innovative response to some uniquely Brazilian problems, but there has been less progress than expected from the government. Nevertheless, the privatization and related reforms deserve our cautious support at the reduced lending levels proposed by the Region.

We expect Mr. Malan to push rather aggressively for the Bank to move quickly on the State Reform Loans and to urge that they be kept at their original levels. This should be resisted for the reasons stated in the briefing:

- The fiscal and external situations are slipping, increasing risks.
- Reforms on intra-government debt are weaker than originally discussed, which will delay the return of the states to creditworthiness.
- The Constitutional Amendment necessary to pursue civil service reform has been delayed, and there is no surety when it will be passed, particularly in view of upcoming elections.

In your discussions, bear in mind that Mr. Malan will argue that Brazil has an 'entitlement' to the Base Case level of lending (or better), citing negative net flows, low levels of new lending in recent years, etc. -- an attempt to put the monkey on our backs. It is important for you to avoid accepting this argument and to keep the onus of further reform squarely on the government's shoulders.

Attachment

Brief for Mr. Wolfensohn's Meeting with Mr. Malan
Tuesday, November 26, 1996

Key Issues for Discussion

Why is Mr. Wolfensohn having the meeting?

- Mr. Malan has requested this meeting. It is expected that he will raise the issues mentioned in the joint letter sent by him and Mr. Kandir, Minister of Planning and Budget, to Mr. Wolfensohn on November 20.

Issues expected to be raised by Mr. Malan

- Brazil's macroeconomic performance would place it "between the base and the high case scenarios" in the latest CAS. Hence, it deserves higher lending. [An oblique reference to negative net transfers to the Bank may also be made].
- Lending (US\$875 million in FY1996) is below other major Latin American borrowers such as Mexico and Argentina.
- State Reform Loans and follow up investment loans to reforming states have been slow to develop. Rapid approval has become an important signal in the Bank-country relationship. These loans are critical to aggregate lending volumes from the Bank.

LAC Region Position

- Negative Net Transfers. The negative net transfers of recent years is correct and averages US\$950 million over FY94-96. It reflects substantially higher volumes of loans in previous years when Brazil's economic performance was better and disbursement capacity was high. The weak macro-economic conditions of the period until 1994, weak portfolio performance in the early 90s, and amortization of past loans has resulted in negative net transfers. Last year's improvements in disbursements and this year's expected improvement, should give us zero or close to zero net disbursements in FY97 for the first time since the late 80s.
- Brazil in Base Case but with Growing Risk. Overall, our assessment is that Brazil remains in the Base Case, but macroeconomic risks are a growing concern. Brazil has performed above expectations on inflation indicators, external reserve position and portfolio implementation but below expectations on fiscal adjustment and the current account deficit. Of particular concern are: (i) the lack of significant progress in reducing the operational fiscal deficit in 1996 (projected at 4.7% of GDP); (ii) continuing lack of progress on external current account deficit in 1996 (estimated at 2.8% of GDP compared to 2.5% in 1995); and (iii) growth of public sector debt (expected to rise from 30.2% of GDP in 1995 to 33.7% at end-1996), (see Annex 1). World Bank efforts in FY96 were geared to improving portfolio performance as a pre-condition to expanding lending volumes. FY97 volumes can make up the prior year slippage up to Base Case levels if the State Reform Loans are approved (for a combined total of US\$580 million).
- The IMF's views. The IMF concluded an Article IV discussion last week, with a similar view: Brazil has continued progress in inflation reduction and a recovery in

growth, albeit accompanied by a weakening of the external trade balance and of public sector deficits. The IMF emphasized a need to strengthen fiscal policy (including a target for the primary surplus of the public sector of 1.5% of GDP in 1997), bank supervision to avert further shocks to a fragile financial system, and a moderate and gradual depreciation of the currency within the existing band system during 1997-98 as fiscal policy is tightened.

