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WORLD BANK OFFICE TRACKING SYSTEM
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Routing and Action Transmittal Sheet

TO:	DATE:
Mr. B. Conable (E-1227)	4/25/91

SUBJECT:

Document From: M. Qureshi (S. Husain)
To: bbc
Dated: 4/24/91 Reference No.: EXC910425002

Topic: BRAZIL: Mtg. with Messrs. ZELIA DE MELLO, EDUARDO TEIXEIRA & IBRAHIM ERIS on SUNDAY, APRIL 28 @ 3:30 pm.

ACTION INSTRUCTIONS:	DUE DATE:

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Remarks: cc: JV (original for FF), Sandstrom, Khanna

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: April 24, 1991

TO: Mr. Barber B. Conable

THROUGH: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 39001

SUBJECT: Brazil: Briefing Note for the Visit of Minister of Economy Zelia Maria Cardoso de Mello, Minister of Infrastructure Eduardo Teixeira and President of the Central Bank Ibrahim Eris

1. This note provides some background information on Brazil's economic program, the status of debt negotiations, and the lending program for FY91 in relation to the visit on Sunday, April 28, 1991 at 3:30 pm of the Brazilian Delegation consisting of Minister of Economy Zelia Maria Cardoso de Mello and Minister of Infrastructure Eduardo Teixeira.

2. Brazil faces a number of economic problems which threaten to derail the economic revolution that President Collor had promised when he took office last March as Brazil's first directly elected President in three decades. His orthodox stabilization program has failed because of inappropriate monetary policy. A new set of stabilization measures, announced on January 31, is also likely to fail: its core is a prices and incomes policy apparently unsupported by the necessary monetary policies. It has been rejected by large segments of Brazilian society, and the prospect, at best, is for a brief pause in inflation, followed by a renewal. Brazil could then see a descent into the stop-go policies that characterized the previous regime.

3. Notwithstanding the uncertain macroeconomic prospects, you may wish to compliment Minister Zelia on the successful structural reforms she has implemented and is continuing to implement -- for example, trade reform, deregulation, privatization, agricultural policies -- and in her success in reaching a final fiscal surplus in 1990. This has constituted a turnaround of about 10% of GDP in one year.

4. We are concerned that inflation may sharply rise by summer's end because of the inconsistent macroeconomic policies of the Collor II Plan. Additional pressures on inflation will intensify at that time in anticipation of the release of the frozen assets. It is projected that the monthly increase of the monetary base due to the release of the frozen assets will amount to 12% of its current monetary base. The situation may become critical if decisions of state courts, which have determined that the freezing of assets is unconstitutional, are upheld by the Supreme Court leading, therefore, to an immediate release of all frozen assets.

DEBT NEGOTIATIONS

5. On April 8, 1991, Brazil and the Bank's Advisory Committee agreed on the issue of arrears. Under the agreement, Brazil will pay 25% of the arrears due through year-end 1990 in cash (about US$2 billion) and will exchange the remaining 75% for bonds. The first cash payment, for 45% of the cash amount, or about US$900 million, will be made ten days after the Brazilian Senate approves the term sheet detailing the agreement. Following this, the term sheet will be sent to Brazil's approximately 600 creditor banks worldwide. The remaining cash payments will be made in eight monthly installments beginning in May and continuing through December. The bonds, which will be dollar denominated bearer instruments, will mature in 10 years, with three years of grace, and have a staggered amortization. The bonds will be issued upon agreement between the Bank Advisory Committee and Brazil on the treatment of the medium- and long-term debt. Creditor banks will have a one-time choice of two interest-rate options on the bonds. Option 1 bonds will have a fixed interest rate of 7 13/16% during the first year, 8 3/8% during the second and 8 3/4% during the third, and a floating rate of 13/16% over the six-month London Interbank Offered Rate (LIBOR) during the final seven years. Option 2 bonds will have a floating interest rate of six-month LIBOR plus 13/16%. The interest rate will have a LIBOR floor of 6% for the first five years and a LIBOR ceiling of 7.2% during the first year, 7.7% during the second year and 8.2% during the third, fourth and fifth years. The bonds will be eligible for use under Brazil's privatization program, as well as under other types of investment programs that Brazil may establish.

THE BANK AND BRAZIL

6. Bank Lending. So far in FY91, the Bank has approved US$450 million in new loans to Brazil (a Science Research and Training project for US$150 million and a Private Sector Finance project for US$300 million). Negotiations for a Hydrocarbons Transport and Processing project (US$260 million) have been completed and we will proceed with Board presentation by early May. Thus, our lending to Brazil in FY91 will be $710 million.

ISSUES THAT MAY BE RAISED BY THE BRAZILIAN DELEGATION

7. The Brazilian Delegation may attempt to persuade senior Bank management that the Government's current policies will lead to a stable macroeconomic environment, albeit on a longer-term basis than in the Collor I Plan. With that in mind, they may request that the Bank provide Brazil with adjustment loans and credit line operations. They may refer to the recent agreement with the commercial banks on arrears and stress that the Bank's adjustment operations and credit lines would facilitate the conclusion of the debt negotiations. You may wish to respond that the Bank is interested and willing to assist Brazil. However, prior to any adjustment loans and credit line operations, the Bank should be satisfied that a viable stabilization program is in place and that a reasonable track record in economic reform and stabilization has been established. Furthermore, we will need satisfactory progress on sectoral reforms and the availability of complementary external financing. For credit lines also we shall need a reasonable macroeconomic environment, because in its absence there is no way to ensure an efficient operation of credit programs.

8. I suggest that you refrain from a discussion of specific operations and ask that the details be followed up with me. If the Minister raises the issue of Bank lending overall, you should inform her that projects are proceeding as they are cleared by COFIEX. Of course, clearance by COFIEX is extremely slow. You should also say that in our lending we would like to emphasize human resources, environment and poverty alleviation. We would not automatically agree to financing a large number of credit lines if the COFIEX suggests so. Brazil's priorities and the Bank's criteria will have to coincide.

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

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~~SS~~
~~BBC~~
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Brazil file

DATE: June 25, 1991

TO: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain SSH

EXTENSION: 39001

SUBJECT: BRAZIL - Hydrocarbon Transport and Processing Project
- Innovations in Basic Education Project
Questions Raised by Executive Directors

1. These projects are scheduled for Board Presentation on June 26, 1991.

2. Messrs. Choksi and Ettinger and Mrs. Bruns had meetings with the Executive Directors' offices of the US, UK, Japan, Germany, France, Italy, Canada, the Netherlands and Scandinavia to brief them on the above loans. Most of the questions raised were in connection with the Hydrocarbon Transport and Processing loan to PETROBRAS, and three Directors (German, U.S., and Japanese) indicated that their Governments' position on the operation was not yet certain. With respect to the education loan, none of the Executive Directors indicated serious problems, although the US and Italian Directors raised three questions which are discussed further below (paras. 12-15).

Hydrocarbon Transport and Processing Project

3. The U.S. Alternate ED (Mr. Cox) indicated his opposition to the loan, but noted that he might be overruled. The Advisor to the Japanese ED (Mr. Amma) did not give his own views, but explained that his government was looking closely at this project in the broader context of a possible Brady deal for Brazil. All of the other ED's offices were supportive of the project. We were told that the US Treasury had written to other G-7 Governments raising its objections. The main questions raised, in most cases by several EDs, are discussed below.

4. Several EDs asked why PETROBRAS cannot borrow commercially for its investments, as it has in the past. We replied that PETROBRAS, like other Brazilian public enterprises, is not able to borrow internationally (except for limited short-term lines of credit) because of perceived "country risk" related to Brazil's external debt situation. There is virtually no domestic capital market because of the high inflation in recent years. This was a good project, with a high ERR (22%) plus many environmental benefits, and should be undertaken as soon as possible.

5. The U.S. and Japan commented that since PETROBRAS' inability to borrow commercially is due to Brazilian Government policy errors, domestic and foreign, this loan might send the wrong signal. In response, we emphasized that the economic policies and performance of the present administration are a major improvement over its predecessor's--in areas

such as trade, fiscal balance, deregulation, privatization, and inflation. While the Bank will not give adjustment loans to Brazil under the present macroeconomic and external debt situation, to further restrict investment lending would give too negative a signal regarding our assessment of Brazilian performance.

6. Several EDs asked why the disbursement period is so short (3 1/2 years, with the bulk in the first 2 years). We answered that PETROBRAS, based on its performance in similar investments, is expected to be very efficient in project implementation. Furthermore, the preparation of detailed design and procurement documents is at an advanced stage, and continued during the 7 months it took to conclude negotiations. Up to US$25 million would be allocated for retroactive financing. The first bid documents have already been received. Of course, as for all investment loans actual disbursements will be made against actual investment expenditures, and may take longer or shorter than projected.

7. Several EDs asked what sectoral conditionality there was particularly as relates to pricing. We explained that PETROBRAS has begun upgrading its costing system, so as to provide information in economic terms (to supplement existing financial information) on the cost of different products, and at various locations. This system would also improve internal efficiency and make any cross-subsidies transparent. PETROBRAS has agreed to complete this system and exchange views with the Bank on its implementation and application. This will provide the data necessary for determining the extent of pricing distortions, so that they can be corrected. In view of the political sensitivity of energy pricing in Brazil, this was as far as we could go in this first operation. However, we were carrying out dialogue on pricing issues on a parallel track, based on an energy sector report which had recently been discussed with the Brazilian authorities.

8. France asked why it will take until end-1993 to complete the costing system. We replied that the system is quite complex, and is being implemented in phases. It involves not only analysis of costs by product and location, but also creation of profit centers within PETROBRAS so as to create the right efficiency incentives.

9. The U.S. commented that the basic problem of the hydrocarbons sector is PETROBRAS' oil monopoly, including its ownership of all underground resources. Why should we make this loan, if it does not address this issue? Our reply was that this issue cannot be addressed until the 1993 review of the Constitution. In the meanwhile, Bank dialogue with Government and PETROBRAS, which will be enhanced by this loan, puts us into a better position to influence the debate on this.

10. France asked about the status of the environmental assessments (EAs) for the project. We explained that EAs need to be carried out as a condition of disbursement for each pipeline. For the two pipelines that go through environmentally sensitive areas, the Bank would need to be satisfied with the EA before it would be sent for state government approval (coincidentally, the first of these two EAs has just been received for our review).

11. Japan asked about Brazil's long-term energy strategy. We responded that at present, the Government does not really have a comprehensive, long-term sector strategy -- because of inter-agency

differences of view, changes in the economic and sectoral teams, and the pressure of short-term concerns (e.g. the Gulf crisis and the financial problems in the power sector). As regards oil, the main long-term strategy is to reduce dependence on imported oil (now 46% of demand) through expanded domestic production. While we have some sympathy with this objective, it should not be pursued at any price. PETROBRAS' costing system will provide the data for determining the cost of production from various fields.

Innovations in Basic Education Project

12. The Italian ED's office questioned the "high (69%) share of the loan going for local cost financing". We replied that many loans for Brazil, particularly in agriculture and the social sectors, necessarily involve considerable local cost financing; in fact, seven of our loans over the past three years have exceeded 50% local cost financing and one exceeded 80%. In the case of the Innovations project, the Bank loan represents only 40% of the total project costs and we believe that any lower share would have undermined our ability to influence the design and implementation of the project.

13. The U.S. ED's office asked about project sustainability and the project size. Specifically, they asked whether the state's capacity to finance the recurrent costs of the program would be jeopardized by continued fiscal deficits at the state level and/or reductions in transfers from the federal government. We replied that the incremental recurrent costs would require about a 20% increase in the state's budget for primary and secondary education over the six years of the project. This increase is quite feasible, given the Constitutional mandate that all states increase their spending on education to at least 25% of total revenues. In Sao Paulo's case, total education spending is currently below 20% of total revenues.

14. With respect to federal transfers, we pointed out that the state's reliance on these transfers is being reduced as a result of the national tax reform currently being phased in, which devolves an increased share of national tax receipts to state and local governments. With respect to the state's budget deficit, we replied that this could be a concern if the new state government does not make progress towards fiscal balance. However, our indications were that this was a priority of the new administration and, in any event, we would monitor the situation very closely.

15. A second point raised was that the project was very large for a "pilot project" involving educational innovations which had never been evaluated. We replied that in fact almost all of the "innovations" had been tried in other countries and were known to be effective. What was not known -- and would be studied carefully under this project -- was, first, which "innovations" were most effective for disadvantaged children in a developing country setting, and second, which were most cost-effective.

cc. Messrs./Mme. Conable, EXC; Aiyer, Duer, LACVP; Choksi, Weissman LA1DR; Papageorgiou, LA1CO; Amoako, LA1PH; Collell, Abbott, LEGLA

BBruns/SJEttinger:syk

International Bank for Reconstruction and Development

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FROM: Vice President and Secretary

July 5, 1991

PILOT PROGRAM TO PRESERVE THE BRAZILIAN RAINFOREST

At the Houston Summit in July 1990, the Heads of State of the G-7 countries requested that the World Bank, in cooperation with the Commission of the European Communities (CEC) and the Brazilian authorities, prepare a pilot program to counteract the threat to tropical rainforests in Brazil. Attached for information is a letter from Mr. Conable, transmitting the proposal prepared by the Government of Brazil, and a cover note to the Brazilian proposal containing the joint recommendations of World Bank management and CEC staff. The Brazilian proposal is available on request.

Questions on the cover note and the Brazilian proposal may be directed to Ms. Birdsall (ext. 38590) or Mr. Kaplan (ext. 39085).

Distribution:

Executive Directors and Alternates
President
President's Council
Vice Presidents, Bank, IFC and MIGA

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THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

July 2, 1991

Dear Colleagues:

As you know, at the Houston summit last year, the heads of state of the Group of Seven requested that the World Bank, in cooperation with the Commission of the European Communities (CEC), prepare a proposal for a pilot program to counteract the threat to tropical rainforests in Brazil. It is my pleasure to submit to you the attached proposal, prepared by the Government of Brazil with technical input from staff of the World Bank and the CEC. The proposal is accompanied by a cover note that reflects the joint understanding and agreement of the management of the World Bank and the staff of the CEC. The cover note proposes the establishment of a trust fund under the Global Environment Facility. However, the intention is not to exclude other options. The exact management of the fund and the participation of various agencies will need to be considered by the donors and the Government of Brazil.

Sincerely,

Barber Conable

Mr. Rosario Bonavoglia
Mr. E. Patrick Coady
Mr. Fritz Fischer
Mr. Jean-Pierre Landau
Mr. David Peretz
Mr. N. Frank Potter
Mr. Masaki Shiratori

attachment

cc: Mr. Jacques Delors, President, Commission of the European Communities
Mr. Paulo Ximenes-Ferreira, Alternate

PILOT PROGRAM TO PRESERVE THE BRAZILIAN RAINFOREST

Introduction

1. At the Houston Meeting in July, 1990 the G-7 Heads of States called for the World Bank, in cooperation with the Commission of the European Communities (CEC), to prepare a proposal for a comprehensive pilot program to counteract the threat to tropical rainforests in Brazil. The Government of Brazil (GOB) expressed its support for such an initiative and formed an Interministerial Commission to oversee preparation of such a proposal. As part of the process of preparing the proposal, staff of the World Bank, the CEC and the GOB held three tripartite meetings and a series of technical missions and discussions. World Bank staff also periodically briefed the Executive Directors of the World Bank representing the G-7 countries, and in response to their requests, and in collaboration with CEC staff, prepared the recommendations set out below regarding the size and activities of the proposed program.

2. The resulting GOB proposal for a pilot program to be executed over a five-year period is attached. The management of the World Bank and the staff of the CEC endorse the objective of the Brazilian proposal and support the establishment, under the administrative umbrella of the Global Environment Facility, of a Rainforest Fund to carry out activities to support that objective. The program would pertain mainly to the Amazon Rainforest but would also provide limited support to preserve the Atlantic Forest.

3. The objective of the pilot program is to maximize the environmental benefits of Brazil's rainforests consistent with Brazil's development goals, through the implementation of a sustainable development approach that will contribute to a continuing reduction of the rate of deforestation. The attainment of this objective would: demonstrate the feasibility of harmonizing economic and environmental objectives in tropical rainforests; help preserve the huge genetic resources of the rainforests; reduce the Amazon's contribution to global carbon emissions; and provide another example of cooperation between developed and developing countries on global environmental issues. Preservation of biodiversity, reduction in carbon emissions, and new knowledge about sustainable activities in tropical rainforests represent benefits that are global in scope and justify financial transfers from the international community to Brazil.

4. The GOB has already committed its own resources for conservation activities in its rainforest areas, including through normal World Bank financing, and is committed to undertaking the activities outlined in the attached proposal with its own resources. New and largely concessional resources would permit more rapid, wide-ranging implementation of these activities than could otherwise be undertaken, given the government's limited resources and other priorities.

5. A mechanism, the Global Environment Facility (GEF), is already in place by which to channel concessional resources to developing countries to address global environmental objectives. Some portion of the proposed pilot program in Brazil could be financed from the Global Environment Trust Fund (GET) under the GEF. However, existing GET resources are inadequate to address the scope and urgency of the threat to Brazil's rainforests, or to realize the potentially large joint benefits to the global community of the proposed pilot program in Brazil. The establishment of a Rainforest Fund under the GEF would permit supplemental global resources to be channeled to Brazil, while at the same time minimizing administrative costs and ensuring close technical

cooperation with other global programs. Finally, a Rainforest Fund under the GEF could eventually be extended to cover other countries with threatened rainforests.

Background and Rationale for Donor Support

6. Conserving the Amazon and Atlantic rainforests would provide benefits to the global community because together they represent the largest repository of biodiversity in the world and because conservation of the Amazon forest would lead to reduced emissions of carbon gases. These rainforests also provide regional and local benefits through their influence on hydrological cycles and thus local climate, the protection they afford to watersheds, and as homes to indigenous communities with distinctive cultures.

7. Beginning in the 1960s, public investments in roads and other infrastructure and public policies supporting colonization encouraged migration into the Amazon and resultant deforestation. Lacking suitable technology, many farmers practiced an unsustainable form of slash-and-burn agriculture with annual crops. Logging increased; squatters, miners and loggers made frequent incursions onto indigenous lands and brought disease and environmental damage. Investments in hydropower dams and in exploitation of major mineral deposits also contributed to deforestation. Legislation encouraged landholders seeking to legalize their titles to clear forest by defining cleared land as "improved." Fiscal incentives encouraged investment in cattle, sawmills and other enterprises without environmental restrictions. Although new parks and other conservation units were created, the Government lacked resources to protect and manage these areas adequately.

8. As a consequence of these activities and policies, deforestation in the Amazon accelerated, reaching a peak in 1987 when the combination of an unusually dry year and uncertainty over future land legislation caused an unprecedented amount of forest clearance and burning. By 1990, an estimated 8% of the Amazon rainforests had been deforested.

9. Policy Changes. The years 1988-91 proved to be a watershed in the evolution of Brazilian environmental policy. The changes in policy are set out in detail in the attached GOB proposal (pp. 3-5).

- In 1988 and each year thereafter the federal government has sponsored a special program to prevent forest burning.

- In early 1989, the Nossa Natureza Program established a National Environmental Fund (FNMA) with the participation of non-governmental organizations (NGOs) on its board; temporarily suspended fiscal incentives for development in the Amazon; and repealed laws encouraging forest clearance as a way of gaining title.

- In 1990 the GOB created an Environmental Secretariat, SEMAM, reporting directly to the President and under it a single national environmental agency, IBAMA, combining four separate agencies into one. All federal ministries were given responsibility for establishing sectoral plans consistent with environmental objectives.

- Also in 1990, President Collor appointed an internationally known environmentalist as Secretary of SEMAM, and the GOB established the

National Environmental Program with support from a large World Bank loan to strengthen IBAMA and to protect major ecosystems nationwide.

- Over the same period, the government instituted new regulations aimed at forest use by industry, initiated a review of federal infrastructure projects and greatly reduced credit subsidies for agriculture and livestock activities (partly as a result of general fiscal austerity).[1]

- In 1991 fiscal incentives for the Amazon and Northeastern regions were officially restored. Congress rejected proposals of the executive branch that would have set market rates of interest for credits under the program. However, the legislation does explicitly restrict subsidies for ranching to areas designated as appropriate on environmental grounds, and mandates environmental licensing for all projects benefiting from incentives.

10. Partly as a result of these changes, and partly as a result of natural and market conditions, rainforest clearing in the Amazon has declined each year since 1987.

11. Existing Constraints. To firmly secure for the future the environmental benefits of the rainforests in Brazil requires that three critical constraints be addressed.

- First, the present largely positive direction of this administration's environmental policy must be consolidated at the federal level between the administration and Congress and must be reinforced at the state and local levels. This implies that pricing, fiscal and investment policies at federal, state and local levels would be consistent with environmental objectives. Policy in Brazil is the outcome of complex interactions among the executive and the legislature at the federal level, and among and between federal, state and local administrators and political representatives. Public opinion, a growing number of organized interest and consumer groups, and a sophisticated press are also important factors in Brazil's open political system. Improved public understanding of the benefits and the costs of rainforest protection and increasing accountability of public institutions on environmental matters are critical to consolidation of a sound policy on rainforest issues.

- Second, relatively weak state and local as well as federal institutions that are responsible for enforcing environmental laws, require strengthening in terms of management, technical skills, and adequate equipment and other infrastructure.

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[1] Brazilian environmental legislation is advanced in other respects. Farmers and ranchers in the Amazon region must obtain permits before clearing and burning land and may not clear more than 50% of the forest on a given property or along watercourses or at the headwaters of streams. Loggers can cut timber only after submitting forest management plans to IBAMA, and IBAMA closely monitors the transport of logs and operation of sawmills.

- o Third, continuing investments in natural and social science research and field applications are needed (a) to ensure that the economic benefits of genetic biodiversity in Brazil's rainforests can be realized, and (b) as a basis for the development and dissemination of sustainable approaches to economic exploitation of the forests.

12. The pilot program is designed to address these needs. Its design reflects concern with all three constraints. The design also represents a new approach to development in rainforest areas in Brazil, marking a profound change from the views and programs of just a few years ago.

The Pilot Program

13. The pilot program has two main parts: structural programs, in which the emphasis is on strengthening of government institutions; and demonstration projects, in which the emphasis is on support for and promotion of grassroots initiatives. The content of each proposed activity is described in detail in Section IV of the attached proposal. Below we describe briefly each major activity, and indicate our recommendation for emphasis in a first phase./2

(a) Conservation Units: Conservation units and indigenous areas in the Amazon, already legally established, would be demarcated and equipped with needed infrastructure./3 These investments would complement those financed under a World Bank loan, and those already proposed by the GOB for financing by the GET. The first phase would include preinvestment activities (reconciling policy and legislation, development of flexible mechanisms for handling land tenure irregularities, and development of detailed management plans for specific units); and financing for demarcation of three indirect-use conservation units (in which no economic activity is permitted); three national forests; four extractive reserves; and six indigenous reserves.

(b) Natural Resource Management and Degraded Areas: Activities would address production, regulation and marketing of fishing and forestry products that are commercially viable and environmentally sustainable, and recovery and reuse of deforested areas. The first phase would consist of formulation of working procedures and program development, and studies of the environmental, social and economic consequences of any investments in recovery of degraded areas.

(c) Environmental Zoning: This program would, once follow-up enforcement capacity is in place, help finance regional and local environmental zoning to guide future public investments and to ensure appropriate use of any fiscal incentives. Emphasis in the first phase would be on support for information systems and on building capacity to carry on zoning exercises at the state level.

/2 The proposed first phase set out in the attached proposal would be fully assessed by staff of the international implementing agency and approved on an annual basis in Brazil by the Coordinating Commission.

/3 Conservation units would also be supported in the Atlantic Forest, as described in Appendix II of the attached proposal.

(d) Scientific and Technical Support: Trust funds would be established under the management of the federal Secretariat of Science and Technology to support INPA (Instituto Nacional de Pesquisas Amazônicas) and the Museu Paraense Emílio Goeldi (also a research institute). The purpose of the trust funds would be to provide a permanent base of sustained support for these two existing centers of excellence of scientific research in the Amazon Region. The trust funds would finance infrastructure and the creation of endowed chairs or topping up of salaries, to ensure that these institutions can attract and retain the best possible talent worldwide as well as in Brazil. An additional trust fund should be considered to provide similar support to other research institutions in the Amazon region, to strengthen the agricultural, biological and social sciences relevant to protection of the Amazon rainforests. Emphasis would be on collaboration among local, national and international centers. In addition, a program of support for basic and applied research aimed at better understanding of the Amazon environment should be established under the management of the Secretariat of Science and Technology, similar to existing research support programs, including PADCT (Program for the Support of Science and Technology). Research grants would be available on a competitive basis to staff at all national institutions, private and public. International and transregional scientific cooperation in funded research would ensure high scientific standards. Advanced training and a scientific information system would also be financed. First phase activities include making arrangements for trust funds, setting priorities and appraising plans for strengthening centers of excellence, and defining the scope and procedures for the research grants program.

(e) Monitoring and Enforcement: A set of activities is proposed to strengthen the capacity of public agencies, especially of the nine state environmental agencies in the Amazon region. Emphasis would be on establishing measures and means to monitor environmental quality including forest cover, fauna, water and air quality, and the status of indigenous people; and to detect infractions of environmental legislation. First phase activities include detailed planning of training programs; design, specifications and site selection for control posts; and development of procedures for augmented monitoring and enforcement.

(f) Environmental Education: Support would go mainly to the Amazon region for preparation and introduction of environmental issues to school curricula. University-level exchanges of information, public education campaigns, and wide dissemination of scientific knowledge are also envisaged. First phase activities include carrying out a diagnosis of current practices and materials in environmental education and design of a comprehensive program of environmental education for the Amazon region.

(g) "Free-standing" Demonstration Projects: Support would go to projects that would test new technologies, organizational forms or techniques to develop sustainable production in the Amazon, or improve conditions for rural dwellers where such support can help reduce itinerant, predatory deforestation. Such projects would be proposed by local or national NGOs, entrepreneurs, local government agencies, and research and extension agencies. Projects sponsored by nongovernment groups could be

funded through one of three channels: (a) the National Environmental Fund (FNMA), (b) direct (bilateral) grants, and (c) a small grants fund administered independently of the Brazilian Government. Such projects would be judged on their potential to achieve tangible results, their sustainability without continued subsidies, and their replicability. Up to 20 of these free-standing demonstration projects would be supported in the first phase.

(h) "Area-based" Demonstration Projects: Support would go to projects sponsored by consortia of government agencies and NGOs in selected strategic areas throughout the Amazon. Emphasis in the first phase would be on detailed "project" planning in three specified geographic areas, one in the western Amazon, two in the eastern Amazon.

14. Because this is a pilot program, heavy emphasis will be placed on: monitoring of program inputs, with feedback to redesigning of activities; supervision of implementation by technical staff at the international level; and evaluation of the impacts of activities, both within Brazil, and through an advisory group at the international level.

Recommendations

15. Initial Commitment. The management of the World Bank and the staff of the CEC recommend that the G-7 endorse the objectives of the pilot program and commit themselves to support on highly concessional terms/4 activities in a first phase, estimated to cost about US$250 million. The duration of the first phase would depend on the pace at which proposed activities can be effectively implemented, but would probably be at least two years. Donors should be prepared to provide US$50 million for an initial nine-month period, to be disbursed against (a) a set of pre-investment and planning activities, (b) implementation of selected aspects of the existing program that are ready for implementation, (c) initial financing of two trust funds to strengthen scientific centers of excellence and of a small grants program fund for NGO activities, and (d) overhead for technical support functions at the international level.

16. The Full Program. The GOB proposal describes activities to be carried out over a five-year period at an estimated cost of US$1.6 billion. These activities would complement those being financed through existing World Bank loans and those proposed by the GOB for financing under the Global Environment Trust Fund. While the precise cost and timing of specific activities require further definition, the magnitude of the potential global and national benefits of preserving the rainforest justifies the sustained commitment of substantial resources.