- Bank's Short-Term Monitoring Group's Views. The Bank's Short-Term Monitoring Group discussed Brazil last week and concluded that while macroeconomic risks were growing, Brazil should remain as a Tier 3 country for now-- a low probability of a major crisis within the next twelve months -- but should be monitored on a monthly basis.
- Bank's State Reform Loans. There have been two major developments in the economic environment since the State Reform Loans were designed. First, Constitutional amendments permitting administrative reforms (allowing redundancies in the civil service) have not yet passed the National Congress.

Second, state finances have deteriorated throughout 1996 relative to plans, although the position now appears to have stabilized. Further, the states remain highly indebted. Our earlier expectation for a return to creditworthiness in 3 to 4 years based on a "Brady"-type debt agreement between the Federal Government and the states proved politically infeasible. Recently agreed debt reschedulings (protocols have been signed with two reforming states) have eased the cash flow situation but a return to creditworthiness can only be expected in 5 to 10 years if tough fiscal control is sustained throughout by both Federal and State governments. Clearly the risks of this not working out as planned are greater over a longer period.

- From the start of the loan design, we had agreed with the Federal Government that completion of negotiations on the State Reform Loans would be deferred until the following actions were taken:
 - (1) Completion of a satisfactory debt rescheduling/debt reduction agreement.
 - (2) Concrete reform action in the states.

This was reaffirmed in Minister Malan's letter to Mr. Wolfensohn dated August 14, 1996. Even now, only Rio Grande do Sul has a debt agreement and begun major reforms. The debt agreement with Rio Grande do Sul, however, did not fulfill our earlier expectations. Minister Malan now believes it was "unrealistic" to expect an optimal agreement. The state of Minas Gerais has also signed a debt rescheduling protocol but still needs to put a major state owned bank up for sale. Rio de Janeiro has initiated strong reforms but has not reached agreement with the Federal Government on debt rescheduling.

- The long gestation of the State Reform loans has been due to the complexity of the political environment in which reforms and debt reschedulings have had to take place. The results, in terms of measures actually taken (particularly the debt rescheduling and delays in administrative reform), while perhaps the best achievable under the circumstances, fall short of what was originally hoped for. However, we believe,

after much soul-searching, that there is a sufficient critical mass of reforms to warrant going forward as soon as the above preconditions are met.

Operations Committee Decisions

- The OC has now approved our proceeding with the first two (Rio Grande do Sul and Rio de Janeiro) loans with the State Reform program in light of changes in the loan design, economic environment and risks.
- The OC has decided to keep the SRLs at 2/3rds the original amounts (i.e., at US\$200 million for Rio de Janeiro and US\$100 million for Rio Grande do Sul).
- And has decided that the follow-up investment loans to the two states will only be processed for Board approval after the SRLs are effective, and will be subject to a pre-agreed ceiling on overall lending to each reforming state.

Risks

- The State Reform operations now carry higher risk than thought when approved by the OC because, while they focus on core irreversible privatization components, they will take place in an environment of weaker state finances and slowness in achieving internal and external macroeconomic balance. The loans have become a factor in complex Federal-State government political negotiations. Nevertheless, the demonstrated political commitment of the State Government to the reform process is encouraging evidence of their project ownership.
- The State Reform operations are designed to manage these risks: they focus on irreversible actions -- privatizations and concessions in key sectors, including in all but one case of the state banks as well -- and up-front actions as "tranche" release conditions. The accompanying investment loans will be kept below a conservatively agreed ceiling, and will be part of a "state assistance strategy" to assist with social sector and productivity enhancing investments that will help make the reforms sustainable.

For your information:

- The total SRL package @ two thirds of 5 loans amounts to US\$580 million.
- Follow-up investment loans in the two states are as follows:
 - Rio Grande do Sul US\$170 million; and
 - Rio de Janeiro US\$187 million.

Mr. Wolfensohn may wish to raise:

- we share (with the IMF) growing concerns about the sustainability of macroeconomic policies, particularly the need for stronger fiscal adjustment. Brazil seems to be in the CAS "base case" with risks on the rise. What fiscal measures are planned for 1997/98?
- will the political agreements necessary for the passage of a Presidential re-election amendment affect the passage of economic reforms?
- given the political realities that led the debt agreements to defer state creditworthiness for some time, why does the Government believe a longer-term creditworthiness program is feasible?

Bio

BIODATA

Minister of Finance: Pedro Malan

- Prior to his appointment as Finance Minister, Dr. Malan served as President of the Central Bank under Itamar Franco's government from September 1993 through December 1994.
- He has held positions as Executive Director for Brazil for the World Bank and Executive Director for Brazil for the Inter-American Development Bank.
- Dr. Malan has a PhD in Economics from the University of California at Berkeley.

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Recent
Macroeconomic
Developments

Annex 1: Recent Macroeconomic Developments

Current Trends

1. As 1996 closes, Brazil's short-term macro indicators look good. Inflation is declining and the annual rate is expected to be no more than 11%. The current account deficit is likely to be around 3% of GDP, with direct investment financing a larger fraction than in previous years. Reserves are equivalent to a year's imports. The international markets are willing to lend more to Brazil and on better terms. At end-October the Federal Government borrowed US\$750 million at 265 basis points above U.S. Treasuries for five years. The rate of growth will be close to 3% this year, with growth picking up significantly in the second half. The latest monthly national unemployment rate is 5.2% (September) and falling.

2. However, this bright picture masks long run risks that are inherent in a stabilization plan that is still very reliant on tight monetary policy, high domestic interest rates, a weak fiscal stance and uncertainty about the ability of the Government to carry through reforms which can turn the situation around. Our assessment is that the risks of a major crisis in 1997 (capital flight, financial sector collapse, return of chronic/hyperinflation) are low. This is, essentially, because of the cushion provided by the reserves and because financing for the fiscal and external deficits is readily available. However, the potential for a crisis over the longer term are very real until we get more evidence that reforms will be far reaching and move fast in 1997.

Risks

The main risks facing Brazil in 1997 are as follows:

1. The problems arising from a loose fiscal stance, tight monetary policy and an exchange rate policy of devaluation within a band that has elements of an anchor. As a consequence interest rates are high, impacting negatively on domestic activity and drawing in capital inflows, which have then to be sterilized to prevent inflation. This problem has been there since the beginning of the Real Plan, which did not incorporate a permanent fiscal adjustment. Additional fiscal pressures have arisen from the need of the Central Bank to support the financial system, which had its profits squeezed as inflation fell. A combination of deficits and high interest rates has resulted in a rapidly growing internal public debt. Total net public debt, internal and external, has risen from 28% of GDP at end-1994 to 35% at present. Internal public debt rose from 20% of GDP to 30% over the same period. The significance of this becomes clear when we observe that the average real domestic rate of interest (overnight/Selic) is very high by international standards. It has averaged 14% in 1996, after exceeding 30% in 1995. The average maturity of the internal debt is less than 4 months. However, less than a fifth is indexed to the dollar exchange rate and foreign residents are not allowed to directly hold this debt. The external debt exposure of domestic private institutions is also growing rapidly as the macro regime gives a large incentive to borrow abroad.
2. A trade imbalance that appears to be very sensitive to domestic growth.

3. Financial sector risks. While the authorities have successfully averted a systemic financial crisis, risks still remain. These can be divided into several categories. At least one major private bank is identified as being in trouble and may need Central Bank resources to merge with a viable institution. Several state owned banks have negative net worth, including the enormous BANESPA, the bank owned by the state of Sao Paulo with a negative net worth of US\$15 to 20 billion. Most of these losses will have to be absorbed by the Federal Government eventually. Finally, the two major federal banks, Caixa Economica Federal and Banco do Brasil have large exposure in the interbank market, having been used as proxies for the Central Bank in supporting other institutions. Both these institutions are short term deposit takers but have asset portfolios of dubious quality that are long term and driven by directed credit rules (housing, lending to states and agriculture).
4. Federal finance problems arising from the inability of state governments to service their debt to the federal government and, in some cases, their debt in the form of bonds.
5. Slow progress in carrying out structural measures to deal with the above set of problems and risks of backsliding in reforms already undertaken, such as trade liberalization in order to avoid immediate crises.