17. However, neither the estimated costs nor the precise activities and timing proposed by the GOB have been fully appraised by staff of the World

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/4 Financing could be in the form of grants, loans on IDA terms, and debt-for-nature swaps to the extent the latter are consistent with the overall approach of the Government of Brazil and creditors to Brazil's external debt. The GOB would provide some counterpart funds (up to 10% for certain parts of the program); state and local governments and residents of the Amazon would also participate in financing.

Bank and the CEC. Donor commitments to finance specific activities under the first and subsequent phases should be made on a rolling basis, and should depend on: (a) annual assessments of specific program activities and proposals; (b) evidence that the program is administratively manageable; and (c) continuing commitment by the GOB to a policy framework consistent with its own stated environmental objectives. The arrangements proposed below for governance and administration incorporate periodic assessment of the progress of the pilot program and of the consistency of overall policy with program objectives, as a basis for periodic redesign of the program and renewal of financial commitments on the part of donors.

18. Specific policy concerns are development and effective enforcement of environmental safeguards in any new use of fiscal incentives in the Amazon region; regulations relating to land titling and taxation; and infrastructural policy, especially as concerns road construction, mining and power.

19. Governance and Administration. The management of the World Bank and the CEC staff recommend that a Rainforest Fund be established under the GEF, with an appropriate review group including representation of the Government of Brazil and donors to the Rainforest Fund./5 Technical functions at the international level would be carried out by an implementing agency or agencies appointed by the donors, and would include annual programming in conjunction with the GOB and monitoring and supervising of program activities.

20. The Government of Brazil has proposed an administrative structure and a system of financial flows in Brazil, the outlines of which are acceptable to the World Bank and CEC staff. The structure and functions of these are set out in Section V of the attached proposal. In Brazil, a Coordinating Commission (CC) composed of representatives of concerned Brazilian federal and state agencies under the chairmanship of the Secretariat for the Environment (SEMAM) would set policy and approve annual programs and internal evaluation and audit reports for submission to the review group constituted for the Rainforest Fund. Technical and operational support for the CC would be provided by the strengthened Executive Secretariat of the National Environment Fund (FNMA) of the Secretariat for the Environment. Implementation of specific activities of the pilot program would be undertaken by the relevant federal and state agencies, research institutes, local communities and NGOs.

21. Donor contributions would be credited in foreign exchange to the Rainforest Fund. Funds for specific activities managed by government entities and approved by the Rainforest Fund review group and the CC would be transferred to the executing agencies in Brazil through a special account in the Central Bank, once approved by the Executive Secretariat. Funds would be transferred from the Central Bank through one of several existing funds in Brazil: FNMA (Fundo Nacional de Meio-Ambiente), or FNDCT (Fundo Nacional de Ciência e Tecnologia). Funds for approved activities managed outside of government could be transferred through the FNMA; disbursed directly from bilateral donors to nongovernment groups; or disbursed from a separate fund for small grants to be managed by an independent entity in Brazil such as the United Nations Development Program (See Figure 4 of the attached proposal). The final details of the administrative and financial arrangements should be

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/5 The review group would take on many of the functions outlined in the GOB proposal for the "Joint Commission".

approved by the implementing agency or agencies on behalf of the Rainforest Fund review group.

22. The proposed governance and financing arrangements will support a critical objective of the pilot program, i.e., to develop and implement new approaches to managing and financing a large comprehensive program that is also flexible and innovative. At the international level, the proposed structure would rely on an existing mechanism. Within Brazil, the proposed structure would not rely excessively on overburdened government institutions, and would create new opportunities for the GOB to establish dialogue with NGOs and concerned populations. Innovative features include: establishment of trust funds to ensure stable support for independent science and field work of international quality; a small grants program, managed by an independent entity, to provide nongovernment organizations with an additional separate source of funds; inclusion of NGO representatives on the policymaking group in Brazil and on the Executive Secretariat of the pilot program; and involvement of community and other groups in the design and implementation of demonstration projects.

THE WORLD BANK

ROUTING SLIP	Date 7/2/91

OFFICE OF THE PRESIDENT

Name	Room No.
Members, President's Council	
cc: Mr. Husain	

	To Handle		Note and File
	Appropriate Disposition		Prepare Reply
	Approval		Per Our Conversation
	Information		Recommendation

Remarks

Re: Brazil G-7 Rainforest Fund and the GEF

Mr. Conable would like to meet with you at 3:30 p.m. this afternoon (assuming that the Board is over by that time) to discuss the attached. He would like to focus on governance and administration issues (see Mohamed El-Ashry's note of July 1 to Wilfried Thalwitz, and footnote 1 on page 2 and para. 19 of the attached summary note, "Pilot Program to Preserve the Brazilian Rainforest").

From Sven Sandstrom

The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: 01-Jul-1991 06:41pm

TO: Wilfried Thalwitz (WILFRIED P. THALWITZ)

FROM: Mohamed T. El-Ashry, ENVDR (MOHAMED T. EL-ASHRY)

EXT.: 33202

SUBJECT: Brazil - G-7 Rainforest Fund and GEF

I think we both agree with Mr. Silard (Legal Dept) that footnote 1 (page 2) should be dropped since there does not seem to be an official, public document to that effect.

That leaves then the specific language in para 19 "Governance and Administration." The way I visualize how it would work is as follows:

GEF as a pilot is an umbrella funding mechanism that could include a number of separate trust funds, each contributed by a group of donors to address specific global environmental concerns worldwide or in a particular geographic region. The GET is one example (addressing four issues worldwide). But in reality, it addresses three, recognizing that the Montreal Protocol Fund was established separately and then folded under GET. The Brazil Trust Fund, under the umbrella of GEF, would be similar to the Montreal Protocol Fund concept, except it deals with one country (but eventually expands to deal with the Amazon Region) and specifically for Tropical Forest conservation.

Since UNEP and UNDP are partners with the Bank under the broad umbrella of GEF, I see no way of getting around their involvement through the Implimentation Committee (IC) in this or any other separate trust fund. The same goes for STAP. But I can see, however, a separate review group (separate from the current "Participants" group), consisting of the donors to the Rainforest Fund, even though most or all may be represented in the GEF Participants -- not unlike the Executive Committee of the Multilateral Fund for the Montreal Protocol. At the same time, STAP could organize a special working group for the technical review of this Rainforest Fund.

I hope this is helpful.

Need to inform other Board members

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: June 27, 1991

TO: Moeen A. Qureshi, OPNSV

FROM: S. Shahid Husain, LACVP

EXTENSION: 39001

SUBJECT: BRAZIL - G-7 Pilot Program for the Brazilian Rainforest

1. The purpose of this note is to inform you of the procedures followed in responding to the request of the Group of 7 (G-7) heads of state at the 1990 Houston Summit that the World Bank, in cooperation with the Commission of the European Communities (CEC) work with the Government of Brazil (GOB) to prepare a comprehensive pilot program to counteract the threat to Brazil's tropical rain forests. Attached, for your review, is the note which, together with the Brazilian proposal, is to be submitted to the G-7. This note has been cleared by Finance and PRE. Also attached, for your consideration, is a draft letter from Mr. Conable transmitting the document to the Executive Directors that represent the G-7 countries. Under separate cover, I believe that Mr. Conable should distribute his letter and the cover note to all members of the Board for information. The Brazilian proposal could be made available on request.

Below, I indicate what has been accomplished. I then briefly review the process by which the results were achieved.

Completion of the Proposal

2. The Bank will fulfill its responsibility on the pilot program with the submission of a proposal from the GOB to the G-7 and a cover note from the Bank and CEC for such a pilot program. Those documents accompany this memorandum.

3. Briefly, the GOB proposes to establish a pilot program the objective of which is (according to the GOB proposal)

> to maintain the environmental benefits of Brazil's tropical rainforest consistent with its development goals and help create a development model for the region that will prove sustainable thus contributing to a continuing reduction of deforestation.

4. The Brazilian proposal is for a pilot program of five years duration at an estimated cost of $1.566 billion. The pilot program (according to the Brazilian proposal) would be supported by concessional financing from the G-7 and possibly other donor countries, with a modest contribution from the GOB. The pilot program reflects the emerging policy of Brazil with regard to the Amazon. Indeed, the process of formulating the proposal resulted in a considerable mobilization of resources and

institutions by the GOB and may have advanced policy formulation. The GOB has indicated that it intends to carry out the pilot program in any case, although it would be implemented much faster with the financing requested.

5. The Brazilian proposal is divided into two major parts: structural programs and demonstration projects. The structural programs would include the strengthening of Brazil's network of conservation units (parks, national forests, biological reserves, etc.), support for management of specific resources such as fisheries, rehabilitation of degraded areas, ecological-economic zoning, strengthening of scientific institutions, scientific research on rainforest preservation, strengthening of federal and state environmental institutions, an environmental education project, and projects to enhance the GOB's ability to monitor rainforest areas and to enforce environmental legislation. The demonstration projects would provide support for innovative projects with a potential to help local populations make better use of existing resources, add value to local products and other activities that would reduce the pressure on the tropical forests of the country. Non-governmental organizations (NGOs) would play a major role in proposing and implementing demonstration projects as well as in implementing the structural program.

6. In the cover note attached to the proposal, the management of the World Bank and the staff of the CEC recommend that the G-7 endorse the objectives of the GOB proposal and commit themselves to support, on highly concessional terms, activities in a first phase estimated to cost about $250 million. Activities in the first phase would consist initially of preinvestment activities, and then, as projects are appraised and approved, mainly of demarcation and strengthening of conservation units, institutional strengthening, science research and field applications, and demonstration projects. The duration of the first phase would depend on the pace of implementation but would probably be at least two years.

Procedures and Processes

7. The GOB responded to the original G-7 communiqué by forming an interministerial commission on October 1, 1990 to prepare a pilot program. The Bank and the CEC sent separate technical missions to Brazil in October and November 1990 respectively, and sent a joint mission in January 1991. Three tripartite meetings were held among the GOB, staff members of the World Bank and staff members of the CEC. The Bank hosted a meeting in Washington D.C. in December; the CEC hosted a meeting in Brussels in March; and the GOB hosted a meeting in Rio de Janeiro in May. At each of these meetings, representatives of the GOB presented proposals for discussion and review by the Bank. At each stage these proposals were refined and improved. Through these discussions, satisfactory agreements were reached concerning the basic outlines of the pilot program, including objectives, governance and administration, the flow of funds and the participation of NGOs. Because different activities proposed for inclusion in the program are at different stages of preparation and have different priority, the GOB agreed to the principle of phasing the program. At the final meeting in Rio de Janeiro, the GOB also presented a detailed preliminary budget, and a procedure was adopted for submission of the proposal to the G-7.

8. Parallel to this process, the Bank and CEC have explored the issue of participation by NGOs in the program. Two special missions were mounted, with GOB cooperation, to contact Brazilian NGOs, to assess their capacity to absorb funds and manage projects, and to determine their interest in participating in a pilot program.

9. Within the Bank, we formed a special advisory committee of Bank staff members with experience in the Amazon region and expertise on tropical forest issues. The advisory committee included staff from LAC, the other regions, Finance, PRE, and OED. This committee has met regularly, has been kept abreast of the progress of discussions and has offered suggestions and comments at every step. The membership of this committee is listed on an attached page.

10. The World Bank Executive Directors (EDs) of the G-7 countries expressed interest in this project. Under the informal chairmanship of the German ED's office, four special briefings were held for the EDs, the most recent being on June 3, 1991. EDs from the G-7 countries and from other countries represented in the CEC were invited. These meetings provided useful feedback from the EDs regarding the concerns of their governments. Many of the issues raised in these meetings have been reflected in the attached cover note.

11. Among the issues raised by the EDs was that of the possible proliferation of special purpose multilateral funds and possible overlap with the Global Environment Facility (GEF). The cover note proposes that the Rainforest Fund be set up as a trust fund under the GEF. This possibility has been discussed with Bank staff in your office (COD) working on the GEF and with Bank staff in the Finance and PRE complexes all of whom are also concerned about the potential proliferation of funds. The implementing agency or agencies for programs under a Rainforest Fund could be different from the implementing agencies of the Global Environment Trust Fund. Finance, PRE and COD are all agreed on the proposal in the cover note.

12. Related to the same issue, some countries might have difficulty contributing to a new multilateral fund because they have no way of doing so under current national legislation. This may be the case with Germany, the UK and Japan. In informal discussions, staff of the German Government have suggested that the proposed pilot program be constituted simply as a way of coordinating separate bilateral financing arrangements focussing on a single country. The G-7 could suggest this mechanism for financing the program. However, this approach could make program coordination difficult, and it might not meet the G-7 request that the pilot program be replicable in other Amazon countries. The cover note does not refer to this possibility.

13. Once the proposal and cover note have been submitted to the G-7, the Bank's role with respect to fulfilling the G-7 request will have ended. The German ED expressed the opinion that the Bank should be involved in this program in the future. But any future role would need to await requests from the G-7 and the response by senior Bank management.

14. We estimate the costs to the Bank of preparing this proposal to be more than $250,000. The direct costs were borne mainly by LA1, with some contribution from the LAC Technical Department. Staff time was provided mainly by the LAC Technical Department, Environment Division, with some contribution from LA1.

cc: Mmes/Messrs: Armeane M. Choksi (LA1DR); Mohamed T. El-Ashry (ENVDR); Basil Kavalsky (FRMDR); Hans Wyss (CODDR); Demetrios Papageorgiou (LA1CO); Phyllis Pomerantz (LA1AG); Nancy Birdsall (LATEN); Edilberto Segura (LATDR).

Attachments: (a) Members of advisory committee; (b) Note to be submitted to the G-7.

DGross/NBirdsall

Advisory Committee Members

Phyllis Pomerantz, LA1AG

Maritta Koch-Weser, ENVAP

John Redwood III, OEDD2

Hans Binswanger, LA2AG

Dennis Mahar, AF2PH

Lorene Yap, FRM

Jeffrey Katz, FRM

Michel Petit, AGRDR

Narendra Sharma, AGRDR

Mohan Munasinghe, ENVPR

Sergio Margulis, LA2AG

Jeremy Warford, ENVDR

Stephen Weissman, LA1DR

Staff Task Force

Demetrios Papageorgiou, Chief, LA1CO

Nancy Birdsall, Chief, LATEN, Task Manager

Daniel R. Gross, LA1AG

Philip Hazelton, LATEN

Robert Kaplan, LATEN

PILOT PROGRAM TO PRESERVE THE BRAZILIAN RAINFOREST

Introduction

1. At the Houston Meeting in July, 1990 the G-7 Heads of States called for the World Bank, in cooperation with the Commission of the European Communities (CEC), to prepare a proposal for a comprehensive pilot program to counteract the threat to tropical rainforests in Brazil. The Government of Brazil (GOB) expressed its support for such an initiative and formed an Interministerial Commission to oversee preparation of such a proposal. As part of the process of preparing the proposal, staff of the World Bank, the CEC and the GOB held three tripartite meetings and a series of technical missions and discussions. World Bank staff also periodically briefed the Executive Directors of the World Bank representing the G-7 countries, and in response to their requests, and in collaboration with CEC staff, prepared the recommendations set out below regarding the size and activities of the proposed program.

2. The resulting GOB proposal for a pilot program to be executed over a five-year period is attached. The management of the World Bank and the staff of the CEC endorse the objective of the Brazilian proposal and support the establishment, under the administrative umbrella of the Global Environment Facility, of a Rainforest Fund to carry out activities to support that objective. The program would pertain mainly to the Amazon Rainforest but would also provide limited support to preserve the Atlantic Forest.

3. The objective of the pilot program is to maximize the environmental benefits of Brazil's rainforests consistent with Brazil's development goals, through the implementation of a sustainable development approach that will contribute to a continuing reduction of the rate of deforestation. The attainment of this objective would: demonstrate the feasibility of harmonizing economic and environmental objectives in tropical rainforests; help preserve the huge genetic resources of the rainforests; reduce the Amazon's contribution to global carbon emissions; and provide another example of cooperation between developed and developing countries on global environmental issues. Preservation of biodiversity, reduction in carbon emissions, and new knowledge about sustainable activities in tropical rainforests represent benefits that are global in scope and justify financial transfers from the international community to Brazil.

4. The GOB has already committed its own resources for conservation activities in its rainforest areas, including through normal World Bank financing, and is committed to undertaking the activities outlined in the attached proposal with its own resources. New and largely concessional resources would permit more rapid, wide-ranging implementation of these activities than could otherwise be undertaken, given the government's limited resources and other priorities.

5. A mechanism, the Global Environment Facility (GEF), is already in place by which to channel concessional resources to developing countries to address global environmental objectives. Some portion of the proposed pilot program in Brazil could be financed from the Global Environment Trust Fund (GET) under the GEF. However, existing GET resources are inadequate to address the scope and urgency of the threat to Brazil's rainforests, or to realize the potentially large joint benefits to the global community of the proposed pilot program in Brazil. The establishment of a Rainforest Fund under the GEF would permit supplemental global resources to be channeled to Brazil, while at the same time minimizing administrative costs and ensuring close technical

cooperation with other global programs. Finally, a Rainforest Fund under the GEF could eventually be extended to cover other countries with threatened rainforests./1

Background and Rationale for Donor Support

6. Conserving the Amazon and Atlantic rainforests would provide benefits to the global community because together they represent the largest repository of biodiversity in the world and because conservation of the Amazon forest would lead to reduced emissions of carbon gases. These rainforests also provide regional and local benefits through their influence on hydrological cycles and thus local climate, the protection they afford to watersheds, and as homes to indigenous communities with distinctive cultures.

7. Beginning in the 1960s, public investments in roads and other infrastructure and public policies supporting colonization encouraged migration into the Amazon and resultant deforestation. Lacking suitable technology, many farmers practiced an unsustainable form of slash-and-burn agriculture with annual crops. Logging increased; squatters, miners and loggers made frequent incursions onto indigenous lands and brought disease and environmental damage. Investments in hydropower dams and in exploitation of major mineral deposits also contributed to deforestation. Legislation encouraged landholders seeking to legalize their titles to clear forest by defining cleared land as "improved." Fiscal incentives encouraged investment in cattle, sawmills and other enterprises without environmental restrictions. Although new parks and other conservation units were created, the Government lacked resources to protect and manage these areas adequately.

8. As a consequence of these activities and policies, deforestation in the Amazon accelerated, reaching a peak in 1987 when the combination of an unusually dry year and uncertainty over future land legislation caused an unprecedented amount of forest clearance and burning. By 1990, an estimated 8% of the Amazon rainforests had been deforested.

9. Policy Changes. The years 1988-91 proved to be a watershed in the evolution of Brazilian environmental policy. The changes in policy are set out in detail in the attached GOB proposal (pp. 3-5).

- In 1988 and each year thereafter the federal government has sponsored a special program to prevent forest burning.

- In early 1989, the Nossa Natureza Program established a National Environmental Fund (FNMA) with the participation of non-governmental organizations (NGOs) on its board; temporarily suspended fiscal incentives for development in the Amazon; and repealed laws encouraging forest clearance as a way of gaining title.

/1 Under the terms of the GEF, a separate trust fund could have a different implementing agency or agencies, a different review group than that of the GET and a different group of donors; and could be organized in a manner consistent with the phasing and arrangements for governance and financing of the pilot program that are set out below.

- In 1990 the GOB created an Environmental Secretariat, SEMAM, reporting directly to the President and under it a single national environmental agency, IBAMA, combining four separate agencies into one. All federal ministries were given responsibility for establishing sectoral plans consistent with environmental objectives.

- Also in 1990, President Collor appointed an internationally known environmentalist as Secretary of SEMAM, and the GOB established the National Environmental Program with support from a large World Bank loan to strengthen IBAMA and to protect major ecosystems nationwide.

- Over the same period, the government instituted new regulations aimed at forest use by industry, initiated a review of federal infrastructure projects and greatly reduced credit subsidies for agriculture and livestock activities (partly as a result of general fiscal austerity).[/2]

- In 1991 fiscal incentives for the Amazon and Northeastern regions were officially restored. Congress rejected proposals of the executive branch that would have set market rates of interest for credits under the program. However, the legislation does explicitly restrict subsidies for ranching to areas designated as appropriate on environmental grounds, and mandates environmental licensing for all projects benefiting from incentives.

10. Partly as a result of these changes, and partly as a result of natural and market conditions, rainforest clearing in the Amazon has declined each year since 1987.

11. Existing Constraints. To firmly secure for the future the environmental benefits of the rainforests in Brazil requires that three critical constraints be addressed.

- First, the present largely positive direction of this administration's environmental policy must be consolidated at the federal level between the administration and Congress and must be reinforced at the state and local levels. This implies that pricing, fiscal and investment policies at federal, state and local levels would be consistent with environmental objectives. Policy in Brazil is the outcome of complex interactions among the executive and the legislature at the federal level, and among and between federal, state and local administrators and political representatives. Public opinion, a growing number of organized interest and consumer groups, and a sophisticated press are also important factors in Brazil's open political system. Improved public understanding of the benefits and the costs of rainforest protection and increasing accountability of public institutions on

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/2 Brazilian environmental legislation is advanced in other respects. Farmers and ranchers in the Amazon region must obtain permits before clearing and burning land and may not clear more than 50% of the forest on a given property or along watercourses or at the headwaters of streams. Loggers can cut timber only after submitting forest management plans to IBAMA, and IBAMA closely monitors the transport of logs and operation of sawmills.

environmental matters are critical to consolidation of a sound policy on rainforest issues.

- o Second, relatively weak state and local as well as federal institutions that are responsible for enforcing environmental laws, require strengthening in terms of management, technical skills, and adequate equipment and other infrastructure.

- o Third, continuing investments in natural and social science research and field applications are needed (a) to ensure that the economic benefits of genetic biodiversity in Brazil's rainforests can be realized, and (b) as a basis for the development and dissemination of sustainable approaches to economic exploitation of the forests.

12. The pilot program is designed to address these needs. Its design reflects concern with all three constraints. The design also represents a new approach to development in rainforest areas in Brazil, marking a profound change from the views and programs of just a few years ago.

The Pilot Program

13. The pilot program has two main parts: structural programs, in which the emphasis is on strengthening of government institutions; and demonstration projects, in which the emphasis is on support for and promotion of grassroots initiatives. The content of each proposed activity is described in detail in Section IV of the attached proposal. Below we describe briefly each major activity, and indicate our recommendation for emphasis in a first phase.[/3]

(a) Conservation Units: Conservation units and indigenous areas in the Amazon, already legally established, would be demarcated and equipped with needed infrastructure.[/4] These investments would complement those financed under a World Bank loan, and those already proposed by the GOB for financing by the GET. The first phase would include preinvestment activities (reconciling policy and legislation, development of flexible mechanisms for handling land tenure irregularities, and development of detailed management plans for specific units); and financing for demarcation of three indirect-use conservation units (in which no economic activity is permitted); three national forests; four extractive reserves; and six indigenous reserves.

(b) Natural Resource Management and Degraded Areas: Activities would address production, regulation and marketing of fishing and forestry products that are commercially viable and environmentally sustainable, and recovery and reuse of deforested areas. The first phase would consist of formulation of working procedures and program development,

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/3 The proposed first phase set out in the attached proposal would be fully assessed by staff of the international implementing agency and approved on an annual basis in Brazil by the Coordinating Commission.

/4 Conservation units would also be supported in the Atlantic Forest, as described in Appendix II of the attached proposal.

and studies of the environmental, social and economic consequences of any investments in recovery of degraded areas.

(c) Environmental Zoning: This program would, once follow-up enforcement capacity is in place, help finance regional and local environmental zoning to guide future public investments and to ensure appropriate use of any fiscal incentives. Emphasis in the first phase would be on support for information systems and on building capacity to carry on zoning exercises at the state level.

(d) Scientific and Technical Support: Trust funds would be established under the management of the federal Secretariat of Science and Technology to support INPA (Instituto Nacional de Pesquisas Amazônicas) and the Museu Paraense Emílio Goeldi (also a research institute). The purpose of the trust funds would be to provide a permanent base of sustained support for these two existing centers of excellence of scientific research in the Amazon Region. The trust funds would finance infrastructure and the creation of endowed chairs or topping up of salaries, to ensure that these institutions can attract and retain the best possible talent worldwide as well as in Brazil. An additional trust fund should be considered to provide similar support to other research institutions in the Amazon region, to strengthen the agricultural, biological and social sciences relevant to protection of the Amazon rainforests. Emphasis would be on collaboration among local, national and international centers. In addition, a program of support for basic and applied research aimed at better understanding of the Amazon environment should be established under the management of the Secretariat of Science and Technology, similar to existing research support programs, including PADCT (Program for the Support of Science and Technology). Research grants would be available on a competitive basis to staff at all national institutions, private and public. International and transregional scientific cooperation in funded research would ensure high scientific standards. Advanced training and a scientific information system would also be financed. First phase activities include making arrangements for trust funds, setting priorities and appraising plans for strengthening centers of excellence, and defining the scope and procedures for the research grants program.

(e) Monitoring and Enforcement: A set of activities is proposed to strengthen the capacity of public agencies, especially of the nine state environmental agencies in the Amazon region. Emphasis would be on establishing measures and means to monitor environmental quality including forest cover, fauna, water and air quality, and the status of indigenous people; and to detect infractions of environmental legislation. First phase activities include detailed planning of training programs; design, specifications and site selection for control posts; and development of procedures for augmented monitoring and enforcement.

(f) Environmental Education: Support would go mainly to the Amazon region for preparation and introduction of environmental issues to school curricula. University-level exchanges of information, public education campaigns, and wide dissemination of scientific knowledge are also envisaged. First phase activities include carrying out a diagnosis of current practices and materials in environmental education and design of

a comprehensive program of environmental education for the Amazon region.

(g) "Free-standing" Demonstration Projects: Support would go to projects that would test new technologies, organizational forms or techniques to develop sustainable production in the Amazon, or improve conditions for rural dwellers where such support can help reduce itinerant, predatory deforestation. Such projects would be proposed by local or national NGOs, entrepreneurs, local government agencies, and research and extension agencies. Projects sponsored by nongovernment groups could be funded through one of three channels: (a) the National Environmental Fund (FNMA), (b) direct (bilateral) grants, and (c) a small grants fund administered independently of the Brazilian Government. Such projects would be judged on their potential to achieve tangible results, their sustainability without continued subsidies, and their replicability. Up to 20 of these free-standing demonstration projects would be supported in the first phase.

(h) "Area-based" Demonstration Projects: Support would go to projects sponsored by consortia of government agencies and NGOs in selected strategic areas throughout the Amazon. Emphasis in the first phase would be on detailed "project" planning in three specified geographic areas, one in the western Amazon, two in the eastern Amazon.

14. Because this is a pilot program, heavy emphasis will be placed on: monitoring of program inputs, with feedback to redesigning of activities; supervision of implementation by technical staff at the international level; and evaluation of the impacts of activities, both within Brazil, and through an advisory group at the international level.

Recommendations

15. Initial Commitment. The management of the World Bank and the staff of the CEC recommend that the G-7 endorse the objectives of the pilot program and commit themselves to support on highly concessional terms[/5] activities in a first phase, estimated to cost about US$250 million. The duration of the first phase would depend on the pace at which proposed activities can be effectively implemented, but would probably be at least two years. Donors should be prepared to provide US$50 million for an initial nine-month period, to be disbursed against (a) a set of pre-investment and planning activities, (b) implementation of selected aspects of the existing program that are ready for implementation, (c) initial financing of two trust funds to strengthen scientific centers of excellence and of a small grants program fund for NGO activities, and (d) overhead for technical support functions at the international level.

/5 Financing could be in the form of grants, loans on IDA terms, and debt-for-nature swaps to the extent the latter are consistent with the overall approach of the Government of Brazil and creditors to Brazil's external debt. The GOB would provide some counterpart funds (up to 10% for certain parts of the program); state and local governments and residents of the Amazon would also participate in financing.