Government Response

3. The Government's response can be divided into two categories. There is an agenda of structural reforms that will help shrink the public sector and restore its fiscal health, thus enabling growth without inflation in the long run. Many of these involve changes in the Constitution, which are difficult to achieve given the fragmented nature of the Congress, the presence of vested interests and the fact that no party or simple coalition has anywhere near a majority of votes, let alone the three fifths needed to change the Constitution. The other is the set of infra-constitutional measure that the Executive can enact on its own to improve the fiscal stance. Recent developments in both these areas have been as follows:

4. Among the Constitutional reforms needed and promised are changes in the social security system, the administrative system (permitting the firing of civil servants at any level of Government), and the fiscal system. The social security system is actuarially unbalanced. Currently it is also running cash deficits. A reform bill has been passed in the lower house but it was so watered down that the Government wants to reintroduce changes in the Senate. An Administrative reform bill is in committee in the lower house. Whether there will be enough support to do away with civil service tenure is unknown at this point. Comprehensive tax reform which could raise the tax ratio is not contemplated at present. The Constitutional reforms are extremely important not so much for their short run impact but for their signaling role that the state has become fiscally viable in the longer run.

5. More relevant immediately are the infra - constitutional measures. An accelerated privatization program is expected to raise US\$5 billion at the federal level in 1997 and US\$10 billion the year after. Many of the states have also set up ambitious programs for concessioning, privatization and asset sales. These are linked to reform programs that are being financed by the Federal Government and may also be supported by World Bank lending in the future. The Federal Government is setting up a program of voluntary retirement with indemnity for 40,000

civil servants. Several of the states have such programs in course. State enterprises, where staff do not have legal tenure for life but which are overstaffed are being cut back. Civil servants did not get a generalized pay raise in 1996 and are expected to get less than inflation in 1997. Public sector tariffs have been raised in 1996 after lagging inflation and the public enterprises have a surplus. Finally, a fiscal package of contention of expenditure in the public enterprises and collection of debts owed to the Government was announced recently. With all these measures, the Government expects the consolidated operational deficit of the public sector to be 2.5% of GDP in 1997. In 1995 the deficit was 5% of GDP and in 1996 it is expected to be around 4%. With a 2.5% operational deficit, the debt to GDP ratio would continue to grow. An IMF Consultation mission, which has just returned from Brazil, has suggested a target primary surplus of 1.5% of GDP in 1997, which should yield an operational deficit of 1.7%.

6. Meanwhile, the Government is continuing with a policy of high interest rates and devaluing the Real between 0.4 to 0.6% a month, thus pegging it in real terms against the U.S. dollar.

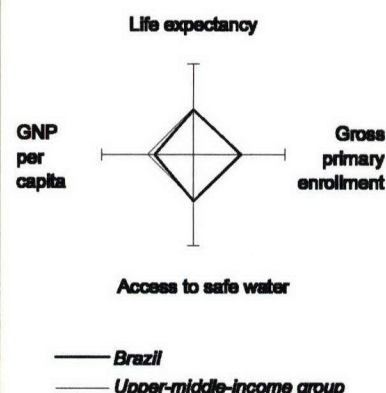
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Brazil at a glance

POVERTY and SOCIAL

	Brazil	Latin America & Carib.	Upper-middle-income
Population mid-1995 (millions)	161.6	480	440
GNP per capita 1995 (US\$)	3,620	3,300	4,300
GNP 1995 (billions US\$)	584.6	1,584	1,892
Average annual growth, 1990-95			
Population (%)	1.7	1.8	1.7
Labor force (%)	1.9	2.4	2.1
Most recent estimate (latest year available since 1989)			
Poverty: headcount index (% of population)	17	..	..
Urban population (% of total population)	78	74	74
Life expectancy at birth (years)	67	68	69
Infant mortality (per 1,000 live births)	55	41	36
Child malnutrition (% of children under 5)	18	..	..
Access to safe water (% of population)	92	81	89
Illiteracy (% of population age 15+)	17	13	13
Gross primary enrollment (% of school-age population)	111	110	107
Male	..	..	..
Female	..	..	..

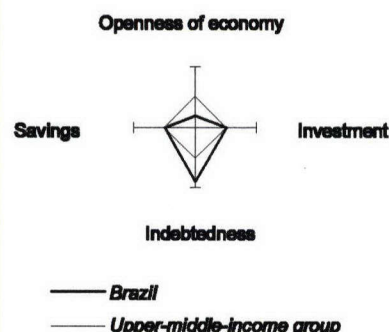
Development diamond*



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

	1975	1985	1994	1995
GDP (billions US\$)	121.7	222.9	554.6	675.0
Gross domestic investment/GDP	26.8	19.2	20.8	21.9
Exports of goods and non-factor services/GDP	7.5	12.2	8.1	6.8
Gross domestic savings/GDP	22.9	24.4	22.4	21.1
Gross national savings/GDP	21.4	19.0	20.6	19.4
Current account balance/GDP	-5.8	-0.2	-0.2	-2.6
Interest payments/GDP	1.7	3.3	0.9	1.2
Total debt/GDP	22.5	47.2	27.2	23.3
Total debt service/exports	43.5	39.1	31.8	40.7
Present value of debt/GDP	..	..	25.2	..
Present value of debt/exports	..	..	276.3	..
(average annual growth)				
GDP	3.0	1.5	5.8	4.2
GNP per capita	0.2	-0.1	3.7	3.8
Exports of goods and nfs	10.4	6.2	7.7	-0.4

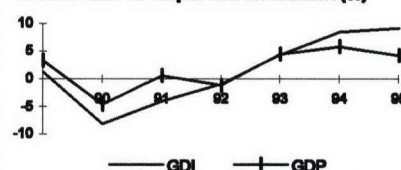
Economic ratios*



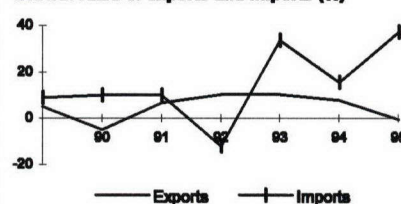
STRUCTURE of the ECONOMY

	1975	1985	1994	1995
(% of GDP)				
Agriculture	12.1	11.5	12.7	12.8
Industry	40.2	45.3	38.7	38.4
Manufacturing	30.3	33.7	25.2	24.8
Services	47.7	43.1	48.7	48.8
Private consumption	66.5	65.8	61.1	62.1
General government consumption	10.6	9.9	16.5	16.8
Imports of goods and non-factor services	11.5	7.1	6.5	7.6
(average annual growth)				
Agriculture	4.2	2.3	7.6	5.9
Industry	3.0	-0.5	7.1	2.0
Manufacturing	2.6	-0.9	5.5	1.6
Services	2.9	3.0	4.4	5.7
Private consumption	4.3	1.9	7.2	7.9
General government consumption	0.8	2.3	-1.0	2.4
Gross domestic investment	-3.2	0.2	8.5	9.2
Imports of goods and non-factor services	-3.7	9.0	15.4	37.3
Gross national product	2.5	1.7	6.2	3.8

Growth rates of output and investment (%)



Growth rates of exports and imports (%)