16. The Full Program. The GOB proposal describes activities to be carried out over a five-year period at an estimated cost of US$1.6 billion. These activities would complement those being financed through existing World Bank loans and those proposed by the GOB for financing under the Global Environment Trust Fund. While the precise cost and timing of specific activities require further definition, the magnitude of the potential global and national benefits of preserving the rainforest justifies the sustained commitment of substantial resources.

17. However, neither the estimated costs nor the precise activities and timing proposed by the GOB have been fully appraised by staff of the World Bank and the CEC. Donor commitments to finance specific activities under the first and subsequent phases should be made on a rolling basis, and should depend on: (a) annual assessments of specific program activities and proposals; (b) evidence that the program is administratively manageable; and (c) continuing commitment by the GOB to a policy framework consistent with its own stated environmental objectives. The arrangements proposed below for governance and administration incorporate periodic assessment of the progress of the pilot program and of the consistency of overall policy with program objectives, as a basis for periodic redesign of the program and renewal of financial commitments on the part of donors.

18. Specific policy concerns are development and effective enforcement of environmental safeguards in any new use of fiscal incentives in the Amazon region; regulations relating to land titling and taxation; and infrastructural policy, especially as concerns road construction, mining and power.

19. Governance and Administration. The management of the World Bank and the CEC staff recommend that a Rainforest Fund be established under the GEF, with an appropriate review group including representation of the Government of Brazil and donors to the Rainforest Fund.[/6] Technical functions at the international level would be carried out by an implementing agency or agencies appointed by the donors, and would include annual programming in conjunction with the GOB and monitoring and supervising of program activities.

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21. Donor contributions would be credited in foreign exchange to the Rainforest Fund. Funds for specific activities managed by government entities

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/6 The review group would take on many of the functions outlined in the GOB proposal for the "Joint Commission".

and approved by the Rainforest Fund review group and the CC would be transferred to the executing agencies in Brazil through a special account in the Central Bank, once approved by the Executive Secretariat. Funds would be transferred from the Central Bank through one of several existing funds in Brazil: FNMA (Fundo Nacional de Meio-Ambiente), or FNDCT (Fundo Nacional de Ciência e Tecnologia). Funds for approved activities managed outside of government could be transferred through the FNMA; disbursed directly from bilateral donors to nongovernment groups; or disbursed from a separate fund for small grants to be managed by an independent entity in Brazil such as the United Nations Development Program (See Figure 4 of the attached proposal). The final details of the administrative and financial arrangements should be approved by the implementing agency or agencies on behalf of the Rainforest Fund review group.

22. The proposed governance and financing arrangements will support a critical objective of the pilot program, i.e., to develop and implement new approaches to managing and financing a large comprehensive program that is also flexible and innovative. At the international level, the proposed structure would rely on an existing mechanism. Within Brazil, the proposed structure would not rely excessively on overburdened government institutions, and would create new opportunities for the GOB to establish dialogue with NGOs and concerned populations. Innovative features include: establishment of trust funds to ensure stable support for independent science and field work of international quality; a small grants program, managed by an independent entity, to provide nongovernment organizations with an additional separate source of funds; inclusion of NGO representatives on the policymaking group in Brazil and on the Executive Secretariat of the pilot program; and involvement of community and other groups in the design and implementation of demonstration projects.

6/18 ~~AK~~ SS
2:30 pm

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
Mr. B. Conable (E-1227)	6/14/91

SUBJECT:

Document From: Mr. Husain (MAQ)
To: bbc
Dated: 6/14/91 Reference No.: EXC910614012

Topic: BRIEFING: Note for the Visit of President Fernando Collor de Mello.

Tuesday, June 18 - 2:30 pm

ACTION INSTRUCTIONS: | DUE DATE:

_____ HANDLE
_____ REVIEW AND RECOMMEND
__XXX__ FOR YOUR INFORMATION
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
_____ PREPARE RESPONSE FOR _____ SIGNATURE
_____ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: JV - ff

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: June 14, 1991

TO: Mr. Barber B. Conable

THROUGH: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 39001

SUBJECT: BRAZIL: Briefing Note for the Visit of President Fernando Collor de Mello

Economic Policies

1. Brazilian economic growth fell from 8.6 percent annually in the 1970s to 2.2 percent in the 1980s. Population grew at about the same rate, so Brazilians passed the decade without improving their average living standard. Poor economic policies distorted incentives for trade, industry and agriculture; investment and savings fell; capital stopped flowing from abroad; and inflation accelerated until consumer prices were doubling almost monthly. Three adjustment programs failed. In March 1990 Fernando Collor de Mello became the first directly elected president in over twenty years. He introduced an unprecedented economic reform program to stabilize the economy, to reduce government intervention and to restore growth.

2. The Collor Government introduced structural reforms in the areas of trade policy, deregulation, privatization and agricultural policy. These policies have been maintained, but the stabilization program collapsed after nine months and "Collor II" was introduced in January 1991. The core of the new stabilization program is a price and income policy, apparently unsupported by the necessary fiscal and monetary measures. Without a renewed effort on tight monetary policy and increased fiscal surpluses, a return to double digit (monthly) inflation cannot be ruled out.

3. The second program met skepticism, and public confidence was at an all time low. In May of 1991, Minister Zelia Cardoso de Mello, the Economy Minister, stepped down. Ambassador Marcilio Marques Moreira's appointment has given new hope internally and particularly to Brazil's foreign creditors, but stabilizing the economy will be difficult. Pressure is building from interest groups to loosen the stabilization measures, and the frozen accounts of the Collor Plan are due to be released beginning September 1991. Inflation is likely to rise and could lead to the collapse of "Collor II".

4. Mr. Choksi met in Brasilia the week of June 10 with Minister Marcilio Marques Moreira and his new team. His first impression was that this team is serious, dedicated, and friendly to the rest of the world and to the Bank, but that their difficult challenges may be insurmountable. The previous team left several time-bombs. First, the wage-price freeze has led to serious

production bottlenecks and deepened the recession. Getting out of this "straitjacket" without an inflationary explosion will be difficult. Second, most of the impressive fiscal improvements are the result of suppressing public sector wages and the interest on domestic public debt. Most Brazilians, including the economic team, acknowledge that public sector wages will increase in real terms in the second half of 1991. The Government cannot place in the market new debt at low interest rates and much higher rates will be required. Third, the Government is obligated to release in twelve monthly installments beginning September 15, about US$25.6 billion of frozen cruzados. The monthly release would be about 25% of the current monetary base if all US$25.6 billion were to be included. The Government is still working on an approach to neutralize the impact of this large monetary injection. This will be very difficult and, unless the Government succeeds, the prospects for a rapid rise in inflation after September are very high. Finally, the Collor Administration has sought to regain political control in the Congress and Senate by making direct arrangements with and political concessions to State Governors. These arrangements include transfers of federal funds to the States and could lead to a spiral of transfers to State Governments making fiscal control very difficult. All of the above indicate a very difficult road ahead for the new team.

5. An IMF Stand-by Negotiation and an Article IV Consultation mission visited Brazil at the end of April 1991. The mission was interrupted in May by the change in the Minister of Economy and a new visit may be scheduled for end-June. It is expected that during Mr. Collor's visit to Washington, this date may be finalized.

Foreign Debt Negotiations

6. On April 8, 1991, Brazil and the Banks' Advisory Committee (BAC) agreed on the repayment of arrears. Under the agreement, Brazil will pay 25 percent of the arrears due through year-end 1990 in cash (about US$2 billion) and will exchange the remaining 75 percent for bonds. The first cash payment, for 45 percent of the cash amount, or about US$900 million, will be made ten days after the Brazilian Senate approves the term sheet detailing the agreement. Following this, the term sheet will be sent to Brazil's approximately 600 creditor banks worldwide. Subsequently, the remaining cash payments will be made in eight monthly installments. The bonds, which will be dollar denominated bearer instruments, will mature in 10 years, with three years of grace, and have a staggered amortization. The bonds will be issued upon agreement between the BAC and Brazil on the treatment of the medium- and long-term debt.

7. The Senate has not approved as yet (June 13) the agreement on the arrears. There is concern in Brasilia that the approval may come too late for President Collor's visit to Washington. In any event, the Government's plan is to initiate negotiations with the banks on the stock of debt immediately following the "road show" on the arrears. Mr. Choksi met in New York recently with several banks--American, British, French, and Japanese--which are members of Brazil's BAC. His impressions are that most, if not all banks, want to get out of Brazil and therefore will be interested in a Brady Plan similar to Mexico's with enhancements from the Fund and the Bank. It seems likely that the Brazilians and the BAC may pursue such an agreement and ask the Bank to participate. If the macroeconomic environment does not improve, the Bank will be unable to provide the necessary enhancements to support the package.

Bank Lending

8. So far in FY91, the Bank has approved US$450 million in loans (a Science Research and Training project for US$150 million and a Private Sector Finance project for US$300 million).

We expect to have two additional projects approved by the Board this month: Innovations in Basic Education (US$245 million) and Hydrocarbon Transport and Processing (US$260 million) for total commitments for the fiscal year of US$955 million. Because of the poor macroeconomic environment, we have ceased all credit line operations including one for Privatization and Capital Markets Reform (US$315 million) which would be ready for negotiation, if the situation were to improve. For the Electricity Distribution and Conservation project (US$300 million), negotiation is conditional on a satisfactory tariff increase and would require a post-appraisal mission. Because of the slow process within Brazil of establishing government priorities, in the next fiscal year our lending will be in the US$700 million-$1 billion range. Net disbursements this fiscal year and the next will continue to be negative and large (around US$200-$300 million).

Environmental Issues

9. The Brazilian Government and the Bank have in recent years confronted a severe problem of public criticism, mostly from the richer countries, of the effect of policies and projects on environmental conservation, especially in the Amazon. These criticisms have diminished recently, a reflection of the attention both the Government and the Bank have given conservation issues. The Bank, the Government, and the Commission of the European Communities are cooperating, under the mandate of the June 1990 Houston Summit of the Group of Seven, to propose by the next summit (June 1991) a joint Pilot Program to Preserve Brazil's Amazon Rain Forests. This joint preparation is proceeding well. To attract serious donor commitment, it will need endorsement at the highest levels of the G-7 governments.

10. We have also recently completed a major report on environmental policies in the Amazon which could change the debate in this area. This report will be discussed with the Government soon. In addition, if the Government were to speed its project approval process, we could bring to the Board in FY92 four or five environmental projects. Both the report and these projects would contribute significantly to Brazil's international image, particularly since the UN Conference on Environment is to be held in Brazil next June.

Issues to be Discussed

11. Your meeting with President Collor is likely to be brief. I suggest that you ask him how he sees the economic prospects. You should underline our concern with the inflationary potential of the release of frozen assets and ask President Collor how he will address the problem. You should also ask Mr. Collor how he proposes to reign in the deficit of the states - a major political issue in Brazil now. As to external debt, you should welcome the agreement on arrears and urge him to proceed with the larger issue of agreement on the entire stock of debt to commercial banks. You should emphasize the importance of external and domestic confidence in economic management. I suggest that you should not initiate a discussion on Bank operations. If the issue comes up, you should emphasize the importance of stabilization and our disappointment regarding the failure of initial attempts largely because of the failure of monetary policy. Until a credible stabilization is in effect, our lending will be limited largely to support environment, agriculture, health and education projects.

cc: Mr. A. M. Choksi

Jen - fyi
(i will log)

BRAZILIAN EMBASSY
3006 Massachusetts Ave., N.W.
Washington, D.C. 20008

FAX: (202) 745-2827

TF

AUTOBIZZO

TELEFAX TRANSMITTAL PAGE

Nº of Pages Including this Cover Sheet	Date
1	06.14.91

From	Phone
Minister Joaquim L.C. Palmeiro Chargē d Affaires, a.i.	(202)745-2783

To	Fax
Mr. Barber Conable, President of the World Bank	(202) 477-1305

Mr. President,

I have the honor to convey to you an invitation by his Excellency Mr. Fernando Collor, President of the Federative Republic of Brazil, for a 20 minute working meeting next Tuesday, June 18th, at 2:30 P.M., to take place at the Blair House.

I avail myself of this opportunity to convey to you the assurances of my highest consideration.

Joaquim L. C. Palmeiro
(Chargē d'Affaires, a.i.)

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

June 17, 1991

Dear Mr. President:

I have learned of your appointment as Alternate Governor for Brazil on the Boards of Governors of The World Bank Group. I realize this is incident to your responsibilities in your own Government, but I hope you will be in a position to actively participate in the affairs of the Bank Group, as well.

The Executive Directors, Officers and Staff of The World Bank Group believe very strongly in its development mission and in the battle against poverty. We look forward to working with you to make the Bank Group even more effective during the coming years. Congratulations on your appointment and thank you for your willingness to take on this additional responsibility.

I look forward to meeting you in the near future, and send my best personal wishes.

Sincerely,

(Signed) Barber B. Conable

Senhor Francisco Gros
Presidente
Banco Central do Brasil
Caixa Postal 04.0170
70074 Brasilia (DF)
Brazil

cc: Mr. Leung
Mr. Choksi
Mr. Santos

ETSanidad:se

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

June 17, 1991

Your Excellency:

I have learned of your appointment as Governor for Brazil on the Boards of Governors of The World Bank Group. I realize this is incident to your responsibilities in your own Government, but I hope you will be in a position to actively participate in the affairs of the Bank Group, as well.

The Executive Directors, Officers and Staff of The World Bank Group believe very strongly in its development mission and in the battle against poverty. We look forward to working with you to make the Bank Group even more effective during the coming years. Congratulations on your appointment and thank you for your willingness to take on this additional responsibility.

I look forward to meeting you in the near future, and send my best personal wishes.

Sincerely,

(Signed) Barber B. Conable

A Sua Excelencia
Senhor Marcilio Marques Moreira
Ministro de Economia, Fazenda
e Planejamento
Esplanada dos Ministerios
Bloco P, 6o andar
70048 Brasilia (DF)
Brazil

cc: Mr. Leung
Mr. Choksi
Mr. Santos

ETSanidad:se

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COMPUTER MESSAGE - PLEASE DO NOT INTERRUPT

IF THIS MESSAGE IS RECEIVED GARBLED, PLEASE ADDRESS YOUR CLAIM TO TEL EX MACHINE 612098 BCBR BR OU 611299 BCBR BR REF:DEORI/91024197-001.

FROM : BANCO CENTRAL DO BRASIL DEORI/91024197-001
TO : INTL.BK RECONSTRUCTION DEVELOPMENT

ATTN.: MR. T. T. THAHANE
SECRETARY

DEORI/GABIN-91/048 - 03.06.91

I AM PLEASED TO INFORM YOU THAT HIS EXCELLENCY THE PRESIDENT OF THE REPUBLIC HAS DESIGNATED THE AMBASSADOR MARCILIO MARQUES MOREIRA, MINISTER OF ECONOMY, FINANCE AND PLANNING, TO ACT AS GOVERNOR FOR BRAZIL BEFORE THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT AND MR. FRANCISCO ROBERTO ANDRE GROS, PRESIDENT OF THE CENTRAL BANK OF BRAZIL, TO ACT AS ALTERNATE GOVERNOR.

SINCERELY YOURS

LUIZ AUGUSTO GALDI FERREIRA
ACTING HEAD OF THE DEPARTMENT FOR INTERNATIONAL ORGANIZATIONS AND AGREEMENTS - DEORI

BANCENTRAL
CX08 END OF MESSAGE

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TO- Executive Director
~~Executive Vice President, MIGA~~
Country Director, Bank
Investments Director, IFC
File Credential

FROM - E. T. Sanidad
SECRETARY'S DEPARTMENT

file Brazil

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
Mr. B. Conable (E-1227)	3/01/91

SUBJECT:

Document From: Marcello Alencar
To: bbc
Dated: 2/20/91 Reference No.: EXC910301008

Topic: Request from the Mayor of Rio de Janeiro to meet BBC.

ACTION INSTRUCTIONS: DUE DATE:

_____ HANDLE
_____ REVIEW AND RECOMMEND
_____ FOR YOUR INFORMATION
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
_____ PREPARE RESPONSE FOR _____ SIGNATURE
__XXX__ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: note: Antonio Pimenta-Neves, LACSA has responded by phone declining request. For the files.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: February 28, 1991

TO: Mrs. Linda McLaughlin, EXC

FROM: Antonio Pimenta-Neves, LACSA

EXTENSION: 38722

SUBJECT: Request From The Mayor Of Rio De Janeiro To Meet With Mr. Conable

Thank you for informing me that Mr. Conable will not be here on the dates required. I have already informed the office of Mr. Alencar that Mr. Conable will not be available. I had to do so by phone because they needed an urgent reply from us as they were organizing the rest of his agenda in the United States.

cc: Messrs. Choksi, Quijano.

PREFEITURA
DA CIDADE DO RIO DE JANEIRO

Feb 20, 1991

Mr. Barber B. Conable
President
The World Bank
1818 H Street
Washington, D.C.
20433 - USA

Dear Mr. Conable,

As you know, Rio de Janeiro will host the UNITED NATIONS CONFERENCE ON ENVIRONMENT AND DEVELOPMENT, to be held in 1992. The population of our City is well aware of the importance of this event, regarded as a unique and historical opportunity to make mankind re-evaluate its relationship with the environment.

Having in mind your interest and actions concerning environmental issues, I would like to meet you during my stay in Washington, D.C., on March 20-22, so that I can have the chance to hear your ideas and opinions on such important matter.

Yours Truly

Marcello Alencar
Mayor

THE WORLD BANK/IFC/M.I.G.A.

ROUTING SLIP	DATE February 11, 1991

NAME	ROOM NO.
Mr. Moeen A. Qureshi	E-1241

	URGENT		PER YOUR REQUEST
	FOR COMMENT		PER OUR CONVERSATION
	FOR ACTION		SEE MY EMAIL
	FOR APPROVAL/CLEARANCE		FOR INFORMATION
	FOR SIGNATURE		LET'S DISCUSS
	NOTE AND CIRCULATE		NOTE AND RETURN

RE: Updating Note on Brazil's Economic Program

REMARKS:

Attached are two copies of Updating Note on Brazil's Economic Program for your review. Since, I would be leaving for Venezuela on Friday, I would like to have your and Mr. Conable's clearance on this by Thursday, if possible. This version reflects Mr. Husain's comments.

Attachments

FROM:	ROOM:	EXTENSION:
Armeane M. Choksi	I-7015	31811

File
Brazil

OK
BAC
2-13

February 11, 1991

BRAZIL: ECONOMIC STABILIZATION WITH STRUCTURAL REFORMS: AN UPDATING NOTE

I. An Overview

1. On March 16, one day after President Collor assumed office, he announced a "New Brazil" (Brasil Novo) economic policy. Both its analysis and its recommendations share much common ground with the Country Economic Memorandum (CEM) "Brazil-Economic Stabilization with Structural Reforms."

2. The program's two principal components, a stabilization policy and an agenda of structural reforms, were interrelated. Both included radical policy changes that distinguish the program from any other in Brazil's recent past. The success of the program is uneven; stabilization has yet to be achieved, but the structural reforms undertaken are almost unparalleled.

3. The stabilization policy rested on two pillars, a drastic reduction of liquidity and the elimination of the large budgetary deficit. The foreign exchange rate was floated and private sector wages were left to be determined by the market. For a while, inflation (having reached about 100 percent per month prior to the plan) seemed to be contained; but after a brief interval it accelerated again, reaching to some 20 percent a month by the end of 1990. The resurgence of inflation originated primarily in monetary developments. Stabilization should have been anchored to money, but the monetary aggregates have kept rising for most of the period, with inflation running at about the same rate. Fiscal policy has also played its part. Although the improvement in the fiscal stance has been impressive, the budgetary target may not be fully reached. Together with the monetary expansion, doubts about the permanence of the fiscal policy reforms have contributed to a substantial loss of credibility. While the stabilization program has not achieved its objective of controlling inflation, it may still be salvaged through fiscal corrections and adoption of strict and credible monetary policy. The magnitude of the salvaging task is not to be underestimated: the success of a program will hinge on its credibility, and this can only be achieved through the planning and implementation of a budget surplus and, above all, the implementation and maintenance of credible monetary targets. The longer a credible program takes to put in place, the deeper will be the recession in its wake.

4. The agenda of structural reforms has been radical, consistent in its implementation, and generally successful. Driven by the perception that government should, where possible, get out of economic activity and allow markets to work freely, the reforms have already started to change the economic ground rules in Brazil. The greatest progress has been made in foreign trade. Within a mere six months, an insulated economy was stripped of almost any trade interventions beyond tariffs. This radical reform will take

some time to work its full effect on Brazilian trade, but if sustained, it will lead to a fundamental structural change. Meanwhile, deregulatory measures have reduced many government restrictions on domestic activities. The Government plans a large-scale privatization, which will greatly reduce the role of public-sector enterprises within a few years. The machinery and principles of the process are now established, and first transactions should take place in April, 1991. A reform of the public-sector administration has started, leading so far to a reduction by over 10 percent of the government's labor force; over 200,000 employees have been fired or removed from their positions, and several public agencies have been abolished. Various market-oriented reform measures have also been taken in the agricultural sector, freeing up the sector from government controls and intervention; and promising changes are beginning to be implemented in the social sector.

5. This paper will take a more detailed look at the new economic policy. It will describe the announced policy package, then analyze implementation and performance; finally, it will make some recommendations.

II. The Policy Package

A. Background

6. The last months of the Sarney Administration saw high and increasing inflation, a large fiscal deficit, and an expansionary, accommodating monetary policy. By the first half of March, 1990, inflation had reached a monthly rate of around 100 percent. While the Brazilian economy had developed various instruments to neutralize some of the impact of inflation, it was generally recognized that this level was so high as to constrain normal economic activity; and, correspondingly, that any serious attempt to stabilize the economy would have to be radically different from the three earlier unsuccessful stabilization plans undertaken between 1986 and 1989. Another program in which fundamental monetary and fiscal adjustments were missing was bound to fail.

7. Brazilians also recognized that their economy was so highly distorted--as discussed in the CEM--that economic growth could not resume without drastic structural transformations. In this, even more than in macroeconomic policy, radical change seemed essential. It was also increasingly accepted, as argued in the CEM, that these two policy areas were related: stabilization without structural transformation was not credible, and transformation without stabilization was not sustainable. President Collor's "New Brazil" policy package thus addressed these two issues simultaneously.

8. Surprisingly, particularly in view of the small representation of the President's own party, Congress passed (within the 30-day period specified by the Constitution) almost all the policy package practically unaltered.

B. Stabilization Policy

9. The stabilization package had four elements: monetary policy, fiscal policy, exchange rate policy and wage-price policy.

(i) Monetary Policy: The program assumed that the stock of liquidity must be reduced dramatically and immediately, in the process also achieving a significant fiscal saving. Along with the creation of a new currency (the cruzeiro), the program thus drastically reduced liquidity. In one day, 70 percent of the liquid financial assets were frozen: total liquidity fell from 30 percent to 9.1 percent of GDP after the Government blocked all overnight accounts, demand deposits, and time and savings deposits above a certain level. Those deposits, denominated in cruzados, were to be frozen at the Central Bank for 18 months and were adjusted for inflation and remunerated at 6 percent per year. Deposits below the specified level were automatically converted into cruzeiros. The frozen cruzados could, however, be used to pay debts contracted before March 15 (including mortgages, taxes and social contributions). To soften the impact on total liquidity, the reserve ratio on demand deposits was reduced from 80 to 40 percent.

(ii) Fiscal Policy: the Plan aimed at substantially improving the public-sector budget, from an estimated operational deficit of 8-10 percent of GDP in 1989 to an operational surplus of 2 percent by the end of 1990. This was to be achieved by a stringent reduction (by some 6 percent of GDP) in the interest bill on the government's domestic debt; by wide-ranging tax reforms and reductions in public spending, including the layoff of public workers; and by an increase in public-sector prices. The following tax measures were introduced: (a) the income tax base was broadened to include agricultural incomes; (b) the value added tax on industrial production (IPI) was raised by 10 to 15 percentage points; (c) the corporate income tax on export profits increased from 16 percent to 35 percent; (d) the financial tax (IOF) was broadened to cover trading of all bonds, gold and gold certificates, and stock market shares.[1/] To avoid tax evasion, all bearer financial instruments were eliminated. The period of tax collection was reduced and all taxes were indexed by the daily measure of inflation (the fiscal BTN). In addition, all fiscal incentives and subsidies were to be suspended for at least one year. Prices of public-sector enterprises were raised by about 40 percent, roughly to their real levels of December, 1988. The government's labor force was reduced immediately by 12,000 employees. Twelve ministries were closed, and 24 enterprises were merged with several governmental agencies. To further reduce public spending, the free public transportation used for more than 20 years by federal workers was eliminated; cars and airplanes were sold; and nonessential expenditures such as travelling and advertising were limited. The government also undertook to sell federally-owned residential property.

1/ Of these measures, (a) and (c) can be implemented by law only in 1991; and (d) was a one-time tax.

(iii) Foreign Exchange Policy: the previous foreign exchange policy (crawling peg) administered by the Central Bank was replaced by a floating exchange rate. However, foreign-exchange control was maintained, allowing for the continuing segmentation of the foreign exchange market into three: the official market for exports and imports, the tourism market created in 1988, and the parallel market.

(iv) Prices and Wages: at first, the prices of goods and services were frozen for 45 days. From May 1 onward, the government would announce the ceiling for monthly price adjustments. The indexation of wages by the previous month's inflation was replaced in the public sector by a pre-fixed indexation system. Wages in March were to be adjusted by February's inflation rate. Starting in April, the government would announce an expected inflation rate as basis for the indexation of wages. In the private sector, wages would be freely negotiated. The minimum wage was to be raised quarterly by 5 percent in real terms.

C. Structural Transformation

10. Basic to the policies of structural transformation was the idea that the size and role of the public sector must be reduced substantially, and that government intervention should be replaced by the operation of the free market--a radical reversal of a deeply ingrained tradition of more than a century in Brazil. The central components of the new policy were trade liberalization, privatization, and domestic deregulation. Other structural reforms were implemented during the last nine months and will be discussed later.

(i) Trade Liberalization: a sweeping reform of trade policy was announced, aimed at replacing all non-tariff import barriers, including all foreign exchange controls, with custom tariffs; and a drastic reduction of the latter within five years. Tariff rates on some goods would be raised at first, to maintain some protection to domestic enterprises as they restructured to face increased international competition. Then, over three to four years, tariffs would decline gradually to reach a low and uniform rate of less than 20 percent.

(ii) Privatization of Public-Sector Enterprises: the Plan envisaged a privatization program to be implemented in the first two years, yielding in 1990 about 2 percent of GDP in fiscal revenues. Privatized companies could be sold to domestic and foreign owners (subject to a 40 percent limit of voting shares for the latter), including workers of the enterprises. To finance the program, nonnegotiable privatization bonds would be issued to be absorbed by financial enterprises, pension funds and insurance companies, up to a certain level of their assets.

(iii) Domestic Deregulation: liberalization was to be extended to the domestic market. To this end, the government created the Federal Deregulation Program to remove State controls over private investment and entry in economic activities. Except for some strategic sectors (not defined), any entrepreneur would be able to invest in any sector without previous government authorization.

III. Implementation and Performance

A. Macroeconomic Performance

(i) Inflation

11. The pattern of inflation is largely explained by monetary policy and developments and, to a lesser extent, by fiscal performance. None of the inflationary process can be explained as a consequence of the development of private-sector wages. Exogenous events--the oil price increase in August is the prime example--have also played a role through their impact on expectations.

12. The paper first presents the pattern of inflation; it then describes the three major elements which may potentially explain the process, namely, money, the budget, and wages; and concludes this section by analyzing the inflationary process. To understand the process, which is quite complicated, various phases in the development over the last 10 months are distinguished.

The Rate of Inflation

13. Four phases appear in the behavior of inflation in the ten months since the introduction of the stabilization plan. Although some of these phases were very short, their pattern helps explain the inflationary process.

14. The first phase lasted for about a month--from mid-March to about mid-April. After a monthly inflation of at least 100 percent on the eve of the new policy, prices remained more or less stable for these few weeks. Price controls were formally applied during that time, but they did not seem to matter much. Indeed many prices may actually have declined, albeit in ways (such as discounting a posted price) which were not recorded in the price indices.

15. The inflationary trend changed sharply in mid-April, to start the second phase. For about two months inflation returned and accelerated. By mid-June, the monthly rate of inflation reached a level of 13-14 percent.[2/] The credibility of the stabilization policy suffered a heavy blow during this period.

16. In mid-June a third phase started, of decelerating inflation. This lasted until the end of July by which time monthly inflation fell to the level of 5-6 percent.

2/ Here and elsewhere, inflation data refer to "instantaneous", weekly estimates of monthly inflation rates inferred by the Department from published data which are provided on a monthly basis.

17. Finally, in early August--not coincidentally with the start of the Gulf crisis and of the campaign for gubernatorial and congressional elections--the fourth phase began. Inflation started accelerating again and kept increasing--although not monotonically--until mid-November, at which time it reached a monthly level of some 20 percent. In December, the rate of inflation was somewhat lower; but it is too early to tell whether this is another trend reversal, a temporary interruption in a phase of still-accelerating inflation, or a phase in which the rate remains at the high level of around 20 percent per month.

Fiscal Policy

18. The government originally sought an operational budgetary surplus of 2 percent of GDP, following a year in which the deficit was at least 8 percent of GDP. Initially, the projections included as revenues proceeds from the sale of public enterprises (or, rather, of government bonds with which the privatized enterprises would be bought). Later the government decided, correctly, that these proceeds (which in any case have not materialized) should be excluded, and the budgetary estimate was revised accordingly to a surplus of 0.5 percent of GDP.

19. Complete budgetary data for 1990 are not yet available. From the limited evidence, it is possible to infer that the budgetary target was mostly achieved, but not completely (see the data on the budgetary cash performance in Table 1).

20. Significant cash surpluses materialized in the first few months following the introduction of the plan. They then practically disappeared towards the end of 1990. Nevertheless, for April-December 1990 as a whole, a cash surplus of US$7 billion is recorded--about 2.5 percent of GDP.

21. Accurate budgetary accounting, namely, on an accrual basis, would have to include the net creation of government commitments which are not recorded in the cash accounting. Of these, the chief component would be the unpaid interest on public-sector external debt. The arrears accumulated during this period happen to be practically identical in size with the cash surplus. Their inclusion would make the budget roughly balanced. There are indications, however, that some increase in domestic federal-government commitments (such as in suppliers' credit) also took place. More important may be credits (through the acquisition of bonds, or otherwise) provided by the public to state and local governments. Taking all this into account, an informed guess would indicate a small operational deficit. The performance was thus somewhat short of the target, but still representing a very impressive change in the budgetary stance. This achievement looks all the more remarkable in view of the large budgetary deficit of the first two-and-one-half months (January through mid-March) prior to the stabilization plan.

22. This improvement has originated, first, from the change in the nature of the government's short-term domestic debt. On the eve of the stabilization plan, this debt amounted to roughly 25 percent of the annual GDP. In the last year before the plan, this debt carried a real interest rate of about 25-30 percent per year--leading to an interest bill of 6-7 percent of

GDP. With the plan, the debt was partly monetized, thus eliminating all interest payments on this part, and mostly converted to an asset (frozen cruzados) yielding an annual real interest rate of 6 percent. This led to a fiscal saving of some 5-6 percent of GDP. Other contributing factors to the fiscal improvement were tax increases--through the elimination of exemptions; the imposition of primarily one-time taxes; the elimination of various subsidies; a significant cut in the government's labor force; and a substantial fall in public-sector real wages (see below).

23. On the other hand, two factors primarily have limited the fiscal improvement, and prevented the full achievement of the targeted surplus. One was the policy concerning public-sector prices. As mentioned earlier, these were increased with the introduction of the plan (by some 40 percent, on average), to reach their end-1988 real levels. But from then on, the government maintained these prices at a constant nominal level for almost half a year--apparently as a means to mitigate cost increases, inflationary expectations, and inflation. Since August, nominal prices have again been raised periodically. By the end of the year, however, they were not only substantially below their end-March real levels (to which the impact of the increase in oil prices should be added), but also lower than their pre-plan level.

24. The other contributor to the deficit was a large increase of the expenditures of state and local governments. The Constitution requires that a large proportion of the increase of tax revenues be directed to these governments. Existing mechanisms, however, cannot completely prevent a commensurate increase of expenditures. Moreover, state and local governments may have increased expenditures even beyond this thus, perhaps, even increasing their deficits. These, in turn, were financed by credit from the Central Bank and from the private sector.

Monetary Policy

25. The strong monetary adjustment was the cornerstone of the stabilization plan. But faced with the prospect of an immediate disruption of activities--and apparently fearing that this was a start of a severe recession--the government changed course abruptly, rapidly injecting a large amount of liquidity into the economy. Beyond the reduction of required reserve ratios on demand deposits from 80 percent to 40 percent (for larger banks), the Central Bank released frozen accounts in a variety of ways--most of them discretionary. It allowed enterprises to pay wages (up to a certain ceiling), as well as taxes, out of the frozen accounts. The Central Bank also created refinancing lines for larger enterprises in four main sectors (civil construction, automobiles, agriculture, and capital goods), and authorized further conversions of cruzados to benefit the Social Security Administration, Federal and local government, rural producers, professional associations, labor unions, charitable associations, etc.

26. As a result, by the end of April, some US$15.7 billion were added to the total quantity of money, raising it from 9.6 percent of GDP on March 16 to 15.1 percent on April 30. Of the overall increase of money supply (US$15.7 billion), the major part--US$12 billion altogether--originated in withdrawals

from frozen accounts. Of these, nearly half--US$5.6 billion--were withdrawals for Federal tax payments. Two smaller sources of increased liquidity were Central Bank net purchases of foreign exchange--US$1.6 billion; and borrowing by firms for payment of wages--US$0.7 billion.

27. By mid-May, with the renewed inflation and the erosion of confidence in the stabilization policy, the government again decided to change course in its monetary policy. Various directives and instruments were applied, in the second half of May, to grant the Central Bank a better control of the monetary aggregates and to constrain their rapid increase. In particular, the automatic repurchase agreement of Treasury notes--long a hallmark of Central-Bank policy and the mainstay of the large overnight market--was discontinued. Banks were thus forced to apply to the rediscount window when a shortfall of reserves had to be covered. Strict monetary targets were also introduced. The major monetary aggregates (the monetary base, M_1, M_4) were targeted to increase by about 10 percent in the second half of 1990 and to remain at constant nominal levels in the first quarter of 1991.

28. It appears that, for a while, a drastic reduction of the rate of monetary expansion was indeed achieved. But within a short period, of about two months, there was again a rapid increase in the monetary aggregates. Indeed, even during the first two months (June-July), M_4 kept rising, although not at its rate during April-May. By end July, M_4 already exceeded by 25 percent its level of end-May.[3/] During the second half of 1990, the monetary base increased by 94 percent; M_1 by 116 percent; and M_4 by 125 percent (see Chart 1). These changes in monetary policy contributed significantly to a decline in the credibility of policy implementation; the public's confidence in the strong medicine administered to conquer inflation started to erode.

29. Real interest rates are, of course, hard to estimate. But it appears that the ex post borrowing real interest rates were very low--mostly negative--during much of the period. Only in October did they increase substantially, reaching in October-December monthly levels of 5-7 percent.[4/] In this sense, monetary policy did become tight towards the end of 1990. The large increase of the real interest rate may be explained by both supply and demand factors. The size of credit to the private sector fell, in comparison with other monetary aggregates. In essence, credit to state and local governments partly displaced credit to the private sector. At the same time, the private sector's demand for credit must have increased in the face of financial difficulties and involuntary accumulation of inventories.

3/ This increase, in face of a given (even falling) monetary base, was possible due to a changing portfolio composition of liquid assets; viz., a relative shift from M_1 (consisting mostly of demand deposits, which are subject to a 40 percent reserve requirement) to other components of M_4 (such as time deposits) which are free of any reserve requirements.

4/ Real interest rates would appear to be only half of this level if deflation is done through next month's price index.

Wages and Wage Policy

30. Unlike previous plans, the Collor stabilization plan did not rely on "wage policy"--specifically, it required no freezing, rules of indexation, or other universal or automatic measures of wage adjustment for the private sector. Wages in the private sector were to be determined freely in private negotiations. Wages in the public sector were to be adjusted by end March in proportion with the February increase in consumer prices; and from then on, to be adjusted monthly in accordance with expected inflation for the coming months.

31. It should be noted that this component of the stabilization plan has faced the fiercest political opposition. It was the only one not endorsed by Congress, and was sustained only through Presidential veto. Throughout the period, Congress has repeatedly tried to introduce a wage policy, primarily through measures of full indexation. These attempts have repeatedly been rebuffed by Presidential veto. Other attempts have been made--originating from the business community, labor unions, or even from the government itself--to determine wages within a framework of a "social pact." Once more, none of these attempts has borne fruit. In the courts, too, the government's wage policy has faced a continuous battle, to the point in which the Supreme Court has ruled it, in mid-January 1991, to be unconstitutional.

32. Data on wages are incomplete. It does, however, appear that in the first few weeks following the policy introduction, nominal wages in the private sector generally did not increase and sometimes even declined. Initially, real wages in the sector fell substantially--by some 25-30 percent. This was followed by rising real wages, but even towards the end of the year, real wages in the private sector appear to be some 10-15 percent lower than prior to the plan. In the public sector, the decline of real wages has been much more significant. Nominal wages were, indeed, adjusted by end March in accordance with the plan. But from then onwards, automatic adjustment ceased. Until the end of the year, two "bonus" increases have raised nominal wages by a total of less than 50 percent, in comparison with consumer-price increases during this period of about 150 percent. Federal-government real wages have thus declined by about 40 percent since the introduction of the plan. The fall of wages in state and local governments, however, has been less sharp.

The Process of Inflation

33. The monetary shock at the introduction of the stabilization plan led to an immediate stability--and even some decline--of the price level. This was a unique event in Brazil's recent history, considering the fact that price controls did not effectively play any role. Within a few weeks, however, following the large new injection of money, inflation reappeared. This re-emergence dealt a major blow to the credibility of the stabilization program and made any further pursuance of stabilization a much more difficult effort--specifically, an effort which could no longer succeed without a significant economic recession.

34. The Government's strong determination and commitment to contain inflation resulted in the imposition of tight monetary policy at the end of

May 1990, and the establishment of very tight targets. Indeed, the monetary base was kept stable, with some small fluctuations, for several months; by end-October it was only at its end-May level. Money in its narrowest definition, M_1, also increased only slightly in June and July. In this way, the new monetary policy appeared to restore some credibity. As a result, the rate of inflation started falling--from 13-14 percent (per month) at end-May to 5-6 percent by end-July. But M_4, the concept of money most appropriate in Brazil's context, behaved quite differently; it kept rising. Some time in August, it appears that the public realized that monetary targets were not being maintained, and that money supply was continuing to expand. A re-emergence of inflationary expectations, and of inflation, was then inevitable. This re-emergence was reinforced by the Gulf crisis. The start of the crisis (on August 2), through its substantial impact on oil prices and the general uncertainty accompanying the event, further contributed to inflationary expectations and to an immediate impact on general price levels.

35. From then onward, a high level of inflation accompanied a high rate of expansion of the monetary aggregates. From end-July to end-December, all the major money aggregates increased at very similar rates--both the monetary base and M_1 increased by 16.3 percent per month, and M_4 by 14.5 percent. The monthly rate of inflation during that period was almost identical--an average of 15.1 percent.

36. It also appears that despite the seemingly satisfactory budgetary balance, an adequate performance is <u>not</u> generally perceived in Brazil as having been established. The suspicion that the apparent balance is merely temporary and unsustainable in even the near future, seems to have become pervasive in recent months. Coming out of the huge deficit of 1989, to gain credibility the budget should have aimed at and resulted in a significant operational <u>surplus</u>.

37. On the other hand, a theory which has traditionally been influential in Brazil, that the behavior of wages is instrumental in sustaining and accelerating inflation, cannot be supported by this experience. With the initial monetary shock, real wages (in the private sector) fell substantially. Even over a longer period, of close to a year, it appears that real wages have displayed substantial downward flexibility.

38. The renewed inflation can still be contained. If monetary aggregates are indeed kept at their announced targets (i.e., remain at a constant <u>nominal</u> level), and the fiscal stance improves by 3-4 percent of GDP, inflation should eventually subside. But this would not happen in the next few months. Given the recent history of events, it will take some time to restore public confidence and to change the public's expectations of inflation. The Government also faces constitutional limits to lowering the fiscal deficit, and this reduces the policy options of the Government. There are reports that the Government intends to attempt to change some parts of the Constitution to gain better control over the fiscal situation. But this process will also take time. Given the history of the last year and the current inflationary expectations of the public, inflation will not be controlled without an economic recession. However, in view of the impressive structural reform measures being implemented by the Government (discussed

below) and the dynamism of the private sector, this recession should be relatively short-lived.

(ii) Economic Performance

Economic Activity

39. As far as economic performance is concerned, it is important to note that industrial activity had already been falling, rather sharply, before the introduction of the plan; its level in January-February 1990 was about 15 percent below its mid-1989 level. The immediate reaction to the plan was a substantial decline of activity, but this was reversed shortly. Already by May the pre-plan level was almost achieved. The increased trend of activity was sustained for several months and industrial activity reached, by August, a peak level--some 15 percent higher than prior to the plan. From September on, however, there has been a decline. Data for the end of the year are not available, but preliminary evidence--such as on the number of firms applying for bankruptcy procedures--suggests that this decline is probably significant. The perception in Brazil in early 1991 is definitely one of a recession, with business firms generally expecting its deepening in the next few months. A preliminary estimate indicates a decline of Brazil's GDP by 4.3 percent from 1989 to 1990. The sectors of civil construction, crop agriculture, and manufacturing show the largest declines (close to, or exceeding, 10 percent).

40. Unemployment data (of Saõ Paulo) provide a somewhat similar pattern, viz., an initial increase and a subsequent reduction to a level only slightly higher (by about 1 percent) than prior to the plan. As yet there are no indications of rising unemployment in recent months. Apparently, labor is still being conserved by firms, probably on the assumption that the slump of activity may be short-lived.

The Foreign-Exchange Rate and Foreign Trade

41. The stabilization plan established a freely floating (the "livre", or commercial) exchange rate, replacing the prior policy of a crawling peg. In actual practice, occasional government intervention has taken place--practically always in the direction of depreciating the exchange rate(i.e., the Central Bank has been a net buyer of foreign exchange, thus increasing its foreign-exchange reserves and the money supply). Most often, this intervention was meant to prevent an appreciation rather than to accelerate a depreciation. The intervention was strongest (i.e., the size of increase of reserves was highest) during the first few months following the introduction of the plan.

42. In addition to the "free" rate, two other exchange rates exist: the "tourist" and the "parallel" rates--the latter being illegal, but generally tolerated. These two rates have always (prior to the plan, as well as since its introduction) been very close to each other and always higher than the official (now "free") rate. The gap between the "parallel" (or "tourist") rate and the "free" rate practically disappeared immediately after the introduction of the plan. It then increased rapidly, reaching levels of 50-60 percent within a few months. After June, however, it declined just as

fast--apparently with the help of government intervention--and reached a level of only 5-7 percent by August. In recent months, the gap has been around 10-15 percent.

43. For about half a year, the real exchange rate did not display any general upward or downward trend, although fluctuations, created by alternating periods of stability and of increases of the nominal rate, were significant. From the end of September onwards, on the other hand, a substantial increase of the rate, which was particularly fast in October and November, has been taking place. By mid-January, the cumulative real depreciation since the end of September amounted to some 35 percent and the rate was about 40 percent above its level immediately following the introduction of the new policy (see Chart 2).

44. Prior to the stabilization plan, from 1988 to early 1990, a substantial currency appreciation had taken place. On the eve of the plan the real exchange rate was only one half of its level during the period 1982-86 (that is, a devaluation of around 100 percent would have been required to reach the "normal" level of the real rate). Thus, even with the substantial recent depreciation, the real exchange rate today is still only at around 70 percent of its "normal" level.

45. The low level of the real exchange rate has been a major reason for the decline in Brazil's trade balance--a trend which had started already in late 1988. From September through November 1990, the trade surplus fell to an annual level of only US$5.5 billion, in comparison with about US$19 billion in 1988 and US$16 billion in 1989. For the calendar year 1990, the trade surplus is expected to amount to around US$11 billion--the smallest since 1986. The reduction of the trade surplus originates from both the imports and the exports sides. The (dollar) value of imports during September-November 1990 exceeded by over 20 percent its value in the same period in 1989. This is partly explained by the increase in oil prices and, in part, by the trade liberalization, unaccompanied by exchange-rate depreciation in the relevant period. The change in exports appears to be less substantial: there was a decline, between the corresponding periods of 1989 and 1990, of 8.5 percent. But in view of the continuous trend of increased exports in Brazil, this is a dramatic decline. Part of this is explained, again, by price changes; i.e. falling world prices of some of Brazil's major primary exports (such as soybeans). But at least part of the fall of exports is due to the low level of the real exchange rate. Another contributing factor has been the substantial reduction of short-term financing of exports transactions (and an increase of the interest rate) due to large contractions of foreign credit lines. This has resulted from the absence of significant progress in the negotiations of external debt between Brazil and its commercial creditors.

(iii) External-Debt Negotiations

46. On December 31, 1990, Brazil's total external debt amounted to US$121.6 billion. Of this, US$14.5 billion was short-term debt; and US$107.1 billion medium- and long-term debt. Of the latter, debt to commercial banks (including arrears) amounted to US$61.8 billion; bilateral inter-government debt (again, including arrears) to US$24.0 billion; and debt to multilateral

organizations to US$14.3 billion, of which US$8.4 billion was owed to the World Bank. Other long-term debts amounted to US$7.0 billion.

47. In relation to the country's GDP, Brazil's external debt is not particularly high.[5/] Debt service as a ratio of exports puts Brazil on a higher place among the heavily-indebted countries; but experience shows that Brazil has the capacity to expand exports rapidly and to generate large trade surpluses. Thus, Brazil's ability to service its external debt is not dependent on its capacity to generate a trade surplus, but rather on its ability to mobilize, through the budget, the required domestic resources. Thus, this again emphasizes the importance of fiscal adjustment in Brazil.

48. The Government of Brazil suspended interest payments on the country's debt to foreign commercial banks in July 1989. This was intended to be a temporary measure to bolster foreign-exchange reserves. Upon assuming office, the Collor government announced that this suspension would be maintained until negotiations led to a restructuring of the debt. By the end of 1990, the accumulated arrears amounted to US$12.3 billion (of which US$8.3 billion accrued on the debt to commercial banks, and US$4.0 billion on the bilateral debt).

49. Negotiations started in October 1990 with the two sides having substantially different positions. The negotiation process since then has yielded some bridging of the gap. The current process of negotiations has involved the Government of Brazil and the Bank Advisory Committee making proposals and counter-proposals designed to reach agreement on the clearance of arrears and the restructuring of the debt. As a provisional measure and as a sign of its desire to successfully conclude negotiations, the Brazilian government announced its intention to pay in the first quarter of 1991 30 percent of the interest due in this quarter regardless of the progress towards an agreement. As of the writing of this note, agreements on the settlement of past arrears and on the restructuring of the debt have not been reached.

(iv) The IMF Program

50. An IMF mission visited Brazil in August, and by early September an agreement had been reached about a Fund Program in Brazil. The Program and the Letter of Intent essentially reflected, in their main features, the announced principles of Brazil's policy. An operational surplus of 0.5 percent of GDP was to be achieved in 1990 with a basically similar operational result in 1991, and the monetary targets for 1990-91 were those established by the Government in May 1990. Fulfilling of these targets was expected to lead to a substantial deceleration of inflation.

51. Consideration of the Program by the Fund's Executive Board was conditional on meaningful progress in the negotiations with the foreign

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5/ See "Brazil: Economic Stabilization and Structural Reforms" Gray Cover, January 1991 for a fuller description of Brazil's debt.

commercial banks over Brazil's debt to the banks. Since that stage had not (and still has not) been reached, the Program has not been brought to the Fund's Board. Given the developments in the intervening period, there is a need to reassess part of the program. To this end, an IMF mission may visit Brazil in March 1991.

B. The Structural Reforms

52. The Collor Government has undertaken and continues to undertake a number of basic, far-reaching structural reforms. These reforms, if maintained, will fundamentally change the policy environment in which economic activity can take place and lay the foundations for long-term stabilization and growth. The underlying principles behind these reforms are the reduction of the role of the government in economic activity, the creation of domestic and international competition and the integration of the Brazilian economy into the world economy. The policies of structural transformation presented here are: (i) trade liberalization; (ii) deregulation; (iii) privatization; (iv) changes in public-sector administration; (v) policies in the agricultural sector; and (vi) social-sector reforms.

Trade Liberalization

53. The process of trade liberalization has been fast and very intensive. Over a period of less than half a year almost all trade barriers (other than tariffs) have been dismantled. Upon implementation of the plan, CACEX was abolished and import licensing, which were still required, were assigned to a department in the Ministry of Economy. This step was of crucial importance since CACEX had, in effect, been conducting the country's import policy in a highly restrictive and discretionary manner. Initially, the government imposed a monthly ceiling of US$2 billion, until the end of June, for total imports. But due to the diminished domestic activity, and a resulting low demand for imports, the latter were probably not effectively constrained by this ceiling.

54. In early May, the government abolished the list of some 1,800 goods whose imports had been prohibited for over a decade, and partially eliminated the "market reserves" policy. The field of application of the highly-restrictive "Law of Similars" was also severely reduced. Goods like automobiles, electrical appliances, toys, tobacco, foodstuff, or chemical products could thus be imported. For about 300 of the 1,800 goods import tariffs were increased. For automobiles, these tariffs ranged from 65 to 85 percent; for toys, from 85 to 105 percent.

55. On July 1, the most radical element of dismantling the QRs system took place. From then on, almost all imports (with the main exceptions to be noted below) became completely free, protected only by tariffs. All controls on the allocation of foreign exchange for imports were eliminated. Import licenses are still required; but they are meant to be granted automatically and immediately and to serve mostly for statistical and price-control purposes. An important administrative step designed to ensure that this indeed should be the practice is planned for April, 1991, when the licensing of imports will be decentralized and "privatized," by being moved to

individual commercial banks. Another important step undertaken in September was the suspension of a long-standing regulation which had allowed imports of capital goods only if they were financed by long-term foreign credit.

56. Practically the only important category still subject to import regulation is that of informatics goods (ranging from microchips to super computers) whose imports are controlled under the "Law of Informatics." The government intends to introduce legislation that would eliminate all the restrictions of this law by October 1992. In the meantime, some of the law's implementing regulations have been changed. Also, from January 1, 1991 import controls apply to only 47 goods rather than to 300. The reduced list, however, maintains protection of the most important items of Brazil's production in this sector.

57. As noted earlier, some tariffs have been increased to partly offset the removal of QRs. But during the second half of 1990, tariff reductions have very often been undertaken, as a means of combatting monopolistic positions of domestic firms. In early 1991, the government intends to announce a concrete four-year plan of gradual tariff reductions. By the end of this period, all goods are expected to fall to one of only three tariff categories: 0, 20, and 40 percent; and the median tariff level is targeted to become 20 percent.

58. The process of removal of non-tariff barriers has indeed been dramatic. Within a half year, Brazil has turned from a country with one of the most highly restrictive trade regimes, which had been well entrenched for decades, to a country whose imports are predominantly free of quantitative restrictions. In the extent and speed of the shift it has few parallels, if any, in contemporary trade policies.

Domestic Deregulation

59. The government has been following a policy of increasing domestic competitiveness in two forms: deregulation, which has involved removing the government's own obstacles to the operation of a freely-competitive market (e.g., requirements to purchase domestic raw materials or capital goods, special tax incentives, requirements to use certain distribution and transport systems, or labor-market controls); and removal of restrictions on the functioning of free markets imposed by the enterprises themselves (e.g., cartels). Monopoly powers granted through state intervention which have been removed include restrictions on entry to certain activities, investment licensing, and rights of access to the purchase of specific raw materials. Equally important, price controls which were used to favor particular industries (e.g., low prices on steel to make automobile production financially competitive) have been liberalized or removed for most products.

60. Various reforms have also been introduced in the areas of telecommunications and transportation. The role of private sector provision of telecommunication services has been redefined, with a consequent limit on the role of the public sector (this is still subject to congressional approval). Operation of cellular telephone networks by private companies and of private telephone networks and data transmission services will be possible.

Port services will be privatized; and various measures restricting the operation of private firms in transportation have been abolished.

61. In addition, the Council for Industrial Development (CDI) was eliminated and the Secretariat for Industrial Development (SDI)--CDI's executing agency--was transferred to the Ministry of the Economy to administer the remaining fiscal incentives. President Sarney's Program of Integrated Sector Development (PSI), which had been envisaged for 18 sectors, was maintained, but the fiscal incentives granted under those programs were dropped. The 1,000-person administrative machinery of the former Ministry of Industry has been replaced by about 100 staff in the Department of Industry in the Ministry of Economy.

Privatization

62. The process of privatization is ongoing, and appears to be taken seriously, despite the fact that as of now no Federal government enterprise has yet been put for sale. The only firm actually privatized, in early September 1990--VASP Airline--was an enterprise of the State of Saõ Paulo. President Collor had declared the privatization of ten firms as a target for 1990. This was too ambitious, since preparation of a transfer of any single firm is a time-consuming process. But during 1990, a Privatization Committee was created; mechanisms, rules, and the principles of the privatization process have been established; and private consortia selected, through a competitive bidding process, to evaluate the first four firms to be sold and to recommend the specific modalities of sale for each. The draft reports of these private consultants are now being reviewed by the Privatization Committee and BNDES (the National Development Bank, which is its executive agency), and three enterprises are scheduled to be offered for sale in April 1991. First and most important in the initial round of privatization would be firms in the steel sector, followed by petrochemicals and fertilizers. The initial round would, correctly, focus on industrial enterprises which operate in competitive markets. Eventually, within about four years, the government intends to sell all state-owned enterprises except those singled out by the Constitution as subject exclusively to government ownership (e.g. Petrobras, the oil company). Already, the two federally-owned electricity distribution companies have been added to the privatization list for the first round. The book value of firms which are (immediate or eventual) candidates for privatization is in the order of US$80-US$100 billion dollars; no good estimate of the market value is available, but it is expected to be well below the book value.

63. The main factor which may adversely affect the privatization program would be lack of progress on the external debt negotiations: the foreign commercial creditors might not grant the waivers needed for the indebted enterprises to be sold if negotiations are not concluded satisfactorily. It might then be very difficult to induce foreign companies to bid for shares in the newly privatized firms. Debt-equity swaps, which may very likely be the main vehicle for such foreign investments, would probably be an outcome of a debt settlement.

Administrative Reforms

64. As part of the original policy package, a reorganization of the central-governments' bureaucracy took place: the number of ministries was halved, and initially, a small number of government employees was dismissed. A major reshuffling, however, took place later, in May-June 1990. At that time, over 200,000 central-government employees--more than 10 percent of the total--were removed from their positions, partly relegated to a "pool" and partly laid off. This is a large fraction by any yardstick, particularly in view of the very short time in which this policy was carried out. In the past, repeated decisions about dismissals on a much smaller scale always came to naught.

65. Further reforms would mostly depend on Constitutional amendments. Provided these can be introduced, the government intends, inter alia, to eliminate tenure and job stability in the public sector; to revise the social-security system; to revise the system of compulsory transfers from the Federal to State and local governments; and to scale down substantially the government's maintenance of higher education. These measures will increase the Government's ability to reduce its fiscal expenditures and thus contribute to the stabilization effort.