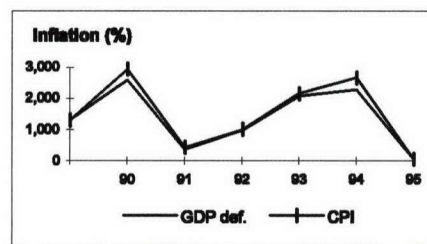


Note: 1995 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

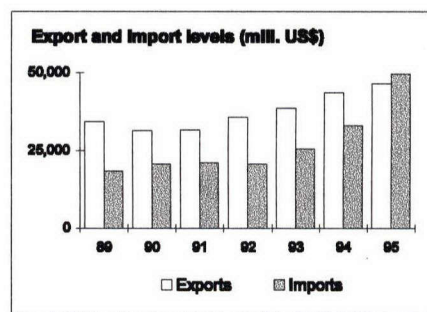
PRICES and GOVERNMENT FINANCE

	1975	1985	1994	1995
Domestic prices				
(% change)				
Consumer prices	29.1	226.9	2,668.6	66.0
Implicit GDP deflator	33.9	231.7	2,284.0	67.4
Government finance				
(% of GDP)				
Current revenue ¹	..	..	24.6	29.7
Current budget balance ²	..	..	5.2	0.4
Overall surplus/deficit ³	..	..	1.3	-5.0



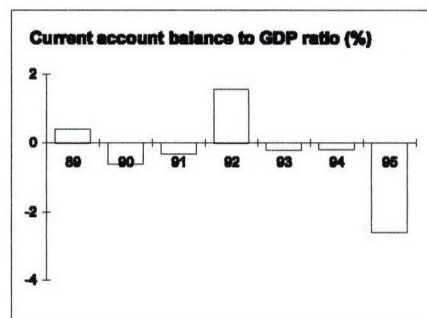
TRADE

	1975	1985	1994	1995
(millions US\$)				
Total exports (fob)	..	25,638	43,563	46,506
Coffee	..	2,607	1,942	2,850
Other food	..	2,545	1,851	2,100
Manufactures	..	13,356	26,844	27,081
Total imports (cif)	..	13,153	33,133	49,663
Food	..	..	4,740	7,500
Fuel and energy	..	6,176	4,695	5,103
Capital goods	..	2,480	11,906	18,200
Export price index (1987=100)	..	97	116	121
Import price index (1987=100)	..	79	139	148
Terms of trade (1987=100)	..	123	84	82



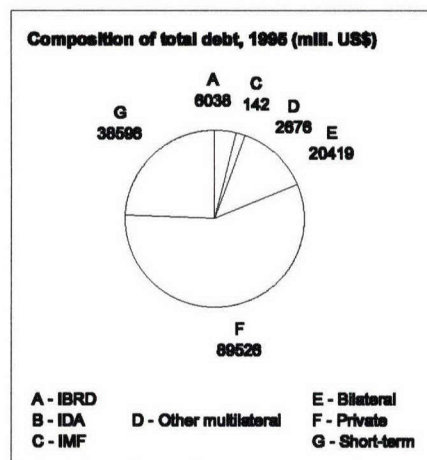
BALANCE of PAYMENTS

	1975	1985	1994	1995
(millions US\$)				
Exports of goods and non-factor services	9,418	27,713	44,966	47,846
Imports of goods and non-factor services	14,323	16,928	36,187	53,516
Resource balance	-4,905	10,785	8,779	-5,670
Net factor income	-2,106	-11,213	-12,580	-15,246
Net current transfers	0	0	2,597	3,513
Current account balance, before official transfers	-7,011	-428	-1,203	-17,404
Financing items (net)	5,946	1,842	8,203	30,450
Changes in net reserves	1,065	-1,414	-7,000	-13,046
Memo:				
Reserves including gold (mill. US\$)	4,166	11,618	39,463	53,704
Conversion rate (local/US\$)	3.0E-12	2.3E-09	0.6	0.9



EXTERNAL DEBT and RESOURCE FLOWS

	1975	1985	1994	1995
(millions US\$)				
Total debt outstanding and disbursed	27,329	105,187	151,104	157,397
IBRD	1,045	5,274	6,311	6,038
IDA	0	0	0	0
Total debt service	4,319	11,471	16,114	21,199
IBRD	98	796	1,883	1,868
IDA	0	0	0	0
Composition of net resource flows				
Official grants	9	34	69	65
Official creditors	1,059	935	-2,116	-1,181
Private creditors	4,213	149	3,717	867
Foreign direct investment	1,302	1,348	3,072	3,100
Portfolio equity	0	0	5,082	2,976
World Bank program				
Commitments	538	1,525	1,024	404
Disbursements	249	765	640	838
Principal repayments	26	405	1,346	1,377
Net flows	224	359	-706	-539
Interest payments	72	391	537	491
Net transfers	152	-32	-1,243	-1,030

¹ Tax revenue.² Primary budget balance.³ Operational budget balance.