Agricultural-Sector Reforms

66. As in the other sectors of the economy, the purpose of policy changes in the agricultural sector is to reduce government involvement and encourage the operation of free markets. An added target for this sector is the protection of the environment. The latter is expected to be achieved, in this context, primarily through the removal or reduction of subsidies which had promoted expansion of the frontiers in the Amazon.

67. The agricultural sector is the only one in which export bans and quotas had been maintained, as well as other measures of regulating exports. Most of the export restrictions have now been removed (on exports of cotton fiber, rice, maize, and soy products). The Brazilian Coffee Institute (IBC) has been abolished and with it all controls and fees on the export of coffee. The Institute of Sugar and Alcohol has also been dismantled, but sugar exports are still subject to quotas and the sector is still subject to price regulation. Sugar has thus remained the only crop subject to quantitative control of exports. Tariffs on various agricultural products have been removed, and tariffs on most capital and intermediate goods destined for agriculture have been lowered substantially.

68. While wheat imports are still restricted, the government's monopoly on both wheat imports and domestic wheat sales has been ended. Domestic wheat processing, formerly tightly controlled through quotas to millers, is now being liberalized. All prices in the wheat industry have remained, however, under the government's controls.

69. Domestic pricing policies have also been modified to approach more closely the operation of free markets. Control of milk prices has been abolished (though at the time in which this became effective the government

applied strong pressure to prevent a substantial price increase). Where minimum prices exist, they are no longer uniform but vary among regions, to reflect regional differences in transportation costs (i.e., to make the minimum-price structure better reflect cost structures).

70. The process of administrative reform has been particularly intensive in the agricultural sector. Major agencies have been closed or merged, clearly signaling policy changes with respect to the role of the public sector in agricultural pricing, storage, and marketing.

71. Finally, income-tax legislation has been changed to remove most (but not all) of the favorable treatment of the sector, by making tax rates similar to those applied elsewhere and by eliminating various exemptions and deductions specific to the sector.

Social-Sector Reforms

72. The "New Brazil" program did not explicitly address social sector reforms. Since March, however, the government has begun to articulate a series of planned reforms in the social sectors, many of which are in line with Bank recommendations and which, if implemented, will have a positive effect on the efficiency and equity of social service delivery.

73. In health, the administration has approved and is beginning to implement the sistema unico de Saude, which introduces a dramatic reorganization and decentralization of the health delivery system. Under this law, INAMPS (the social security health benefits administration), the largest financier of hospital care, will come under the jurisdiction of the Ministry of Health. Price controls on most pharmaceutical products have been removed.

74. The government has also taken initiatives to improve coordination of social sector programs. To rationalize various government programs oriented toward the health and education of young children, President Collor mandated the creation of an inter-ministerial coordinating body called the Ministry of the Child. The administration has also stated its intention to reform the National Milk Program, the largest and least well-targeted of the nutritional supplementation programs, as well as to put the coordination of all nutrition programs under INAN, the National Institute of Food and Nutrition.

75. In education, government price controls on tuition for private primary and secondary schools have been eliminated; the current policy is that tuition levels should be negotiated directly between schools and parents. In January of 1991, the Minister of Economy announced that one of her targets this year would be the introduction of tuition in public higher education. The government has also introduced a US$500 million program to fight illiteracy and improve the quality of public education, called the Programa Nacional de Alfabetizacao da Cidanania (PNAC). This program emphasizes primary education; it is designed to strengthen state and municipal school systems, expand primary school access, and ensure that children complete more years of schooling, through improvements in school quality.

IV. Concluding Note

76. The Collor Plan ("Brasil Novo") has been comprehensive and far-reaching. It is the first stabilization program in Brazil's recent history which has tried to tackle the fundamental sources of inflation rather than deal temporarily and superficially with some of its manifestations. Probably of even greater significance, it is the first attempt in generations of introducing a radical transformation, moving the economy from heavy reliance on regulation by the government to one in which free markets are the rule and the private sector becomes predominant.

77. The success of the stabilization program is, at the moment, not assured. Unless monetary and fiscal policies change, inflation would persist and accelerate. The policy changes required now are not as drastic as those undertaken in March 1990. But any policy implemented now must be of sufficient credibility to alter permanently inflationary expectations. This is of crucial importance. The reforms would include, at least, the following changes in fiscal and monetary policies:

(i) To establish credibility, a budgetary surplus must be planned for and implemented, and the public must perceive that the deficit has been eliminated permanently. In addition to the measures already taken by the Government this would require, at a minimum, two major steps. First, a substantial reduction of the deficits of state and local governments. This would probably be the most difficult policy for the Federal government to implement. It would call for an effective control by the Federal government over the borrowing capacity of the states and, the abolition of Central-Bank lending to the states, directly or through state banks. Second, a substantial increase in public-sector prices and the continuous maintenance of these prices at least at their end-1988 real levels. In addition, the attempts by the Government to amend the Constitution in order to permit greater fiscal control of the budget are important steps in the right direction.

(ii) Most importantly, stabilization requires the implementation and maintenance of credible monetary targets--viz., a low nominal growth in the supply of money--through predetermined changes in the Central Bank's major asset components and the use of other monetary instruments at its disposal.

78. Another component bearing on the success of stabilization would be an agreement with Brazil's creditors on the settlement and the restructuring of its foreign debt. Such an agreement should significantly increase the credibility of stabilization policy and would facilitate the privatization process.

79. In contrast to the uncertain performance of the stabilization plan, the process of structural transformation undertaken by the government has been admirable. Fundamental, thorough reforms have been carried out continuously and persistently. If these can be sustained--and the likelihood of this eventuality is not independent of the achievement of stabilization--Brazil should face the prospect of rapid growth once the short-term recessionary impact of stabilization is over.

Postscript

80. On January 31, 1991, the government of Brazil announced a set of additional measures designed to combat inflation. The major elements are as follows:

(i) The budget. Prices of public-sector goods and services have been raised by between 20 percent to over 70 percent, with a weighted average of close to 50 percent. The government also announced its intention to cut public-sector expenditures by an amount equivalent to 1.5 percent of GDP.

(ii) Monetary policy. In essence, the monetary measures amount mostly to the elimination of indexation of various financial assets, or of other contracts. Indexation will be replaced by the use of a "reference interest rate", which the Central Bank will calculate on the basis of interest rates on commercial-bank certificates of deposit (CDB). The overnight account has been eliminated and replaced by the establishment of overnight accounts in private funds which, in turn, will invest primarily in government bonds or will channel loans into government-prescribed activities.

(iii) Wage-price policy. Prices are to be frozen, at their January 30 levels, for an indefinite period--with an expected slow, gradual exit out of the freeze through government-authorized price changes. Some prices (such as rents, or school fees) will be indexed, as before, to salary levels. February's wages will be determined so that their real levels will be equal to the average of the last 12 months. Thenceforth, nominal wages will be adjusted twice a year, in June and January, through free negotiations.

(iv) The policy announcement of January 31 also included the introduction of a program for the gradual reduction of import tariffs. This is a further evidence of the thoroughness of the trade reform and the determination of the Government to continue to implement structural reforms.

81. The details of these measures are not completely clear; some have yet to be fully articulated. Moreover, many of these measures will require Congressional approval and may change significantly. Thus, the final set of measures that can and will be implemented are not yet known.

Table 1: TREASURY'S CASH FLOW, 1990

Month	Net Cash Receipts (US$ Billions)
January	-6.57
February	-5.15
March	-1.02
April	3.04
May	2.64
June	.31
July	.35
August	.35
September	.33
October	.04
November	.01
December	.02
Total, January-February	-11.72
Percentage of GDP (approximate)	-20.10
Total, April-December	7.09
Percentage of GDP (approximate)	2.70

Note: Cruzeiro data were transformed into dollars by using each month's average rate of exchange. Annual GDP is assumed here at US$350 billion.

Chart 1

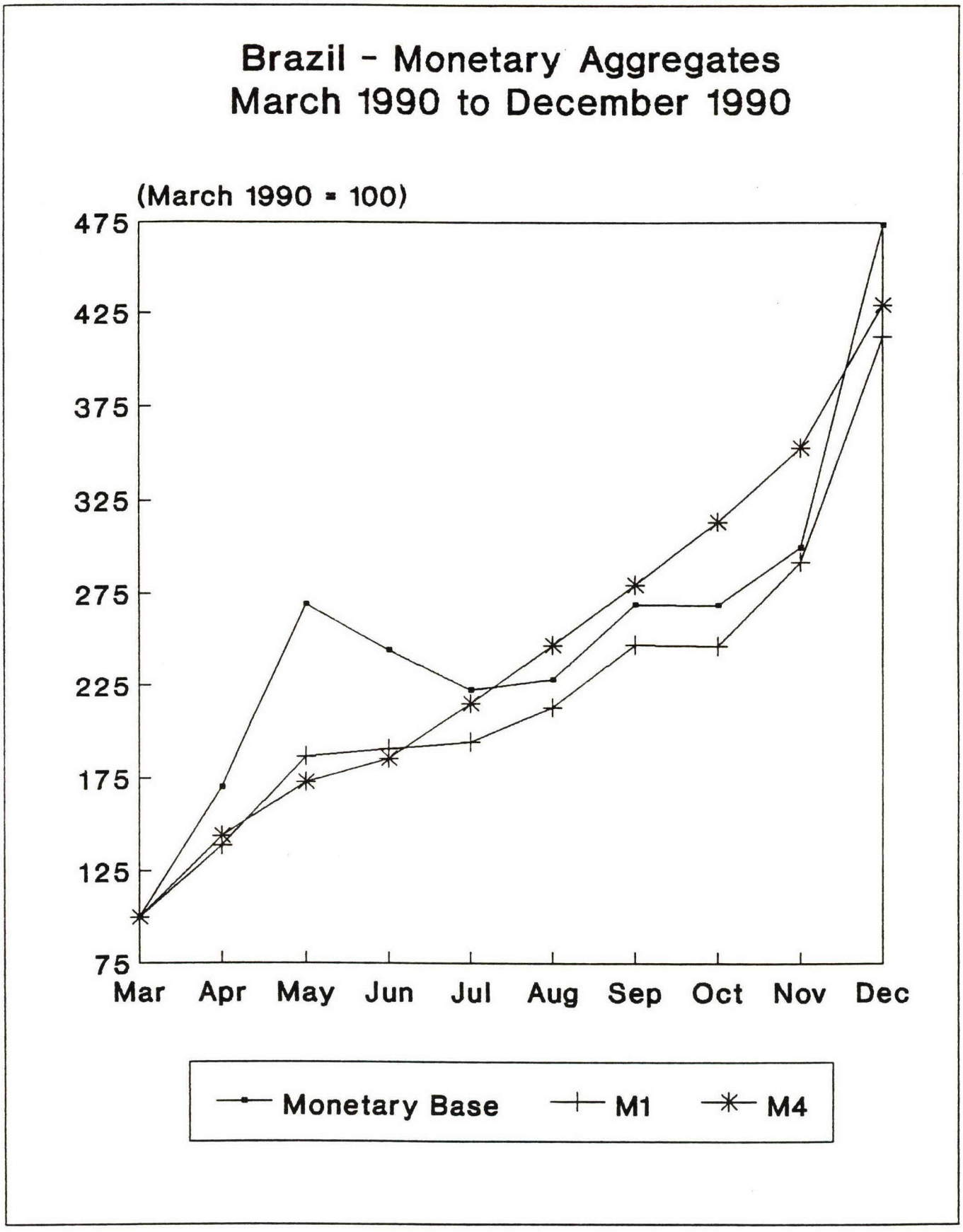
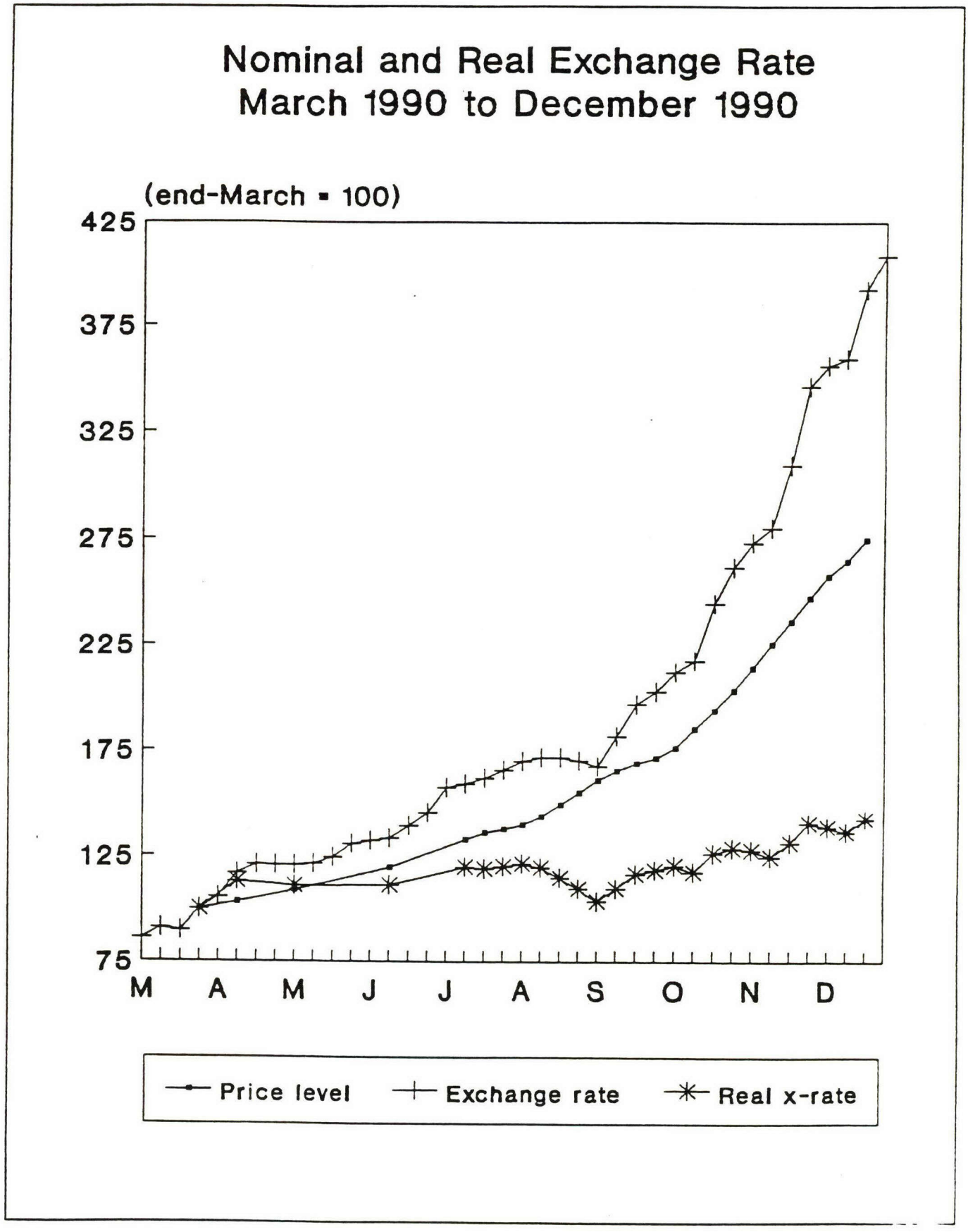

Brazil - Monetary Aggregates
March 1990 to December 1990
(March 1990 = 100)
475
425
375
325
275
225
175
125
75
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
Monetary Base
M1
M4

Chart 2


Nominal and Real Exchange Rate
March 1990 to December 1990
(end-March = 100)
425
375
325
275
225
175
125
75
M
A
M
J
J
A
S
O
N
D
Price level
Exchange rate
Real x-rate

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

February 11, 1991

His Excellency
Marcilio Marques Moreira
The Ambassador of Brazil
Embassy of Brazil
Washington, D.C.

Dear Ambassador Moreira:

I appreciate the kind invitation of the Government of Brazil and the Minister of Education, Dr. Carlos Chiarelli, to attend the "International Conference on Literacy and Citizenship" in Brasilia. The conference stresses an important theme which is a major impediment to economic development.

I understand from recent communications that the dates for the conference have been changed to May 3-4. As you see from the enclosed copy of the response to Minister Chiarelli, unfortunately, previous commitments will make it impossible for me to attend the conference personally. However, I have requested Mr. Adriaan Verspoor, Chief of the Education and Employment Division of the Population and Human Resources Department, to represent the World Bank at the Brasilia conference. Mr. Verspoor also was a member of the World Bank delegation to the World Conference on Education for All last year in Thailand.

We look forward to continuing to work with the Brazilian Government in its efforts to develop new programs to strengthen primary education and literacy in Brazil.

I will follow with great interest the deliberations of the International Conference on Literacy and Citizenship, and send my best wishes for its success.

Sincerely,

Barber Conable

Enclosure

The World Bank
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

1818 H Street, N.W.
Washington, D.C. 20433
U.S.A.

(202) 477-1234
Cable Address: INTBAFRAD
Cable Address: INDEVAS

February 1, 1991

The Honorable Carlos Chiarelli
Minister of Education
Ministry of Education
Brasilia, Brazil

Dear Minister Chiarelli,

In Mr. Husain's absence, I would like to thank you for your letter to him of January 24, inviting him to participate in the International Conference on Literacy and Citizenship being organized by the Ministry of Education for May 3-5, 1991.

I deeply regret that neither President Conable nor Mr. Husain will be able to attend the Conference on those dates, because of other commitments. However, we very much appreciate your invitation to this important meeting and President Conable has proposed that the World Bank be represented by Mr. Adriaan Verspoor, Chief of the Education and Employment Division of the World Bank's Population and Human Resources Department.

As you know, the World Bank played a major role in the organization of last year's World Conference on Education for All (WCEFA), and we welcome the initiative being taken by the Brazilian Government to develop new programs designed to strengthen primary education in Brazil, as well as to promote international discussion of primary education issues.

I understand from your letter that the Ministry is planning to hold preparatory meetings for the Conference in Brasilia on February 18 - 19. I have asked Ms. Maria Emilia Freire of the World Bank's Brasilia office to represent the World Bank at these preparatory meetings.

I would also like to take this opportunity to thank you for your visit here two weeks ago. I know that Mr. Husain enjoyed his conversation with you and was gratified to hear of the Brazilian Government's recent initiatives in the area of primary education, which we at the World Bank consider to be of critical importance for Brazil's future economic growth and political stability.

Sincerely,

Rainer B. Steckhan

Rainer B. Steckhan
Acting Vice President
Latin America and the Caribbean Region

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
Mr. M. Qureshi (E-1241)	1/25/91

SUBJECT:

Document From: Marcilio Moreira
To: bbc
Dated: 1/24/91 Reference No.: EXC910124002

Topic: Amb. of Brazil: conveying an inv. to BBC to attend the Int'l. Conference on Literacy -- on Feb. 18-21, 1991

ACTION INSTRUCTIONS: | DUE DATE:

_____ HANDLE
_____ REVIEW AND RECOMMEND
_____ FOR YOUR INFORMATION
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
__XXX__ PREPARE RESPONSE FOR _BBC's SIGNATURE 2/01/91
_____ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: cc: Mr. Thalwitz

January 22, 1991

N°01

His Excellency
Barber B. Conable
President
The World Bank
1818 H Street, N.W.
Washington, D.C. 20433

Dear President Conable:

On behalf of the Government of Brazil and Dr. Carlos Chiarelli, Brazilian Minister of Education, I would like to reiterate the invitation conveyed to you by Sharid Husain, Vice-President of the World Bank for Latin America and the Caribbean Region to attend the "International Conference on Literacy and Citizenship" to be held in Brasília, Brazil, on February 18 to 21, 1991.

The objective of the Conference is to provide a forum to analyze domestic and foreign experience with literacy improvement, focusing on the individual's right to become literate and to participate as a conscious citizen in the political, social and economic development of the nation.

Minister Carlos Chiarelli expects this international event to stimulate international cooperation in the advancement of literacy. It will also contribute much to the formulation of a successsful national program of literacy and citizenship, and to elicit external support both in terms of human and financial resources.

Accept, Sir, the renewed assurances of my highest consideration.

Marcilio Marques Moreira
Ambassador of Brazil

(1) SS

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO: (2) Mr. B. Conable (E-1227)	DATE: 2/06/91

(3) AK

Copy to LM pls. for trip file. Thanks. done CL.

SUBJECT:

Document From: M. Qureshi
To: bbc
Dated: 2/05/91 Reference No.: EXC910206001

Topic: BRAZIL: New Economic Measures Announced by the Government

ACTION INSTRUCTIONS:	DUE DATE:

_____ HANDLE
_____ REVIEW AND RECOMMEND
__XXX__ FOR YOUR INFORMATION
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
_____ PREPARE RESPONSE FOR _____ SIGNATURE
_____ FOR YOUR FILES
(4) __XXX__ RETURN TO __MARIA FOR FILING __
_____ OTHER: _____

Remarks: _____
_____
_____

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: February 5, 1991

TO: Mr. Barber B. Conable

FROM: Moeen A. Qureshi

EXTENSION: BRAZIL: New Economic Measures Announced by the Government

1. On January 31, Zelia Cardoso de Mello, the Minister of the Economy, Finance, and Planning (MEFP), announced a series of major new measures to combat inflation. The announcement of what some newspapers are calling the "Collor Plan 2" comes in the context of a public perception that, with the monthly inflation rate continuing to grow (and exceeding 20 percent in January), President Collor's March, 1990 Plan has failed in its stabilization objective. Measures to complete the process of deindexation and to raise public-sector prices can be considered as continuations or correctives to the original Collor Plan. But the introduction of a full prices and wages freeze (described as a prices and wages "truce") appears to be a major "heterodox" amendment.

2. These measures were announced in a televised press conference, and there seems to be some public confusion on how to interpret them. You should take our description of these measures as preliminary; we will confirm, correct, or clarify them when we get more specific information.

3. Deindexation. The Government has eliminated the BTN, an index used in financial and other contracts based largely on historical inflation. It will also no longer use the IRVF (another price index) in fixing interest on saving accounts. Savings and rural savings accounts will henceforth be based on a "Reference Interest Rate" -- denoted "TR" -- which the Central Bank will calculate on the basis of a sample of commercial-bank certificate-of-deposit rates. Thus the TR will reflect market expectations of inflation rather than past inflation. From February onwards savings-account interest will be based on the TR plus 6 percent per annum (and rural savings on TR plus 9 percent). The measures eliminate (and, we understand, make illegal) all post-fixed indexing mechanisms in Brazil.

4. Other developments in the financial market. The Government envisages the elimination of the overnight market through a financial reform which will lengthen credit instruments, but does not spell out the measures intended. However, it did announce other measures, for instance elimination of double taxation of dividends, to encourage equity markets. The Government also envisaged the creation of Investment Funds -- for social development and for development of industrial competitiveness -- without spelling out how private money would be attracted.

5. Wage and price policy. Prices are to be frozen at their January 30 levels (list prices) -- with price rise subject to MEFP authorization -- for an indeterminate period. The exit from the freeze will be slow (by means as yet apparently undefined). But, for public services and natural-monopoly goods the price-authorization regime will become permanent. Rents, mortgages, school fees, and contracts for goods and services will continue to be "coordinated with" salaries. Greater use of the anti-competition law will be made to combat price abuses.

6. February's wages will be fixed, in real terms, at the average for the preceding 12 months of wages. Thenceforth, salaries

will be adjusted twice a year (in June and January) on the basis of free negotiations sector by sector. The Government will, within 45 days, send a draft law to Congress establishing the rules for these negotiations and making provisions for profit-sharing. The minimum wage (now adjusted to Cr. 15,840) will henceforth be fixed in May and November of each year.

7. Public-sector tariffs. These have been raised by 20 to over 70 percent. Gas and fuel-alcohol prices (and producer prices for sugar and alcohol) rise by 47 percent, electricity 60 percent, train tickets 36-40 percent, letters 71 percent.

8. The Government also announced the intention to cut public expenditure in an amount equivalent to some 1.5 percent of GDP. The Government intends to apply tighter controls on state-owned enterprises and on tax evasion. It may be presumed that part of the expenditure saving will also come through the lower state-owned-enterprise deficits following the public-sector tariff adjustments.

WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

cc! JW - for info.

DATE: February 5, 1991

TO: Mr. Barber B. Conable

FROM: Moeen A. Qureshi

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8. The Government also announced the intention to cut public expenditure in an amount equivalent to some 1.5 percent of GDP. The Government intends to apply tighter controls on state-owned enterprises and on tax evasion. It may be presumed that part of the expenditure saving will also come through the lower state-owned-enterprise deficits following the public-sector tariff adjustments.

CC: EDs

Brazil

The World Bank/IFC/MIGA
OFFICE MEMORANDUM

DATE: 15-Jan-1991 11:36am

TO: Sven Sandstrom (SVEN SANDSTROM)

FROM: Chitra Perera, EXC (CHITRA PERERA)

EXT.: 81132

SUBJECT: **Re: BRAZIL - Note from Mr. Ximenes, Alt. ED, dated Jan. 11**

Sven:

I just had word from Mr. Qureshi's office that **no written response** is necessary on this -- Mr. Husain has taken care of it.

I will place the copy in our country files.

Chitra

CC: Maria Fernandez (MARIA FERNANDEZ)
CC: Linda Jean McLaughlin (LINDA JEAN MCLAUGHLIN)
CC: June Nemeyer (JUNE NEMEYER)
CC: Jennifer Anne Volk (JENNIFER ANNE VOLK)

SS

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
Mr. M. Qureshi (E-1241)	1/11/91

SUBJECT:

Document From: Paulo Ximenes Ferreira
To: bbc
Dated: 1/11/91 Reference No.: EXC910111001

Topic: BRAZIL - Proposed Modification of the Highways Management and Rehabilitation Project (Loan 3169-BR)

ACTION INSTRUCTIONS:	DUE DATE:

_____ HANDLE
_____ REVIEW AND RECOMMEND
_____ FOR YOUR INFORMATION
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
__XXX__ PREPARE RESPONSE FOR _BBC'S SIGNATURE 1/14/91
_____ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: NOTE: Hand-delivered to EXC on Jan. 11 (10:28 am). The ED has also requested an appt. to see BBC today re BRAZIL. (CP)

cc: Messrs. S. Husain, Bock

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Country Files: Brazil - Correspondence 03	1779608

Document Date	Document Type
January 11, 1991	Memorandum

Correspondents / Participants
To: Mr. Barber B. Conable, President, World Bank
From: Paulo Ximenes A. Ferreira, Alternate Executive Director

Subject / Title
Brazil - Proposed Modification of the Highways Management and Rehabilitation Project (Loan 3169-BR)

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	Date
Shiri Alon	October 26, 2023

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Country Files: Brazil - Correspondence 03	1779608

Document Date	Document Type	
January 16, 1991	Memorandum	

Correspondents / Participants
To: Mr. E. Patrick Coady
From: Mr. Barber B. Conable, President

Subject / Title
Schedule for Brazil operations

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	Date
Shiri Alon	October 26, 2023

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: January 15, 1991

TO: Mr. Barber B. Conable

FROM: S. Shahid Husain

EXTENSION: 39001

SUBJECT: BRAZIL - Review of Project Implementation

1. Regarding the Board discussion on November 29, 1990, on the Brazil Portfolio, I have gone through the verbatim transcripts of that meeting and I would like to draw your attention to two issues.

2. First, contrary to what Mr. Coady said to me yesterday, at no time did you, Mr. Qureshi or I promise the Board that we would refrain from sending them any documentation on individual loans that might be restructured or cancelled, or whose disbursements might be suspended, until the overview report on the review of the portfolio was sent to the Board. In fact, you, in your summing up (page 133 of the transcripts) and Mr. Qureshi, on three separate occasions during the discussion (pages 64, 65 and 131), agreed to circulate a report to the Board once the discussions with the Brazilian authorities and the review process were completed. During this discussion, it was made very clear by the staff that the status of the process, as of that date, was that agreement had been reached with the Brazilian authorities on actions to be taken on individual loans, and now the process of implementation would begin. As you know, standard Bank policy requires that the Board be informed on a loan-by-loan basis of each action (e.g., suspension of disbursements) as they take place. Consequently, documents would have to be sent to the Board during the process of completing this review, and your commitment was that, after the process was completed, the report would be circulated to the Board indicating the changes agreed with the authorities and their effect on the Bank's overall exposure. You have now agreed with Mr. Potter that this overview report will be circulated to the Board later this month which we shall do.

3. Second, during the discussion, Mr. Choksi also told the Board that it had already received one notice of suspension of disbursments on one project (page 53). He was referring to the Itaparica project. Later on in the discussion, he also informed the Board that the Brazilian Government had wanted to review projects that had already been approved by the Board and the Government had requested some restructuring of one loan and that this would be sent to the Board shortly (page 62). In this case, he was referring to the Federal Highway Management project whose modification is the subject of Board discussion on Thursday, the 17th. Thus, the Board on November 29, had been alerted to this modification also.

cc: Messrs. M. A. Qureshi (o/r), W. A. Wapenhans
A. M. Choksi

THE WORLD BANK

Brazil

February 11, 1991

Mrs. Iweala:

This should be sent to Mr. Conable too and then issued to the Board.

① BBC

② Return to AK.

MOEEN A. QURESHI
Senior Vice President, Operations

THE WORLD BANK/IFC/M.I.G.A.

ROUTING SLIP	DATE February 8, 1991

NAME	ROOM NO.
Mr. Moeen A. Qureshi	E-1241

	URGENT		PER YOUR REQUEST
	FOR COMMENT		PER OUR CONVERSATION
	FOR ACTION		SEE MY EMAIL
	FOR APPROVAL/CLEARANCE		FOR INFORMATION
	FOR SIGNATURE		LET'S DISCUSS
	NOTE AND CIRCULATE		NOTE AND RETURN

RE: BRAZIL - CEM

REMARKS:

OK PPBC

Please find attached two (2) copies of the Brazil's CEM entitled "Economic Stabilization with Structural Reforms." As is normal practice for putting all ESW into grey cover reports, this document has been discussed with and cleared by the Government of Brazil. We also plan to send the attached note with the CEM. You may wish to review it.

Attachments

Armeane

FROM:	ROOM:	EXTENSION:
Armeane M. Choksi, LA1DR	I-7015	31811

FROM: Vice President and Secretary February 8, 1991

BRAZIL: Country Economic Memorandum

Attached is the Country Economic Memorandum for Brazil titled "Economic Stabilization with Structural Reforms." Since the writing of this report, the Government has implemented several stabilization and structural reform measures. An updating note on these measures will be circulated shortly.

Questions pertaining to this document should be addressed to Mr. Michael Michaely (ext. 38718).

File
Brazil

Country: BRAZIL
April 28 @ 3:30 pm

Delegation: Ms. Z. CARDOSO DE MELLO, Min. of Economy
Mr. E. TEIXIERA, Min. of Infrastructure
Mr. I. ERIS, Governor Central Bank

BACKGROUND

- January stabilization measures also likely to fail; prospect is for a brief pause in inflation followed by sharp renewal by summer's end, particularly in anticipation of release of frozen assets.
- Government did achieve success in reaching in final fiscal surplus in 1990 (turnaround of 10% of GDP in one year).
- Notwithstanding macroecnomic uncertainties, Government has implemented and is continuing to implement major structural reforms (e.g., trade, deregulation, privatization, agricultural policy).
- **Debt Negotiations:** Agreement on arrears issue reached with Bank Advisory Committee on April 8, 1991. Twenty-five percent of arrears (through end 1990) will be paid in cash and remaining 75% exchanged for bonds (10-year, dollar denominated, bearer instruments with two interest rate options).
- **Bank lending** so far in FY91 totals $450 million (two loans). One more operation expected this fiscal year (Hydrocarbons, $260 million) for which negotiations have been completed.

POINTS TO MAKE TO DELEGATION

1. **Compliment Minister** on continued implementation of structural reforms.

2. **Inquire about macroeconomic situation** - any developments since your visit in February?

3. **Note progress on debt negotiations** with commercial banks.

IF THE DELEGATION REQUESTS:

1. **Bank to provide adjustment loans and credit line operations** and suggests that these would facilitate the conclusion of debt negotiations.

   YOU MAY RESPOND that the Bank needs to be satisfied that a viable stabilization program is in place and a reasonable track record established. Also need satisfactory progress on sectoral reforms and the availability of complementary external financing. Credit lines also need reasonable macroeconomic environment.

2. **Level of Bank lending and composition of program**

   YOU SHOULD INDICATE that our processing is dependent on clearance by COFIEX which is very slow. Of course, operations must be according to Brazil's priorities but must also meet Bank criteria.

   We would like to emphasize human resources, environment and poverty alleviation.

   Shahid Husain and company will be happy to follow up and discuss details.
   (PLEASE DO NOT GET INTO DISCUSSION OF SPECIFIC OPERATIONS IN THIS MEETING.)

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Country Files: Brazil - Correspondence 03	1779608

Document Date	Document Type	
January 16, 1991	Memorandum	

Correspondents / Participants
To: Mr. E. Patrick Coady
From: Mr. Barber B. Conable, President

Subject / Title
Schedule for Brazil operations

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	Date
Shiri Alon	October 26, 2023

International Bank for Reconstruction and Development

FOR OFFICIAL USE ONLY

File

Brazil

DECLASSIFIED

OCT 20 2023

WBG ARCHIVES

SecM91-163/1

FROM: Vice President and Secretary

February 19, 1991

BRAZIL: THE "BRASIL NOVO" ECONOMIC PROGRAM:

An Updating Note

Attached is a note on the "Brasil Novo" economic program. It updates the Country Economic Memorandum titled "Economic Stabilization with Structural Reforms" circulated on February 13, 1991 (SecM91-163).

Questions pertaining to this document should be addressed to Mr. Michael Michaely (ext. 38718).

Distribution:

Executive Directors and Alternates
President
President's Council
Vice Presidents, Bank, IFC and MIGA

This document has a restricted distribution and may be used by recipients only in the performance of their official duties. Its contents may not otherwise be disclosed without World Bank authorization.

February 14, 1991

BRAZIL: THE "BRASIL NOVO" ECONOMIC PROGRAM: AN UPDATING NOTE

I. An Overview

1. On March 16, 1990, one day after President Collor assumed office, he announced a "New Brazil" (Brasil Novo) economic policy. Both its analysis and its recommendations share much common ground with the Country Economic Memorandum (CEM) "Brazil-Economic Stabilization with Structural Reforms."

2. The program's two principal components, a stabilization policy and an agenda of structural reforms, were interrelated. Both included radical policy changes that distinguish the program from any other in Brazil's recent past. The success of the program is uneven; stabilization has yet to be achieved, but the structural reforms undertaken are almost unparalleled.

3. The stabilization policy rested on two pillars, a drastic reduction of liquidity and the elimination of the large budgetary deficit. The foreign exchange rate was floated and private sector wages were left to be determined by the market. For a while, inflation (having reached about 100 percent per month prior to the plan) seemed to be contained; but after a brief interval it accelerated again, reaching some 20 percent a month by the end of 1990. The resurgence of inflation originated primarily in monetary developments. Stabilization should have been anchored to money, but the monetary aggregates have kept rising for most of the period, with inflation running at about the same rate. Fiscal policy has also played its part. Although the improvement in the fiscal stance has been impressive, the budgetary target may not be fully reached. Together with the monetary expansion, doubts about the permanence of the fiscal policy reforms have contributed to a substantial loss of credibility. While the stabilization program has not achieved its objective of controlling inflation, it may still be salvaged through fiscal corrections and adoption of strict and credible monetary policy. The magnitude of the salvaging task is not to be underestimated: the success of a program will hinge on its credibility, and this can only be achieved through the planning and implementation of a budget surplus and, above all, the implementation and maintenance of credible monetary targets. The longer a credible program takes to put in place, the deeper will be the recession in its wake.

4. The agenda of structural reforms has been radical, consistent in its implementation, and generally successful. Driven by the perception that government should, where possible, get out of economic activity and allow markets to work freely, the reforms have already started to change the economic ground rules in Brazil. The greatest progress has been made in foreign trade. Within a mere six months, an insulated economy was stripped of almost any trade interventions beyond tariffs. This radical reform will take

some time to work its full effect on Brazilian trade, but if sustained, it will lead to a fundamental structural change. Meanwhile, deregulatory measures have reduced many government restrictions on domestic activities. The Government plans a large-scale privatization, which will greatly reduce the role of public-sector enterprises within a few years. The machinery and principles of the process are now established, and first transactions should take place in April, 1991. A reform of the public-sector administration has started, leading so far to a reduction by over 10 percent of the government's labor force; over 200,000 employees have been fired or removed from their positions, and several public agencies have been abolished. Various market-oriented reform measures have also been taken in the agricultural sector, freeing up the sector from government controls and intervention; and promising changes are beginning to be implemented in the social sector.

5. This paper will take a more detailed look at the new economic policy. It will describe the announced policy package, then analyze implementation and performance; finally, it will make some recommendations.

II. The Policy Package

A. Background

6. The last months of the Sarney Administration saw high and increasing inflation, a large fiscal deficit, and an expansionary, accommodating monetary policy. By the first half of March, 1990, inflation had reached a monthly rate of around 100 percent. While the Brazilian economy had developed various instruments to neutralize some of the impact of inflation, it was generally recognized that this level was so high as to constrain normal economic activity; and, correspondingly, that any serious attempt to stabilize the economy would have to be radically different from the three earlier unsuccessful stabilization plans undertaken between 1986 and 1989. Another program in which fundamental monetary and fiscal adjustments were missing was bound to fail.

7. Brazilians also recognized that their economy was so highly distorted--as discussed in the CEM--that economic growth could not resume without drastic structural transformations. In this, even more than in macroeconomic policy, radical change seemed essential. It was also increasingly accepted, as argued in the CEM, that these two policy areas were related: stabilization without structural transformation was less credible, and transformation without stabilization was less sustainable. President Collor's "New Brazil" policy package thus addressed these two issues simultaneously.

8. Surprisingly, particularly in view of the small representation of the President's own party, Congress passed (within the 30-day period specified by the Constitution) almost all the policy package practically unaltered.

B. Stabilization Policy

9. The stabilization package had four elements: monetary policy, fiscal policy, exchange rate policy and wage-price policy.

(i) Monetary Policy: The program assumed that the stock of liquidity must be reduced dramatically and immediately, in the process also achieving a significant fiscal saving. Along with the creation of a new currency (the cruzeiro), the program thus drastically reduced liquidity. In one day, 70 percent of the liquid financial assets were frozen: total liquidity fell from 30 percent to 9.1 percent of GDP after the Government blocked all overnight accounts, demand deposits, and time and savings deposits above a certain level. Those deposits, denominated in cruzados, were to be frozen at the Central Bank for 18 months and were adjusted for inflation and remunerated at 6 percent per year. Deposits below the specified level were automatically converted into cruzeiros. The frozen cruzados could, however, be used to pay debts contracted before March 15 (including mortgages, taxes and social contributions). To soften the impact on total liquidity, the reserve ratio on demand deposits was reduced from 80 to 40 percent.

(ii) Fiscal Policy: the Plan aimed at substantially improving the public-sector budget, from an estimated operational deficit of 8-10 percent of GDP in 1989 to an operational surplus of 2 percent by the end of 1990. This was to be achieved by a stringent reduction (by some 6 percent of GDP) in the interest bill on the government's domestic debt; by wide-ranging tax reforms and reductions in public spending, including the layoff of public workers; and by an increase in public-sector prices. The following tax measures were introduced: (a) the income tax base was broadened to include agricultural incomes; (b) the value added tax on industrial production (IPI) was raised by 10 to 15 percentage points; (c) the corporate income tax on export profits increased from 16 percent to 35 percent; (d) the financial tax (IOF) was broadened to cover trading of all bonds, gold and gold certificates, and stock market shares.[1/] To reduce tax evasion, all bearer financial instruments were eliminated. The period of tax collection was reduced and all taxes were indexed by the daily measure of inflation (the fiscal BTN). In addition, all fiscal incentives and subsidies were to be suspended for at least one year. Prices of public-sector enterprises were raised by about 40 percent, roughly to their real levels of December, 1988. The government's labor force was reduced immediately by 12,000 employees. Twelve ministries were closed, and 24 enterprises were merged with several governmental agencies. To further reduce public spending, the free public transportation used for more than 20 years by federal workers was eliminated; cars and airplanes were sold; and nonessential expenditures such as travelling and advertising were limited. The government also undertook to sell federally-owned residential property.

1/ Of these measures, (a) and (c) can be implemented by law only in 1991; and (d) was a one-time tax.

(iii) Foreign Exchange Policy: the previous foreign exchange policy (crawling peg) administered by the Central Bank was replaced by a floating exchange rate. However, foreign-exchange control was maintained, allowing for the continuing segmentation of the foreign exchange market into three: the official market for exports and imports, the tourism market created in 1988, and the parallel market.

(iv) Prices and Wages: at first, the prices of goods and services were frozen for 45 days. From May 1 onward, the government would announce the ceiling for monthly price adjustments. The indexation of wages by the previous month's inflation was replaced in the public sector by a pre-fixed indexation system. Wages in March were to be adjusted by February's inflation rate. Starting in April, the government would announce an expected inflation rate as basis for the indexation of wages. In the private sector, wages would be freely negotiated. The minimum wage was to be raised quarterly by 5 percent in real terms.

C. Structural Transformation

10. Basic to the policies of structural transformation was the idea that the size and role of the public sector must be reduced substantially, government intervention should be lowered, and the operation of the free market should be encouraged. This was a reversal of a deeply ingrained tradition of more than a century in Brazil. The central components of the new policy were trade liberalization, privatization, and domestic deregulation. Other structural reforms were implemented during the last nine months and will be discussed later.

(i) Trade Liberalization: a sweeping reform of trade policy was announced, aimed at replacing all non-tariff import barriers, including all foreign exchange controls, with custom tariffs, and at a drastic reduction of the latter within five years. Tariff rates on some goods would be raised at first, to maintain some protection to domestic enterprises as they restructured to face increased international competition. Then, over three to four years, tariffs would decline gradually to reach a low and uniform rate of less than 20 percent.

(ii) Privatization of Public-Sector Enterprises: the plan envisaged a privatization program to be implemented in the first two years, yielding in 1990 about 2 percent of GDP in fiscal revenues. Privatized companies could be sold to domestic and foreign owners (subject to a 40 percent limit of voting shares for the latter), including workers of the enterprises. To finance the program, nonnegotiable privatization bonds would be issued to be absorbed by financial enterprises, pension funds and insurance companies, up to a certain level of their assets.

(iii) Domestic Deregulation: liberalization was to be extended to the domestic market. To this end, the government created the Federal Deregulation Program to remove State controls over private investment and entry in economic activities. Except for some strategic sectors (not defined), any entrepreneur would be able to invest in any sector without previous government authorization.

III. Implementation and Performance

A. Macroeconomic Performance

(i) Inflation

11. The pattern of inflation is largely explained by monetary policy and performance and, to a lesser extent, by fiscal performance. None of the inflationary process can be explained as a consequence of the development of private-sector wages. Exogenous events--the oil price increase in August is the prime example--have also played a role through their impact on expectations.

12. The paper first presents the pattern of inflation; it then describes the three major elements which may potentially explain the process, namely, money, the budget, and wages; and concludes this section by analyzing the inflationary process. To understand the process, which is quite complicated, various phases in the development over the last 10 months are distinguished.

The Rate of Inflation

13. Four phases appear in the behavior of inflation in the ten months since the introduction of the stabilization plan. Although some of these phases were very short, their pattern helps explain the inflationary process.

14. The first phase lasted for about a month--from mid-March to about mid-April. After a monthly inflation of at least 100 percent on the eve of the new policy, prices remained more or less stable for these few weeks. Price controls were formally applied during that time, but they did not seem to matter much. Indeed many prices may actually have declined, albeit in ways (such as discounting a posted price) which were not recorded in the price indices.

15. The inflationary trend changed sharply in mid-April, to start the second phase. For about two months inflation returned and accelerated. By mid-June, the monthly rate of inflation reached a level of 13-14 percent.[2/] The credibility of the stabilization policy suffered a heavy blow during this period.

16. In mid-June a third phase started, of decelerating inflation. This lasted until the end of July, by which time monthly inflation fell to the level of 5-6 percent.

2/ Here and elsewhere, inflation data refer to "instantaneous", weekly estimates of monthly inflation rates inferred by the Department from published data which are provided on a monthly basis.

17. Finally, in early August--not coincidentally with the start of the Gulf crisis and of the campaign for gubernatorial and congressional elections--the fourth phase began. Inflation started accelerating again and kept increasing--although not monotonically--until mid-November, at which time it reached a monthly level of some 20 percent. In December, the rate of inflation was somewhat lower; but it is too early to tell whether this is another trend reversal, a temporary interruption in a phase of still-accelerating inflation, or a phase in which the rate remains at the high level of around 20 percent per month.

Fiscal Policy

18. The government originally sought an operational budgetary surplus of 2 percent of GDP, following a year in which the deficit was at least 8 percent of GDP. Initially, the projections included as revenues proceeds from the sale of public enterprises (or, rather, of government bonds with which the privatized enterprises would be bought). Later the government decided, correctly, that these proceeds (which in any case have not materialized) should be excluded, and the budgetary estimate was revised accordingly to a surplus of 0.5 percent of GDP.

19. Complete budgetary data for 1990 are not yet available. From the limited evidence, it is possible to infer that the budgetary target was mostly achieved, but not completely (see the data on the budgetary cash performance in Table 1).

20. Significant cash surpluses materialized in the first few months following the introduction of the plan. They then practically disappeared towards the end of 1990. Nevertheless, for April-December 1990 as a whole, a cash surplus of US$7 billion is recorded--about 2.5 percent of GDP.

21. Accurate budgetary accounting, namely, on an accrual basis, would have to include the net creation of government commitments which are not recorded in the cash accounting. Of these, the chief component would be the unpaid interest on public-sector external debt. The arrears accumulated during this period happen to be practically identical in size with the cash surplus. Their inclusion would make the budget roughly balanced. There are indications, however, that some increase in domestic federal-government commitments (such as in suppliers' credit) also took place. More important may be credits (through the acquisition of bonds, or otherwise) provided by the public to state and local governments. Taking all this into account, an informed guess would indicate a small operational deficit. The performance was thus somewhat short of the target, but still representing a very impressive change in the budgetary stance. This achievement looks all the more remarkable in view of the large budgetary deficit of the first two-and-one-half months (January through mid-March) prior to the stabilization plan.

22. This improvement has originated, first, from the change in the nature of the government's short-term domestic debt. On the eve of the stabilization plan, this debt amounted to roughly 25 percent of the annual GDP. In the last year before the plan, this debt carried a real interest rate of about 25-30 percent per year--leading to an interest bill of 6-7 percent of

GDP. With the plan, the debt was partly monetized, thus eliminating all interest payments on this part, and mostly converted to an asset (frozen cruzados) yielding an annual real interest rate of 6 percent. This led to a fiscal saving of some 5-6 percent of GDP. Other contributing factors to the fiscal improvement were tax increases--through the elimination of exemptions; the imposition of primarily one-time taxes; the elimination of various subsidies; a significant cut in the government's labor force; and a substantial fall in public-sector real wages (see below).

23. On the other hand, two factors primarily have limited the fiscal improvement, and prevented the full achievement of the targeted surplus. One was the policy concerning public-sector prices. As mentioned earlier, these were increased with the introduction of the plan (by some 40 percent, on average), to reach their end-1988 real levels. But from then on, the government maintained these prices at a constant nominal level for almost half a year--apparently as a means to mitigate cost increases, inflationary expectations, and inflation. Since August, nominal prices have again been raised periodically. By the end of the year, however, they were not only substantially below their end-March real levels (to which the impact of the increase in oil prices should be added), but also lower than their pre-plan level.

24. The other contributor to the deficit was a large increase of the expenditures of state and local governments. The Constitution requires that a large proportion of the increase of tax revenues be directed to these governments. Existing mechanisms, however, cannot completely prevent a commensurate increase of expenditures. Moreover, state and local governments may have increased expenditures even beyond this thus, perhaps, even increasing their deficits. These, in turn, were financed by credit from the Central Bank and from the private sector.

Monetary Policy

25. The strong monetary adjustment was the cornerstone of the stabilization plan. But faced with the prospect of an immediate disruption of activities--and apparently fearing that this was a start of a severe recession--the government changed course abruptly, rapidly injecting a large amount of liquidity into the economy. Beyond the reduction of required reserve ratios on demand deposits from 80 percent to 40 percent (for larger banks), the Central Bank released frozen accounts in a variety of ways--most of them discretionary. It allowed enterprises to pay wages (up to a certain ceiling), as well as taxes, out of the frozen accounts. The Central Bank also created refinancing lines for larger enterprises in four main sectors (civil construction, automobiles, agriculture, and capital goods), and authorized further conversions of cruzados to benefit the Social Security Administration, Federal and local government, rural producers, professional associations, labor unions, charitable associations, etc.

26. As a result, by the end of April, some US$15.7 billion were added to the total quantity of money, raising it from 9.6 percent of GDP on March 16 to 15.1 percent on April 30. Of the overall increase of money supply (US$15.7 billion), the major part--US$12 billion altogether--originated in withdrawals

from frozen accounts. Of these, nearly half--US$5.6 billion--were withdrawals for Federal tax payments. Two smaller sources of increased liquidity were Central Bank net purchases of foreign exchange--US$1.6 billion; and borrowing by firms for payment of wages--US$0.7 billion.

27. By mid-May, with the renewed inflation and the erosion of confidence in the stabilization policy, the government again decided to change course in its monetary policy. Various directives and instruments were applied, in the second half of May, to grant the Central Bank a better control of the monetary aggregates and to constrain their rapid increase. In particular, the automatic repurchase agreement of Treasury notes--long a hallmark of Central-Bank policy and the mainstay of the large overnight market--was discontinued. Banks were thus forced to apply to the rediscount window when a shortfall of reserves had to be covered. Strict monetary targets were also introduced. The major monetary aggregates (the monetary base, M_1, M_4) were targeted to increase by about 10 percent in the second half of 1990 and to remain at constant nominal levels in the first quarter of 1991.

28. It appears that, for a while, a drastic reduction of the rate of monetary expansion was indeed achieved. But within a short period, of about two months, there was again a rapid increase in the monetary aggregates. Indeed, even during the first two months (June-July), M_4 kept rising, although not at its rate during April-May. By end July, M_4 already exceeded by 25 percent its level of end-May.[3/] During the second half of 1990, the monetary base increased by 94 percent; M_1 by 116 percent; and M_4 by 125 percent (see Chart 1). These changes in monetary policy contributed significantly to a decline in the credibility of policy implementation; the public's confidence in the strong medicine administered to conquer inflation started to erode.

29. Real interest rates are, of course, hard to estimate. But it appears that the ex post borrowing real interest rates were very low--mostly negative--during much of the period. Only in October did they increase substantially, reaching in October-December monthly levels of 5-7 percent.[4/] In this sense, monetary policy did become tight towards the end of 1990. The large increase of the real interest rate may be explained by both supply and demand factors. The size of credit to the private sector fell, in comparison with other monetary aggregates. In essence, credit to state and local governments partly displaced credit to the private sector. At the same time, the private sector's demand for credit must have increased in the face of financial difficulties and involuntary accumulation of inventories.

3/ This increase, in face of a given (even falling) monetary base, was possible due to a changing portfolio composition of liquid assets; viz., a relative shift from M_1 (consisting mostly of demand deposits, which are subject to a 40 percent reserve requirement) to other components of M_4 (such as time deposits) which are free of any reserve requirements.

4/ Real interest rates would appear to be only half of this level if deflation is done through next month's price index.

Wages and Wage Policy

30. Unlike previous plans, the Collor stabilization plan did not rely on "wage policy"--specifically, it required no freezing, rules of indexation, or other universal or automatic measures of wage adjustment for the private sector. Wages in the private sector were to be determined freely in private negotiations. Wages in the public sector were to be adjusted by end March in proportion with the February increase in consumer prices; and from then on, to be adjusted monthly in accordance with expected inflation for the coming months.

31. It should be noted that this component of the stabilization plan has faced the fiercest political opposition. It was the only one not endorsed by Congress, and was sustained only through Presidential veto. Throughout the period, Congress has repeatedly tried to introduce a wage policy, primarily through measures of full indexation. These attempts have repeatedly been rebuffed by Presidential veto. Other attempts have been made--originating from the business community, labor unions, or even from the government itself--to determine wages within a framework of a "social pact." Once more, none of these attempts has borne fruit. In the courts, too, the government's wage policy has faced a continuous battle, to the point in which the Supreme Court has ruled it, in mid-January 1991, to be unconstitutional.

32. Data on wages are incomplete. It does, however, appear that in the first few weeks following the policy introduction, nominal wages in the private sector generally did not increase and sometimes even declined. Initially, real wages in the sector fell substantially--by some 25-30 percent. This was followed by rising real wages, but even towards the end of the year, real wages in the private sector appear to be some 10-15 percent lower than prior to the plan. In the public sector, the decline of real wages has been much more significant. Nominal wages were, indeed, adjusted by end March in accordance with the plan. But from then onwards, automatic adjustment ceased. Until the end of the year, two "bonus" increases have raised nominal wages by a total of less than 50 percent, in comparison with consumer-price increases during this period of about 150 percent. Federal-government real wages have thus declined by about 40 percent since the introduction of the plan. The fall of wages in state and local governments, however, has been less sharp.

The Process of Inflation

33. The monetary shock at the introduction of the stabilization plan led to an immediate stability--and even some decline--of the price level. This was a unique event in Brazil's recent history, considering the fact that price controls did not effectively play any role. Within a few weeks, however, following the large new injection of money, inflation reappeared. This re-emergence dealt a major blow to the credibility of the stabilization program and made any further pursuance of stabilization a much more difficult effort--specifically, an effort which could no longer succeed without a significant economic recession.

34. The Government's strong determination and commitment to contain inflation resulted in the imposition of tight monetary policy at the end of

May 1990, and the establishment of very tight targets. Indeed, the monetary base was kept stable, with some small fluctuations, for several months; by end-October it was only at its end-May level. Money in its narrowest definition, M_1, also increased only slightly in June and July. In this way, the new monetary policy appeared to restore some credibity. As a result, the rate of inflation started falling--from 13-14 percent (per month) at end-May to 5-6 percent by end-July. But M_4, the concept of money most appropriate in Brazil's context, behaved quite differently; it kept rising. Some time in August, it appears that the public realized that monetary targets were not being maintained, and that money supply was continuing to expand. A re-emergence of inflationary expectations, and of inflation, was then inevitable. This re-emergence was reinforced by the Gulf crisis. The start of the crisis (on August 2), through its substantial impact on oil prices and the general uncertainty accompanying the event, further contributed to inflationary expectations and to an immediate impact on general price levels.

35. From then onward, a high level of inflation accompanied a high rate of expansion of the monetary aggregates. From end-July to end-December, all the major money aggregates increased at very similar rates--both the monetary base and M_1 increased by 16.3 percent per month, and M_4 by 14.5 percent. The monthly rate of inflation during that period was almost identical--an average of 15.1 percent.

36. It also appears that despite the seemingly satisfactory budgetary balance, an adequate performance is <u>not</u> generally perceived in Brazil as having been established. The suspicion that the apparent balance is merely temporary and unsustainable in even the near future, seems to have become pervasive in recent months. Coming out of the huge deficit of 1989, to gain credibility the budget should have aimed at and resulted in a significant operational <u>surplus</u>.

37. On the other hand, a theory which has traditionally been influential in Brazil, that the behavior of wages is instrumental in sustaining and accelerating inflation, cannot be supported by this experience. With the initial monetary shock, real wages (in the private sector) fell substantially. Even over a longer period, of close to a year, it appears that real wages have displayed substantial downward flexibility.