OFFICE MEMORANDUM

DATE: November 26, 1996

TO: Files

FROM: Homi Kharas, Chief, LA1C1

EXTENSION: 39757

SUBJECT: **Minutes of meeting with Mr. Wolfensohn**

Mr. Wolfensohn met with Brazilian Finance Minister Pedro Malan for about half an hour on November 26, 1996. The Brazilian delegation also included Messrs. Murilo Portugal, Alternate ED and Roberto Jaguaribe (Secretary for International Affairs, Ministry of Planning). Messrs. Nankani (Acting LAC RVP), Perry (LACCE) and Kharas (LA1C1) attended on the Bank's side.

Mr. Malan expressed his satisfaction that the Bank was moving ahead with investment loans in reforming States, but indicated his concern with the negative signal the Bank would send to reforming States by modifying the loan size. He suggested a compromise position of a third tranche that would permit the original loan size to be retained. Mr. Wolfensohn acknowledged the issue and noted that he was expecting Mr. Malan to work out a solution with Mr. Koch-Weser. Mr. Malan looked forward to a mutually satisfactory solution.

On broader macroeconomic issues, Mr. Malan asked that the Bank not join the voices of concern over the recent one-month increase in the current account deficit, explaining that many other successful economies had much higher deficits and that in Brazil the current account was largely financed by foreign direct investment. On the fiscal deficit he pointed to an improvement relative to last year, and highlighted the privatization of Cerj for \$605 million.

Mr. Wolfensohn noted that for the markets it was not the level of the deficits that was disquieting as much as the fact that performance had not measured up to expectations. He congratulated Mr. Malan on the efforts at strengthening of State finances which he recognized as central to the Brazilian program.

Mr. Malan briefly outlined the timetable for key constitutional reforms: the re-election amendment (January), public administration reform (February) and later social security.

Good progress on portfolio performance was noted. Mr. Nankani said that meetings to finalize the Portfolio Commission report would be held next week.

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Mr. Wolfensohn apologized for the press reports over Mercosul and for the Bank's handling of this. He indicated that this was really more of a storm in a teacup. He warned against trying to censor publication and proposed to treat the leaked paper as normal business. He mentioned that a disclaimer on the cover page had now become standard policy. A series of Mercosul related papers would be put out at the same time as discussion drafts, some with a positive assessment, others tempered with more caution.

Mr. Wolfensohn welcomed Mr. Portugal and expressed his deep appreciation for the performance of his predecessor, Mr. Marcos Caramuru de Paiva.

cc: Messrs./Mmes. Wolfensohn, Koch-Weser (EXC); Schilling (OPRDR); Nankani, Perry, Ody (LACVP); LA1DMT; LACIC

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November 27, 1996 10:32 AM



No.: EXC-13662

CORRESPONDENCE MANAGEMENT FOR THE PRESIDENT'S OFFICE

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FOR ACTION: Javed Burki

STATUS: Open

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CORRESPONDENCE DESCRIPTION:

From: Organization :	Pedro Malan, Minister of Finance, and Antonio Kandir, Minister of Planning and Budget Federative Republic of Brazil
To:	Mr. Wolfensohn
Dated:	11/20/96
Topic:	Follow up to meeting in September and request for Mr. Wolfensohn's personal assistance

ACTION INSTRUCTIONS:

Due Date: 12/02/96

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- If you would like our office to handle the dispatch of the original, please include an envelope with your division's code marked clearly on the envelope. If no envelope is attached, the letter will be returned by special messenger as soon as it is signed. If a letter is to be couriered, please attach both an envelope and the courier request sheet;
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**FEDERATIVE REPUBLIC OF BRAZIL
MINISTRY OF FINANCE
MINISTRY OF PLANNING AND BUDGET**