38. The renewed inflation can still be contained. If monetary aggregates are indeed kept at their announced targets (i.e., remain at a constant <u>nominal</u> level), and the fiscal stance improves by 3-4 percent of GDP, inflation should eventually subside. But this would not happen in the next few months. Given the recent history of events, it will take some time to restore public confidence and to change the public's expectations of inflation. The Government also faces constitutional limits to lowering the fiscal deficit, and this reduces the policy options of the Government. There are reports that the Government intends to attempt to change some parts of the Constitution to gain better control over the fiscal situation. But this process will also take time. Given the history of the last year and the current inflationary expectations of the public, inflation will not be controlled without an economic recession. However, in view of the impressive structural reform measures being implemented by the Government (discussed

below) and the dynamism of the private sector, this recession should be relatively short-lived.

(ii) Economic Performance

Economic Activity

39. As far as economic performance is concerned, it is important to note that industrial activity had already been falling, rather sharply, before the introduction of the plan; its level in January-February 1990 was about 15 percent below its mid-1989 level. The immediate reaction to the plan was a substantial decline of activity, but this was reversed shortly. Already by May the pre-plan level was almost achieved. The increased trend of activity was sustained for several months and industrial activity reached, by August, a peak level--some 15 percent higher than prior to the plan. From September on, however, there has been a decline. Data for the end of the year are not available, but preliminary evidence--such as on the number of firms applying for bankruptcy procedures--suggests that this decline is probably significant. The perception in Brazil in early 1991 is definitely one of a recession, with business firms generally expecting its deepening in the next few months. A preliminary estimate indicates a decline of Brazil's GDP by 4.3 percent from 1989 to 1990. The sectors of civil construction, crop agriculture, and manufacturing show the largest declines (close to, or exceeding, 10 percent).

40. Unemployment data (of Saõ Paulo) provide a somewhat similar pattern, viz., an initial increase and a subsequent reduction to a level only slightly higher (by about 1 percent) than prior to the plan. As yet there are no indications of rising unemployment in recent months. Apparently, labor is still being conserved by firms, probably on the assumption that the slump of activity may be short-lived.

The Foreign-Exchange Rate and Foreign Trade

41. The stabilization plan established a freely floating (the "livre", or commercial) exchange rate, replacing the prior policy of a crawling peg. In actual practice, occasional government intervention has taken place--practically always in the direction of depreciating the exchange rate(i.e., the Central Bank has been a net buyer of foreign exchange, thus increasing its foreign-exchange reserves and the money supply). Most often, this intervention was meant to prevent an appreciation rather than to accelerate a depreciation. The intervention was strongest (i.e., the size of increase of reserves was highest) during the first few months following the introduction of the plan.

42. In addition to the "free" rate, two other exchange rates exist: the "tourist" and the "parallel" rates--the latter being illegal, but generally tolerated. These two rates have always (prior to the plan, as well as since its introduction) been very close to each other and always higher than the official (now "free") rate. The gap between the "parallel" (or "tourist") rate and the "free" rate practically disappeared immediately after the introduction of the plan. It then increased rapidly, reaching levels of 50-60 percent within a few months. After June, however, it declined just as

fast--apparently with the help of government intervention--and reached a level of only 5-7 percent by August. In recent months, the gap has been around 10-15 percent.

43. For about half a year, the real exchange rate did not display any general upward or downward trend, although fluctuations, created by alternating periods of stability and of increases of the nominal rate, were significant. From the end of September onwards, on the other hand, a substantial increase of the rate, which was particularly fast in October and November, has been taking place. By mid-January, the cumulative real depreciation since the end of September amounted to some 35 percent; and the rate was about 40 percent above its level immediately following the introduction of the new policy (see Chart 2).

44. Prior to the stabilization plan, from 1988 to early 1990, a substantial currency appreciation had taken place. On the eve of the plan the real exchange rate was only one half of its level during the period 1982-86 (that is, a devaluation of around 100 percent would have been required to reach the "normal" level of the real rate). Thus, even with the substantial recent depreciation, the real exchange rate today is still only at around 70 percent of its "normal" level.

45. The low level of the real exchange rate has been a major reason for the decline in Brazil's trade balance--a trend which had started already in late 1988. From September through November 1990, the trade surplus fell to an annual level of only US$5.5 billion, in comparison with about US$19 billion in 1988 and US$16 billion in 1989. For the calendar year 1990, the trade surplus is expected to amount to around US$11 billion--the smallest since 1986. The reduction of the trade surplus originates from both the imports and the exports sides. The (dollar) value of imports during September-November 1990 exceeded by over 20 percent its value in the same period in 1989. This is partly explained by the increase in oil prices and, in part, by the trade liberalization, unaccompanied by exchange-rate depreciation in the relevant period. The change in exports appears to be less substantial: there was a decline, between the corresponding periods of 1989 and 1990, of 8.5 percent. But in view of the continuous trend of increased exports in Brazil, this is a dramatic decline. Part of this is explained, again, by price changes; i.e. falling world prices of some of Brazil's major primary exports (such as soybeans). But at least part of the fall of exports is due to the low level of the real exchange rate. Another contributing factor has been the substantial reduction of short-term financing of exports transactions (and an increase of the interest rate) due to large contractions of foreign credit lines. This has resulted from the absence of significant progress in the negotiations of external debt between Brazil and its commercial creditors.

(iii) External-Debt Negotiations

46. On December 31, 1990, Brazil's total external debt amounted to US$121.6 billion. Of this, US$14.5 billion was short-term debt; and US$107.1 billion medium- and long-term debt. Of the latter, debt to commercial banks (including arrears) amounted to US$61.8 billion; bilateral inter-government debt (again, including arrears) to US$24.0 billion; and debt to multilateral

organizations to US$14.3 billion, of which US$8.4 billion was owed to the World Bank. Other long-term debts amounted to US$7.0 billion.

47. In relation to the country's GDP, Brazil's external debt is not particularly high.[5/] Debt service as a ratio of exports puts Brazil on a higher place among the heavily-indebted countries; but experience shows that Brazil has the capacity to expand exports rapidly and to achieve large trade surpluses. Thus, Brazil's ability to service its external debt is not dependent on its capacity to generate a trade surplus, but rather on its ability to mobilize, through the budget, the required domestic resources. This again emphasizes the importance of fiscal adjustment in Brazil.

48. The Government of Brazil suspended interest payments on the country's debt to foreign commercial banks in July 1989. This was intended to be a temporary measure to bolster foreign-exchange reserves. Upon assuming office, the Collor government announced that this suspension would be maintained until negotiations led to a restructuring of the debt. By the end of 1990, the accumulated arrears amounted to US$12.3 billion (of which US$8.3 billion accrued on the debt to commercial banks, and US$4.0 billion on the bilateral debt).

49. Negotiations started in October 1990 with the two sides having substantially different positions. The negotiation process since then has yielded some bridging of the gap. The current process of negotiations has involved the Government of Brazil and the Bank Advisory Committee making proposals and counter-proposals designed to reach agreement on the clearance of arrears and the restructuring of the debt. As a provisional measure and as a sign of its desire to successfully conclude negotiations, the Brazilian government announced its intention to pay in the first quarter of 1991 30 percent of the interest due in this quarter regardless of the progress towards an agreement. As of the writing of this note, agreements on the settlement of past arrears and on the restructuring of the debt have not been reached.

(iv) The IMF Program

50. An IMF mission visited Brazil in August, and by early September an agreement had been reached about a Fund Program in Brazil. The Program and the Letter of Intent essentially reflected, in their main features, the announced principles of Brazil's policy. An operational surplus of 0.5 percent of GDP was to be achieved in 1990 with a basically similar operational result in 1991, and the monetary targets for 1990-91 were those established by the Government in May 1990. Fulfilling of these targets was expected to lead to a substantial deceleration of inflation.

51. Consideration of the Program by the Fund's Executive Board was conditional on meaningful progress in the negotiations with the foreign

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5/ See "Brazil: Economic Stabilization and Structural Reforms" Gray Cover, January 1991 for a fuller description of Brazil's debt.

commercial banks over Brazil's debt to the banks. Since that stage had not (and still has not) been reached, the Program has not been brought to the Fund's Board. Given the developments in the intervening period, there is a need to reassess part of the program. To this end, an IMF mission may visit Brazil in March 1991.

B. The Structural Reforms

52. The Collor Government has undertaken and continues to undertake a number of basic, far-reaching structural reforms. These reforms, if maintained, will fundamentally change the policy environment in which economic activity can take place and lay the foundations for long-term stabilization and growth. The underlying principles behind these reforms are the reduction of the role of the government in economic activity, the creation of domestic and international competition and the integration of the Brazilian economy into the world economy. The policies of structural transformation presented here are: (i) trade liberalization; (ii) deregulation; (iii) privatization; (iv) changes in public-sector administration; (v) policies in the agricultural sector; and (vi) social-sector reforms.

Trade Liberalization

53. The process of trade liberalization has been fast and very intensive. Over a period of less than half a year almost all trade barriers (other than tariffs) have been dismantled. Upon implementation of the plan, CACEX was abolished and import licensing, which was still required, was assigned to a department in the Ministry of Economy. This step was of crucial importance since CACEX had, in effect, been conducting the country's import policy in a highly restrictive and discretionary manner. Initially, the government imposed a monthly ceiling of US$2 billion, until the end of June, for total imports. But due to the diminished domestic activity, and a resulting low demand for imports, the latter were probably not effectively constrained by this ceiling.

54. In early May, the government abolished the list of some 1,800 goods whose imports had been prohibited for over a decade, and partially eliminated the "market reserves" policy. The field of application of the highly-restrictive "Law of Similars" was also severely reduced. Goods like automobiles, electrical appliances, toys, tobacco, foodstuff, or chemical products could thus be imported. For about 300 of the 1,800 goods import tariffs were increased. For automobiles, these tariffs ranged from 65 to 85 percent; for toys, from 85 to 105 percent.

55. On July 1, the most radical element of dismantling the QRs system took place. From then on, almost all imports (with the main exceptions to be noted below) became completely free, protected only by tariffs. All controls on the allocation of foreign exchange for imports were eliminated. Import licenses are still required; but they are meant to be granted automatically and immediately and to serve mostly for statistical and price-control purposes. An important administrative step designed to ensure that this indeed should be the practice is planned for April, 1991, when the licensing of imports will be decentralized and "privatized," by being moved to

individual commercial banks. Another important step undertaken in September was the suspension of a long-standing regulation which had allowed imports of capital goods only if they were financed by long-term foreign credit.

56. Practically the only important category still subject to import regulation is that of informatics goods (ranging from microchips to super computers) whose imports are controlled under the "Law of Informatics." The government intends to introduce legislation that would eliminate all the restrictions of this law by October 1992. In the meantime, some of the law's implementing regulations have been changed. Also, from January 1, 1991 import controls apply to only 47 goods rather than to 300. The reduced list, however, maintains protection of the most important items of Brazil's production in this sector.

57. As noted earlier, some tariffs have been increased to partly offset the removal of QRs. But during the second half of 1990, tariff reductions have very often been undertaken, as a means of combatting monopolistic positions of domestic firms. In early 1991, the government intends to announce a concrete four-year plan of gradual tariff reductions. By the end of this period, all goods are expected to fall to one of only three tariff categories: 0, 20, and 40 percent; and the median tariff level is targeted to become 20 percent.

58. The process of removal of non-tariff barriers has indeed been dramatic. Within a half year, Brazil has turned from a country with one of the most highly restrictive trade regimes, which had been well entrenched for decades, to a country whose imports are predominantly free of quantitative restrictions. In the extent and speed of the shift it has few parallels, if any, in contemporary trade policies.

Domestic Deregulation

59. The government has been following a policy of increasing domestic competitiveness in two forms: deregulation, which has involved removing the government's own obstacles to the operation of a freely-competitive market (e.g., requirements to purchase domestic raw materials or capital goods, special tax incentives, requirements to use certain distribution and transport systems, or labor-market controls); and removal of restrictions on the functioning of free markets imposed by the enterprises themselves (e.g., cartels). Monopoly powers granted through state intervention which have been removed include restrictions on entry to certain activities, investment licensing, and rights of access to the purchase of specific raw materials. Equally important, price controls which were used to favor particular industries (e.g., low prices on steel to make automobile production financially competitive) have been liberalized or removed for most products.

60. Various reforms have also been introduced in the areas of telecommunications and transportation. The role of private sector provision of telecommunication services has been redefined, with a consequent limit on the role of the public sector (this is still subject to congressional approval). Operation of cellular telephone networks by private companies and of private telephone networks and data transmission services will be possible.

Port services will be privatized; and various measures restricting the operation of private firms in transportation have been abolished.

61. In addition, the Council for Industrial Development (CDI) was eliminated and the Secretariat for Industrial Development (SDI)--CDI's executing agency--was transferred to the Ministry of the Economy to administer the remaining fiscal incentives. President Sarney's Program of Integrated Sector Development (PSI), which had been envisaged for 18 sectors, was maintained, but the fiscal incentives granted under those programs were dropped. The 1,000-person administrative machinery of the former Ministry of Industry has been replaced by about 100 staff in the Department of Industry in the Ministry of Economy.

Privatization

62. The process of privatization is ongoing, and appears to be taken seriously, despite the fact that as of now no Federal government enterprise has yet been put for sale. The only firm actually privatized, in early September 1990--VASP Airline--was an enterprise of the State of Saõ Paulo. President Collor had declared the privatization of ten firms as a target for 1990. This was too ambitious, since preparation of a transfer of any single firm is a time-consuming process. But during 1990, a Privatization Committee was created; mechanisms, rules, and the principles of the privatization process have been established; and private consortia selected, through a competitive bidding process, to evaluate the first four firms to be sold and to recommend the specific modalities of sale for each. The draft reports of these private consultants are now being reviewed by the Privatization Committee and BNDES (the National Development Bank, which is its executive agency), and three enterprises are scheduled to be offered for sale in April 1991. First and most important in the initial round of privatization would be firms in the steel sector, followed by petrochemicals and fertilizers. The initial round would, correctly, focus on industrial enterprises which operate in competitive markets. Eventually, within about four years, the government intends to sell all state-owned enterprises except those singled out by the Constitution as subject exclusively to government ownership (e.g. Petrobras, the oil company). Already, the two federally-owned electricity distribution companies have been added to the privatization list for the first round. The book value of firms which are (immediate or eventual) candidates for privatization is in the order of US$80-US$100 billion dollars; no good estimate of the market value is available, but it is expected to be well below the book value.

63. The main factor which may adversely affect the privatization program would be lack of progress on the external debt negotiations: the foreign commercial creditors might not grant the waivers needed for the indebted enterprises to be sold if negotiations are not concluded satisfactorily. It might then be very difficult to induce foreign companies to bid for shares in the newly privatized firms. Debt-equity swaps, which may very likely be the main vehicle for such foreign investments, would probably be an outcome of a debt settlement.

Administrative Reforms

64. As part of the original policy package, a reorganization of the central-government's bureaucracy took place: the number of ministries was halved, and initially, a small number of government employees was dismissed. A major reshuffling, however, took place later, in May-June 1990. At that time, over 200,000 central-government employees--more than 10 percent of the total--were removed from their positions, partly relegated to a "pool" and partly laid off. This is a large fraction by any yardstick, particularly in view of the very short time in which this policy was carried out. In the past, repeated decisions about dismissals on a much smaller scale always came to naught.

65. Further reforms would mostly depend on Constitutional amendments. Provided these can be introduced, the government intends, inter alia, to eliminate tenure and job stability in the public sector; to revise the social-security system; to revise the system of compulsory transfers from the Federal to State and local governments; and to scale down substantially the government's maintenance of higher education. These measures will increase the Government's ability to reduce its fiscal expenditures and thus contribute to the stabilization effort.

Agricultural-Sector Reforms

66. As in the other sectors of the economy, the purpose of policy changes in the agricultural sector is to reduce government involvement and encourage the operation of free markets. An added target for this sector is the protection of the environment. The latter is expected to be achieved, in this context, primarily through the removal or reduction of subsidies which had promoted expansion of the frontiers in the Amazon.

67. The agricultural sector is the only one in which export bans and quotas had been maintained, as well as other measures of regulating exports. Most of the export restrictions have now been removed (on exports of cotton fiber, rice, maize, and soy products). The Brazilian Coffee Institute (IBC) has been abolished and with it all controls and fees on the export of coffee. The Institute of Sugar and Alcohol has also been dismantled, but sugar exports are still subject to quotas and the sector is still subject to price regulation. Sugar has thus remained the only crop subject to quantitative control of exports. Tariffs on various agricultural products have been removed, and tariffs on most capital and intermediate goods destined for agriculture have been lowered substantially.

68. While wheat imports are still restricted, the government's monopoly on both wheat imports and domestic wheat sales has been ended. Domestic wheat processing, formerly tightly controlled through quotas to millers, is now being liberalized. All prices in the wheat industry have remained, however, under the government's controls.

69. Domestic pricing policies have also been modified to approach more closely the operation of free markets. Control of milk prices has been abolished (though at the time in which this became effective the government

applied strong pressure to prevent a substantial price increase). Where minimum prices exist, they are no longer uniform but vary among regions, to reflect regional differences in transportation costs (i.e., to make the minimum-price structure better reflect cost structures).

70. The process of administrative reform has been particularly intensive in the agricultural sector. Major agencies have been closed or merged, clearly signaling policy changes with respect to the role of the public sector in agricultural pricing, storage, and marketing.

71. Finally, income-tax legislation has been changed to remove most (but not all) of the favorable treatment of the sector, by making tax rates similar to those applied elsewhere and by eliminating various exemptions and deductions specific to the sector.

Social-Sector Reforms

72. The "New Brazil" program did not explicitly address social sector reforms. Since March, however, the government has begun to articulate a series of planned reforms in the social sectors, many of which are in line with Bank recommendations and which, if implemented, will have a positive effect on the efficiency and equity of social service delivery.

73. In health, the administration has approved and is beginning to implement the sistema unico de Saude, which introduces a dramatic reorganization and decentralization of the health delivery system. Under this law, INAMPS (the social security health benefits administration), the largest financier of hospital care, will come under the jurisdiction of the Ministry of Health. Price controls on most pharmaceutical products have been removed.

74. The government has also taken initiatives to improve coordination of social sector programs. To rationalize various government programs oriented toward the health and education of young children, President Collor mandated the creation of an inter-ministerial coordinating body called the Ministry of the Child. The administration has also stated its intention to reform the National Milk Program, the largest and least well-targeted of the nutritional supplementation programs, as well as to put the coordination of all nutrition programs under INAN, the National Institute of Food and Nutrition.

75. In education, government price controls on tuition for private primary and secondary schools have been eliminated; the current policy is that tuition levels should be negotiated directly between schools and parents. In January of 1991, the Minister of Economy announced that one of her targets this year would be the introduction of tuition in public higher education. The government has also introduced a US$500 million program to fight illiteracy and improve the quality of public education, called the Programa Nacional de Alfabetizacao da Cidanania (PNAC). This program emphasizes primary education; it is designed to strengthen state and municipal school systems, expand primary school access, and ensure that children complete more years of schooling, through improvements in school quality.

IV. Concluding Note

76. The Collor Plan ("Brasil Novo") has been comprehensive and far-reaching. It is the first stabilization program in Brazil's recent history which has tried to tackle the fundamental sources of inflation rather than deal temporarily and superficially with some of its manifestations. Probably of even greater significance, it is the first attempt in generations of introducing a radical transformation, moving the economy from heavy reliance on regulation by the government to one in which free markets are the rule and the private sector becomes predominant.

77. The success of the stabilization program is, at the moment, not assured. Unless monetary and fiscal policies change, inflation would persist and accelerate. The policy changes required now are not as drastic as those undertaken in March 1990. But any policy implemented now must be of sufficient credibility to alter permanently inflationary expectations. This is of crucial importance. The reforms would include, at least, the following changes in fiscal and monetary policies:

(i) To establish credibility, a budgetary surplus must be planned for and implemented, and the public must perceive that the deficit has been eliminated permanently. In addition to the measures already taken by the Government this would require, at a minimum, two major steps. First, a substantial reduction of the deficits of state and local governments. This would probably be the most difficult policy for the Federal government to implement. It would call for an effective control by the Federal government over the borrowing capacity of the states and the abolition of Central-Bank lending to the states, directly or through state banks. Second, a substantial increase in public-sector prices and the continuous maintenance of these prices at least at their end-1988 real levels. In addition, the attempts by the Government to amend the Constitution in order to permit greater fiscal control of the budget are important steps in the right direction.

(ii) Most importantly, stabilization requires the implementation and maintenance of credible monetary targets--viz., a low nominal growth in the supply of money--through predetermined changes in the Central Bank's major asset components and the use of other monetary instruments at its disposal.

78. Another component bearing on the success of stabilization would be an agreement with Brazil's creditors on the settlement and the restructuring of its foreign debt. Such an agreement should significantly increase the credibility of stabilization policy and would facilitate the privatization process.

79. In contrast to the uncertain performance of the stabilization plan, the process of structural transformation undertaken by the government has been admirable. Fundamental, thorough reforms have been carried out continuously and persistently. If these can be sustained--and the likelihood of this eventuality is not independent of the achievement of stabilization--Brazil should face the prospect of rapid growth once the short-term recessionary impact of stabilization is over.

Postscript

80. On January 31, 1991, the government of Brazil announced a set of additional measures designed to combat inflation. The major elements are as follows:

(i) The budget. Prices of public-sector goods and services have been raised by between 20 percent to over 70 percent, with a weighted average of close to 50 percent. The government also announced its intention to cut public-sector expenditures by an amount equivalent to 1.5 percent of GDP.

(ii) Monetary policy. In essence, the monetary measures amount mostly to the elimination of indexation of various financial assets, or of other contracts. Indexation will be replaced by the use of a "reference interest rate", which the Central Bank will calculate on the basis of interest rates on commercial-bank certificates of deposit (CDB). The overnight account has been eliminated and replaced by the establishment of overnight accounts in private funds which, in turn, will invest primarily in government bonds or will channel loans into government-prescribed activities.

(iii) Wage-price policy. Prices are to be frozen, at their January 30 levels, for an indefinite period--with an expected slow, gradual exit out of the freeze through government-authorized price changes. Some prices (such as rents, or school fees) will be indexed, as before, to salary levels. February's wages will be determined so that their real levels will be equal to the average of the last 12 months. Thenceforth, nominal wages will be adjusted twice a year, in June and January, through free negotiations.

(iv) The policy announcement of January 31 also included the introduction of a program for the gradual reduction of import tariffs. This is a further evidence of the thoroughness of the trade reform and the determination of the Government to continue to implement structural reforms.

81. The details of these measures are not completely clear; some have yet to be fully articulated. Moreover, many of these measures will require Congressional approval and may change significantly. Thus, the final set of measures that can and will be implemented are not yet known.

Table 1: TREASURY'S CASH FLOW, 1990

Month	Net Cash Receipts (US$ Billions)
January	-6.57
February	-5.15
March	-1.02
April	3.04
May	2.64
June	.31
July	.35
August	.35
September	.33
October	.04
November	.01
December	.02
Total, January-February	-11.72
Percentage of GDP (approximate)	-20.10
Total, April-December	7.09
Percentage of GDP (approximate)	2.70

Note: Cruzeiro data were transformed into dollars by using each month's average rate of exchange. Annual GDP is assumed here at US$350 billion.

Chart 1

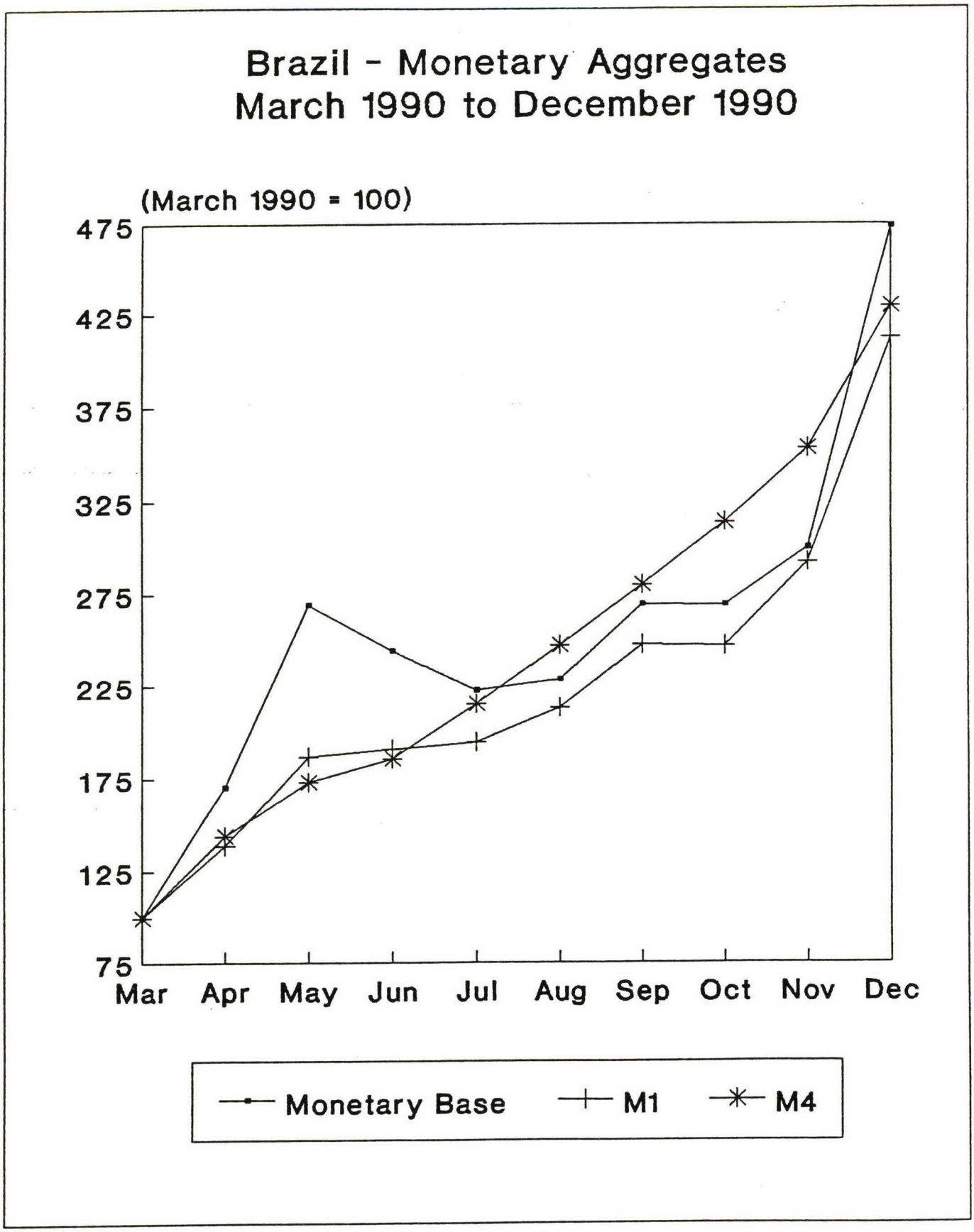
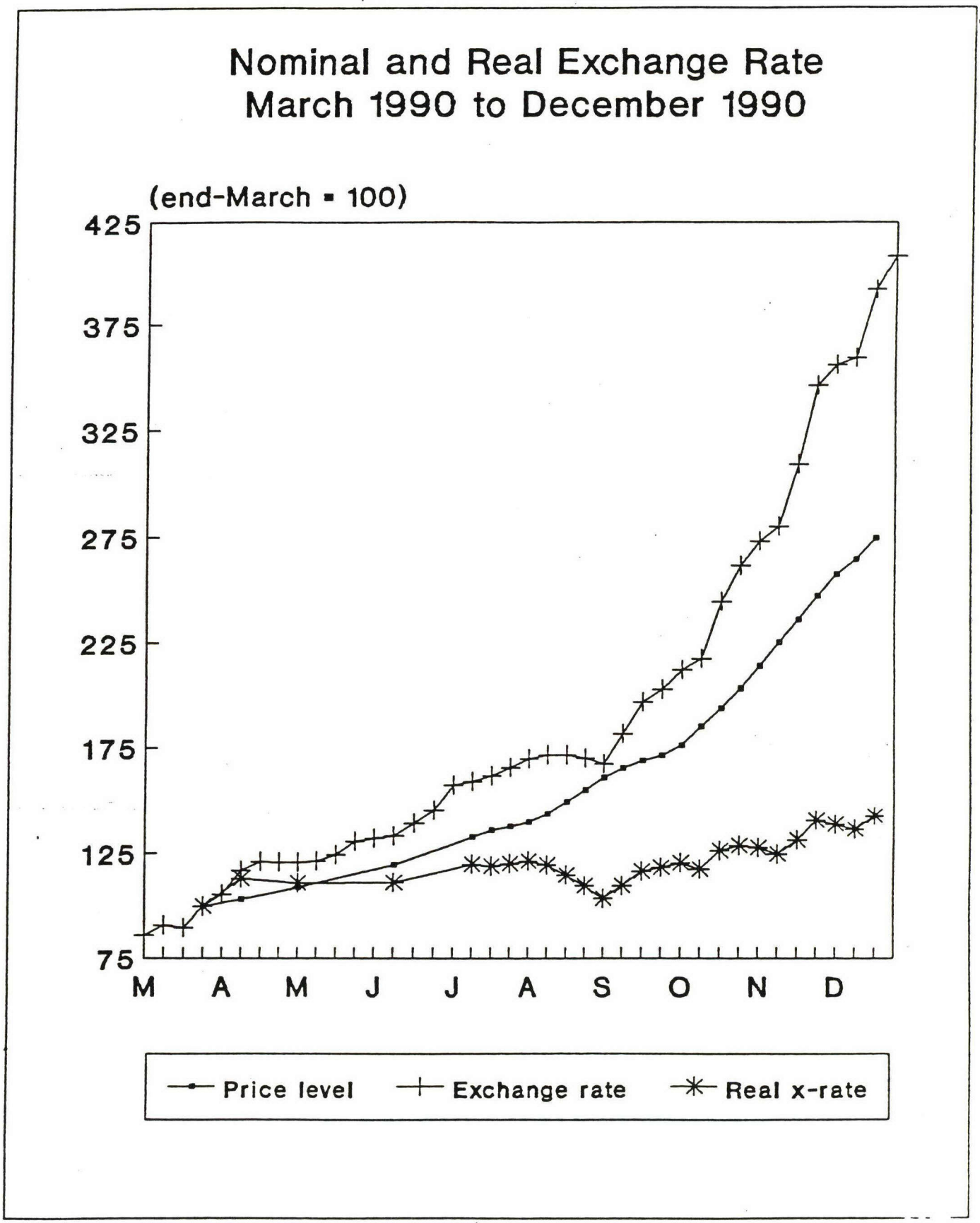

Brazil - Monetary Aggregates
March 1990 to December 1990
(March 1990 = 100)
475
425
375
325
275
225
175
125
75
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
Monetary Base
M1
M4

Chart 2


Nominal and Real Exchange Rate
March 1990 to December 1990
(end-March = 100)
425
375
325
275
225
175
125
75
M
A
M
J
J
A
S
O
N
D
Price level
Exchange rate
Real x-rate

Record Removal Notice

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File Title	Barcode No.
Country Files: Brazil - Correspondence 03	1779608

Document Date	Document Type	
January 11, 1991	Memorandum w/attachment	

Correspondents / Participants
To: Mr. Frank Potter
From: Mr. Barber B. Conable, President

Subject / Title
Re: Brazil - Proposed Modification of the Highways Management and Rehabilitation Project (loan 3169-BR)

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	Date
Shiri Alon	October 26, 2023

Brazil

The World Bank
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

1818 H Street, N.W.
Washington, D.C. 20433
U.S.A.

(202) 477-1234
Cable Address: INTBAFRAD
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AR
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BBC
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December 4, 1990

logged out 10/7

Minister Zélia Cardoso de Mello
Minister of Economy, Finance and Planning
Esplanada dos Ministerios, Bloco 5
70048 Brasilia, D.F.
Brazil

Re: Loan 2721-BR (Public Sector Management Project)
Extension of Closing Date

Dear Madame Minister:

We acknowledge receipt of your request to extend the closing date of the above-referenced project.