FAX Nº 3283/96

Brasilia, 11/20/96

**TO: MR. JAMES D. WOLFENSOHN
PRESIDENT
THE WORLD BANK
FAX (001-202-5223031)**

**FROM: PEDRO MALAN
MINISTER OF FINANCE**

**ANTONIO KANDIR
MINISTER OF PLANNING AND BUDGET**

NUMBER OF PAGES 3 (INCLUDING THIS ONE)

OBS: In case of bad transmission, please call (55-61) 225-7185

Dear Mr. Wolfensohn

We are writing you following our interview of last September in Washington. As you know, Brazil and the World Bank have been working on revising our traditional portfolio with a view to enhancing project execution and concentrating Bank support on a number of selected priority areas. During your visit to Brazil last year, we touched on a number of relevant issues focusing particularly on portfolio performance. Since then, we have made significant progress.

Disbursement in fiscal year 1996 surpassed the ambitious US\$ 1 billion target for the high case scenario established in the Country Assistance Strategy (CAS) for Brazil. In fact, many of the targets set for the high case scenario in the Brazilian CAS were met in 1996, one exception being related to fiscal results, an area in where additional progress significantly depends on efforts at the State level and where we are developing new projects with the Bank.

The indicators established in the CAS would place Brazilian performance between the base and the high case scenarios. The first scenario establishes a lending level of US\$ 1.4 billion, whereas the second one a level of US\$ 2 billion. In spite of the auspicious results of our economic performance and Brazil's and the Bank's efforts, lending levels in the recent past have been much below these figures, reaching only US\$ 550 million in 1995 and US\$ 875 million in 1996. These shortcomings become even more clear when compared to the Bank's recent lending to other major Bank borrowers from Latin America or from other regions.

One of the reasons for not reaching the lending figures expected in fiscal year 1996 has been the complexity of the elaboration process of the State Reform Loans, originally envisaged for approval that year. These loans, which have been discussed with the Bank for over two years, were conceived with the purpose of reversing the adverse impact State accounts have on the overall public deficit (together with the Municipal ones they account for more than 50% of overall public deficit in Brazil), improving the States' fiscal results, helping the States to carry out structural reforms and to achieve a primary surplus, and ultimately improve their investment ability. The process of elaboration of the initial State reform Loans has finally been concluded, but we are now faced with new obstacles derived from the Bank's perception of the agreement the Federal Government has reached with the relevant States related to their consolidated debt.

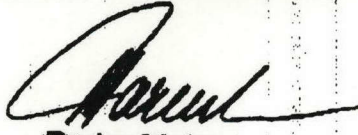
We are concerned with further delays which can jeopardize the confidence those States have deposited in their relation with the Bank. The alterations now proposed by the Bank in these loans and the correlated ones send the wrong signals to State Governors, they weaken those who have committed their administrations to the achievement of structural reform and fiscal soundness and expected to count with positive and swift Bank response.

The present state of relations with the World Bank is the best we have had over the last 15 years. This is largely due both to the close understanding we have with you and with the competent and diligent senior administrators directly allocated to the Latin American region, and to a deepened coincidence in our diagnosis and prognosis of Brazilian social and economic issues. We are convinced that this overall situation warrants better results than those we have

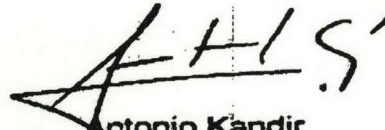
achieved so far, particularly in the Bank's responses to our specific and critical demands such as those related to the State Reform Loans.

We ask your personal assistance in this matter and are ready to inform you directly on our more detailed concerns over these loans and correlated ones and to conclude our understandings with the Bank.

Sincerely,



Pedro Matan
Minister of Finance



Antonio Kandir
Minister of Planning and Budget

cc: Mr. Gobind Nankani: Director LA1