The Bank has been negotiating with Messrs. Kandir and Moreira the possible extension of the Public Sector Management Loan since the end of June 1990. We have agreed on a number of steps to be taken to ensure that the remaining uncommitted funds be used effectively. A Bank mission is presently in the field to assess the implementation of these steps which have been established as conditions of closing date extension.

The decision concerning the extension of the closing date will be taken following the mission's return to Washington, D.C. and will be communicated to you by the end of December.

Sincerely yours,

Armeane M. Choksi
Director
Country Department I
Latin America and the Caribbean
Regional Office

cc: Messrs./Mmes. Conable, Qureshi. Husain (LACVP); Pimenta-Neves (LACSA); Weissman, Vincent (LA1DR); Chaudry (LATPS); Papageorgiou, Cordeiro (LA1CO)

WORLD BANK OFFICE TRACKING SYSTEM
SENIOR VICE PRESIDENT OPERATIONS
Routing and Action Transmittal Sheet

EXPEDITE

TO:	DATE:
Mr. Husain (I-8-015)	12/03/90

SUBJECT:

Document From: Zelia Cardoso
To: bbc
Dated: 11/07/90 Reference No.: OPS901203001

Topic: BRAZIL - Ltr. from Min. of Fin soliciting to schedule the 2721-BR Loan for Dec. 31/90 instead of Dec. 31/91.

Incoming Reference Number: EXC901130004
Incoming Action Requested: TO HANDLE
Requested Due Date: 12/12/90

ACTION INSTRUCTIONS:	DUE DATE:

__XXX__ HANDLE 12/12/90
_____ REVIEW AND RECOMMEND
_____ FOR YOUR INFORMATION
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
_____ PREPARE RESPONSE FOR _____ SIGNATURE
_____ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: pls. provide Messrs. Conable and Qureshi with copy of response.

AK
SS

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
Mr. M. Qureshi (E-1241)	11/30/90

SUBJECT:

Document From: Zelia Cardoso
To: bbc
Dated: 11/07/90 Reference No.: EXC901130004

Topic: Minister of Finance, Brazil: soliciting to schedule the 2721-BR Loan for Dec. 31/90 instead of Dec. 31/91.

ACTION INSTRUCTIONS: | DUE DATE:

__XXX__ HANDLE 12/12/90
_____ REVIEW AND RECOMMEND
_____ FOR YOUR INFORMATION
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
_____ PREPARE RESPONSE FOR _____ SIGNATURE
_____ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: pls. provide Mr. Conable a copy of resp.

AVISO Nº 1021 Em, 07.11.90

Senhor Presidente,

Tenho a honra de dirigir-me a Vossa Excelência no sentido de solicitar a extensão do prazo final de execução do contrato de Empréstimo nº 2721-BR, anteriormente previsto para 31 de dezembro de 1990, para 31 de dezembro de 1991. Esta nova data é condizente com o cronograma de projetos em execução e os previstos para serem desenvolvidos, contemplando as prioridades definidas pela atual equipe de Governo no âmbito do empréstimo em referência.

Aproveito a oportunidade para renovar a Vossa Excelência os meus protestos de elevada estima e consideração.

ZÉLIA MARIA CARDOSO DE MELLO
Ministra de Estado da Economia,
Fazenda e Planejamento

A Sua Excelência o Senhor
Doutor BARBER CANABLE
DD. Presidente do Banco Internacional para
Reconstrução e Desenvolvimento - **BIRD**
WASHINGTON - DC

TRANSMISSION REPORT

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DEPARTMENT	

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
Mr. B. Conable (E-1227)	12/12/90

Has seen 12/12/90

SUBJECT:

Document From: Mr. Shahid Husain
To: bbc
Dated: 12/12/90 Reference No.: EXC901212004

Topic: Transfer of responsibilities for Peru, Venezuela and Brazil.

ACTION INSTRUCTIONS:	DUE DATE:

_____ HANDLE
_____ REVIEW AND RECOMMEND
__XXX__ FOR YOUR INFORMATION 12/12/90
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
_____ PREPARE RESPONSE FOR _____ SIGNATURE
_____ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: cc: LM/AK/SS

December 12, 1990

Mr. Barber B. Conable

Barber,

With Moeen's agreement, I have decided to transfer the responsibility for Peru from Pieter Bottelier, and for Venezuela from Ping Loh, to Armeane Choksi.

Choksi's department, therefore, will have Brazil, Venezuela and Peru. I have done this to bring about improved flexibility in Choksi's work. There was excessive dependence on Brazil and some resources were not fully employed. On the other hand, Ping Loh had eighteen countries and Bottelier had six. Both were complaining of overwork. These changes will be effective January 1.

I have informed Camarasa, representing Peru, and Ximenes, representing Brazil. They are quite happy with the changes. Moises Naim, who represents Venezuela, is unhappy. He came back from Venezuela only yesterday and therefore I did not have a chance to speak to him until today. I had held back the formal announcement until I spoke to him. But Naim probably wanted an explicit role in an organizational decision. He has also suggested that he should have a role in the selection of the Bank's Resident Representative in Venezuela. I have responded that we would seek his Government's clearance to the person selected by us.

I have assured Naim that Choksi would be at least as good as Loh and, in any case, I shall be playing an active role in relations with Venezuela during the transition.

Naim may bring up this issue at your lunch tomorrow and I hope you will reassure him of our desire to support Venezuela and continue the excellent relations that Ping Loh had built up.

Shahid

Shahid [illegible]

Brazil C.F. LM AK SS

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
Mr. B. Conable (E-1227)	11/29/90

SUBJECT:

Document From: Mr. Husain
To: Mr. Qureshi/BBC
Dated: 11/28/90 Reference No.: EXC901129005

Topic: Briefing; Brazil--Private Sector Finance Project Board Presentation.

ACTION INSTRUCTIONS:	DUE DATE:

_____ HANDLE
__XXX__ REVIEW AND RECOMMEND
_____ FOR YOUR INFORMATION
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
_____ PREPARE RESPONSE FOR _____ SIGNATURE
_____ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: _____
_____
_____

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Mr. Conable

DATE: November 28, 1990

TO: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 39001

SUBJECT: BRAZIL - Private Sector Finance Project
Board Presentation

1. This project is scheduled for board presentation on November 29, 1990.

2. We received questions at two separate meetings--from Mr. Mark T. Cox, Alternate Executive Director for the United States and from representatives of the US Treasury and Federal Reserve; and from Mr. Cesare Caranza, Executive Director for Greece, Italy, Malta, Portugal and Poland (and who monitors Brazil for the G-7) and from the technical staff of Mr. Caranza's office. The meeting with Mr. Cox was attended by Messrs. Choksi (LA1), Mosse (LA1EI), Wolff (LAT) and the meeting with Mr. Caranza was attended by Messrs. Choksi (LA1), Papageorgiou (LA1CO), and Wolff (LAT).

3. The questions raised at both meetings were similar. The main thrust of the questions related to (i) Brazil's macroeconmic environment, (ii) the relationship between the project and the Bank's financial sector strategy for Brazil, and (iii) BNDES' financial performance and loan portfolio.

4. Bank staff made a brief presentation on the current economic situation of Brazil. They mentioned that while there is an overall concern about the current rate of inflation, the economic measures taken by the government are expected to be effective in controlling inflation which is expected to decrease significantly by early next year.

5. Bank staff explained that the Private Sector Finance Loan addresses institution-specific reforms that have a positive impact on the financial sector and the fiscal stance of the government, reforms which are better addressed by an investment rather than an adjustment loan. As BNDES plays a leading role in the financial sector, its reforms will have a significant and welcome impact on the way long-term credit is allocated in Brazil. BNDES' reforms are fully consistent with the Bank's objective and strategy for the financial sector because they improve the efficiency of financial intermediation, reduce government interference in credit markets, and reduce government financing of public enterprises.

6. Regarding BNDES' financial and loan portfolio condition, Bank staff said that BNDES has been a profitable and efficient institution. With the exception of BNDES' lending to the SIDERBRAS group, which is responsible for most of BNDES' arrears, the balance of BNDES loan portfolio was healthy. In a letter to the Bank, BNDES' President points out that

BNDES will settle these affected loans and arrears in the context of the federal government's privatization program, since all the companies that comprised the ex-SIDERBRAS group are now scheduled for privatization.

cc: Messrs./Mmes. Conable, EXC; Aiyer, Duer, LACVP; Choksi, Weissman, LA1DR; Papageorgiou, LA1CO; Collell, Carvalho, LEGLA

RMosse:csc

Mr. Sandstrom

THE WORLD BANK/IFC/M.I.G.A.

ROUTING SLIP	DATE: November 9, 1990
NAME	ROOM NO.
Mr. Qureshi	E-1241

	URGENT		PER YOUR REQUEST
	FOR COMMENT		PER OUR CONVERSATION
	FOR ACTION		SEE MY EMAIL
	FOR APPROVAL/CLEARANCE		FOR INFORMATION
	FOR SIGNATURE		LET'S DISCUSS
	NOTE AND CIRCULATE		NOTE AND RETURN

RE: BRAZIL - Status of Negotiations w/Comm.Banks

REMARKS:

FROM:	ROOM NO.:	EXTENSION:
G.T.Nankani, Actg. Director	I7131	31851

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: November 9, 1990

TO: Mr. Moeen A. Qureshi, SVP, Operations

THROUGH: Sri Ram Aiyer, LACVP

FROM: Gobind T. Nankani, Acting Director, LA1

EXTENSION: 31851

SUBJECT: Brazil - Status of Negotiations with Commercial Creditors

1. As you know, Brazil resumed formal negotiations on its external debt with its commercial creditors on October 10, 1990. The Brazilian government submitted to the Banks' Advisory Committee a proposal for the renegotiation of its external debt to commercial creditors named "Brazil's Public Sector Debt Restructuring Plan". The commercial banks rejected Brazil's proposal. They claimed it did not represent a basis for negotiations. The commercial banks sent an economic mission to Brazil at the end of October, to assess the assumptions under which the Brazilian Delegation presented alternative scenarios of the country's ability to pay in the future.

2. The Brazilian proposal is based on the principle that Brazil intends to pay its external debt while at the same time it takes into account the country's severe fiscal constraints. Therefore, the government argues that its ability to pay would be determined every year as a residual, by the public sector surplus to be generated. The thrust of the proposal is the transformation of the outstanding medium and long term external debt to commercial creditors (approximately $60 billion, which would include fully capitalized arrears) into bonds with maturities up to 45 years. Maturing private sector external debt (approximately $6 billion) would not be included in the negotiation. Private debtors would negotiate their external liabilities directly with foreign commercial banks, and payments abroad could be resumed as soon as the negotiation is completed. The attachment presents the main elements of Brazil's proposal.

3. The commercial banks' counter-proposal deals only with the outstanding arrears and the forthcoming interest payments through March 31, 1991. Their proposal would require Brazil to pay one third of the interest in arrears accruing until December 31, 1990 (about $2.4 billion) in cash, and the remaining amount (about $4.8 billion) to be converted into five year bearer bonds, at LIBOR plus 1% interest, to be serviced in semi-annual payments. This proposal would also require that Brazil make interest payments until March 31, 1991 (about $1.37 billion) as they become due, 50% in cash and 50% to be converted into the same type of bonds as those of the arrears. The banks are not prepared to discuss restructuring of the outstanding stock of Brazil's external debt unless a satisfactory agreement on arrears is reached. It appears that

the banks' negotiating strategy is first, to strike a deal about arrears and future interest payments due by settlement date, then to request waivers from the rest of the banks and at the same time start discussing with the Brazilians the restructuring of the outstanding stock of external debt.

4. Following the formal presentation of the banks' proposal, the Brazilian delegation departed for Brasilia without making any comments on it. The delegation is expected to return to New York for more discussions early next week. Meanwhile, the IMF has not changed its position with regard to the Stand-by Arrangement. It will not proceed with Board presentation until it is satisfied with the progress made on the debt negotiations.

cc: Messrs./Mmes.: Khanna, Sandstrom (EXC), Husain (LACVP) (o/r), Choksi (LA1DR (o/r), Kashiwaya (CFSVP), Bock (OPNSV), Shilling (CFSFA)
LA1 Management Team

SVatnick

Attachment

MAIN ELEMENTS OF BRAZIL'S PROPOSAL TO ITS COMMERCIAL CREDITORS

1. Arrears to commercial banks accruing through December 31, 1990 or until a new agreement becomes effective, would be paid with the proceeds of a bridge financing provided by those creditors. The amount of the bridge financing would be included in the debt to be restructured. Brazil will make interest payments of $427 million in 1991, and $154 million in 1992 for this brigde. Should Brazil generate additional resources from the World Bank or IDB, it would increase interest payments by that amount. In his speech to the Advisory Committee, Mr. Dauster mentioned that should Brazil negotiate a sectoral adjustment loan with the Bank in 1991, the proceeds of that loan would be made available to finance the bridge loan for the arrears.

2. Short Term External Debt: Trade and Interbank Lines of Credit will become voluntary at the expiration, in March 1991, of the 1988 Trade Commitment and Interbank Commitment Letters, provided that a satisfactory solution is found for the funding of foreign branches and agencies of Brazilian banks abroad.

3. Menu of Options: Three options are included:

   (a) Zero Coupon Bonds: 45 year zero coupon bonds issued by the government in bearer form without collateral or guarantee, with an implicit interest rate of 9% per year. Redemption of the bonds will be based on Brazil's ability to pay (defined as contingent on the fiscal performance) and will take place through government held quarterly auctions at a discount. In case creditors do not make any bids or the bids submitted do not cover the full amount allocated for redemption, bonds to be redeemed will be selected by lottery. Contingent enhancement would be made available for redemption of the zero coupon bonds if (1) Brazil's quarterly GDP grows at least at a 7% annual equivalent rate for two succesive quarters; and (2) Brazil's international reserves (cash concept) exceed five times the monthly average amount of total imports in the preceding 12 months.

   (b) Interest Reduction Bonds: 25 year, bullet maturity bond issued by the government in bearer form without collateral or guarantee, with a 1.23% interest rate in the first year increasing to a 7% in the tenth year, after which it remains constant.

   (c) Exit Bond: 15 year, bullet maturity bond issued by the government in bearer form without collateral or guarantee, with a 1.23% interest rate in the first year, increasing through the fourth year when it becomes constant at 3% per annum.

4. All instruments will be eligible for use in Brazil's Privatization Program. The government will determine the criteria for eligibility of any of these instruments for other types of conversions, e.g. debt for equity, debt for export, debt for nature, to safeguard its monetary and fiscal policy.

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
Mr. B. Conable (E-1227)	11/09/90

SUBJECT:

Document From: Mr. Stern
To: bbc
Dated: 11/08/90 Reference No.: EXC901109011

Topic: Note -- re loans to Brazil.

ACTION INSTRUCTIONS: DUE DATE:

_____ HANDLE
_____ REVIEW AND RECOMMEND
__XXX__ FOR YOUR INFORMATION 11/09/90
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
_____ PREPARE RESPONSE FOR _____ SIGNATURE
_____ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: cc: AK/SS

orig. sent to Watergate

November 8, 1990

Mr. Conable

Barber -

As promised, I have spoken with Nigel Wicks. My understanding from him is that the emerging G-7 consensus is to not oppose the loans in the Board but to make some strong statements. David Mulford had talked to Nigel and, apparently, my conversation with David had some effect. Efforts are now directed at getting adequate message to the Brazilians rather than trying to suspend the loans. However, if Brazil remains behind in their payments, we will apply the usual rule---which is not to take the loans to the Board.

Ernest Stern

The World Bank
Washington, D.C. 20433
U.S.A.

Office of the President

November 9, 1990

Mr. Conable

Sven

Re: Brazil

Ernie has another note which is attached.

The Brazilian loans are still on the agenda for Tuesday. However, if the overdues are not cleared today, they will be pulled out on Monday.

The Country Department informs me that the Brazilians have told them that they have instructed the Fed in New York to make the requisite transfers. Our Cashiers' Department is waiting for the confirmation.

Anupam

Attachment

Update 6:00 pm

All $18 million, except $164,000, are in. The $164,000 are expected in later today or over the weekend.

File / Brazil

cc: AK
SS o/r

November 17, 1990

Mr. Conable

Re: Brazil Loans

The reason for scheduling the Brazil loans for November 29 was the very large overdues as of the 13th -- $75 million. There was a very high probability that loans scheduled for the 20th would have to be postponed once again. The Brazilians would have been badly embarrased since they were to restart negotiations with the commercial banks with a revised and more conciliatory proposal. We had obtained the agreement of the Brazilian Finance Minister to the date of 29th; she did not want the embarrasement of a second postponement either. In fact, as of now $85,000 are overdue by more than sixty days and the loans would have had to be postponed.

I have been making a determined effort to resolve the issue of recurring arrears in Brazil and took up the matter with the Finance Minister during my recent visit. I have been promised improvement but the Brazilian procedures are complex and the bureancracy is not quite efficient. As the government tries to resolve the situation, we have to be firm, linking new loans to the clearance of overdues.

The postponement had nothing to do with my and Choksi's travel. There are division chiefs and others in Washington who are fully conversant with the projects and the economic situation in Brazil.

c. c. Mr. Qureshi
Mr. E. Stern
Mr. Choksi

Shahid

Shahid Husain

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
Mr. B. Conable (E-1227)	11/14/90

SUBJECT:

Document From: Mr. Stern
To: bbc
Dated: 11/14/90 Reference No.: EXC901114022

Topic: Note -- Brazil (postponement of Board mtg. to Nov. 29)

ACTION INSTRUCTIONS: DUE DATE:

_____ HANDLE
_____ REVIEW AND RECOMMEND
_____ FOR YOUR INFORMATION
*__XXX__ DISCUSS WITH __BBC FOR ANY COMMENTS__ 11/14/90
_____ AS WE DISCUSSED
_____ PREPARE RESPONSE FOR _____ SIGNATURE
_____ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: _____
_____
_____

DECLASSIFIED

OCT 26 2023

WBG ARCHIVES

CONFIDENTIAL

November 14, 1990

Mr. Conable

Barber -

Re: Brazil

Although I dislike revisiting actions past, I cannot help but note that the decision to postpone the Brazil loans to November 29 displays a high degree of insensitivity to recent events in our own position.

After arguing for two weeks with various governments about the importance of moving on the Brazil loans as scheduled, we follow up an unexpected Japanese request for postponement with a further nine-day delay of our own. And what are the reasons? As far as I have been able to learn, they are (a) some people will be out-of-town on November 20; and (b) Brazil may not have paid its bills by November 20.

The first is, of course, no reason at all. Trips can be postponed and the Government of Japan would presumably be the first to understand that a conflict had arisen because of the Brazil loans. But it is inconceivable that not a a single responsible adult dealing with Brazil would be left in town; or that single person's travel schedule could be changed. After all, the discussion is not going to focus on the loans, but on the status of the adjustment program and the debt discussions.

The second reason is plain injudicious. We have rules. If Brazil is overdue by 60 days on November 20, we would have pulled the loans. That is routine practice. The point is that such a delay would clearly be Brazil's responsibility. The current delay is our responsibility. Moreover, the presumption that Brazil will be current by November 29 but not by November 20 is sheer speculation. Much can go wrong in between. If they are overdue by the 29th, a further postponement will be required--again at our initiative. It is unlikely to create confidence--however unjustified--that we are not stalling.

Well, why the rush? The answer should be obvious, but apparently was not. We have been under pressure to postpone these loans. We have resisted because we thought the approach inappropriate and dangerous. Yet, we are not permanently immune to pressure. The Bank's offer is on the table; a response is expected; the debt issue is politically sensitive in Brazil.

Perhaps, all will go well. Perhaps, something will go wrong. How do we benefit, except for the maintenance of some personal travel schedules, from a further nine-day postponement? We do not. The risk has increased--needlessly in my view.

Having spent considerable effort on the matter, it would have been little more than common courtesy to inform me before the Board announcement was agreed on.

Ernest Stern

cc: Mr. Choksi
Mr. Karaosmanoglu
Mr. Wood

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

C. F. (Brazil)

*AK
SSO/K

TO:	DATE:
Mr. B. Conable (E-1227)	11/14/90

AK discussed with Choksi, then Stern 11/14/90

SUBJECT:

Document From: Mr. Stern
To: bbc
Dated: 11/14/90 Reference No.: EXC901114022

Topic: Note -- Brazil (postponement of Board mtg. to Nov. 29)

Noted in log.
CP 11/15

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Remarks: _____
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CONFIDENTIAL

November 14, 1990

DECLASSIFIED

OCT 26 2023

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Ernest Stern

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Mr. Karaosmanoglu
Mr. Wood

cc: AK
SS o/r
JWS

November 17, 1990

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Shahid

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Brazil

The World Bank
Washington, D.C. 20433
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Office of the President

November 9, 1990

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Anupam

Attachment

Update 6:00 pm

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Update 6:30 pm

All $18 million is in -

THE WORLD BANK/IFC/M.I.G.A.

ROUTING SLIP	DATE: November 9, 1990
NAME	ROOM NO.
Mr. Qureshi	E-1241
MR. CONABLE	

	URGENT		PER YOUR REQUEST
	FOR COMMENT		PER OUR CONVERSATION
	FOR ACTION		SEE MY EMAIL
	FOR APPROVAL/CLEARANCE		FOR INFORMATION
	FOR SIGNATURE		LET'S DISCUSS
	NOTE AND CIRCULATE		NOTE AND RETURN

RE: BRAZIL - Status of Negotiations w/Comm.Banks

REMARKS:

FROM:	ROOM NO.:	EXTENSION:
G.T.Nankani, Actg. Director	I7131	31851

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: November 9, 1990

TO: Mr. Moeen A. Quereshi, SVP, Operations

THROUGH: Sri Ram Aiyer, LACVP

FROM: Gobind T. Nankani, Acting Director, LA1

EXTENSION: 31851

SUBJECT: Brazil - Status of Negotiations with Commercial Creditors

1. As you know, Brazil resumed formal negotiations on its external debt with its commercial creditors on October 10, 1990. The Brazilian government submitted to the Banks' Advisory Committee a proposal for the renegotiation of its external debt to commercial creditors named "Brazil's Public Sector Debt Restructuring Plan". The commercial banks rejected Brazil's proposal. They claimed it did not represent a basis for negotiations. The commercial banks sent an economic mission to Brazil at the end of October, to assess the assumptions under which the Brazilian Delegation presented alternative scenarios of the country's ability to pay in the future.

2. The Brazilian proposal is based on the principle that Brazil intends to pay its external debt while at the same time it takes into account the country's severe fiscal constraints. Therefore, the government argues that its ability to pay would be determined every year as a residual, by the public sector surplus to be generated. The thrust of the proposal is the transformation of the outstanding medium and long term external debt to commercial creditors (approximately $60 billion, which would include fully capitalized arrears) into bonds with maturities up to 45 years. Maturing private sector external debt (approximately $6 billion) would not be included in the negotiation. Private debtors would negotiate their external liabilities directly with foreign commercial banks, and payments abroad could be resumed as soon as the negotiation is completed. The attachment presents the main elements of Brazil's proposal.

3. The commercial banks' counter-proposal deals only with the outstanding arrears and the forthcoming interest payments through March 31, 1991. Their proposal would require Brazil to pay one third of the interest in arrears accruing until December 31, 1990 (about $2.4 billion) in cash, and the remaining amount (about $4.8 billion) to be converted into five year bearer bonds, at LIBOR plus 1% interest, to be serviced in semi-annual payments. This proposal would also require that Brazil make interest payments until March 31, 1991 (about $1.37 billion) as they become due, 50% in cash and 50% to be converted into the same type of bonds as those of the arrears. The banks are not prepared to discuss restructuring of the outstanding stock of Brazil's external debt unless a satisfactory agreement on arrears is reached. It appears that

the banks' negotiating strategy is first, to strike a deal about arrears and future interest payments due by settlement date, then to request waivers from the rest of the banks and at the same time start discussing with the Brazilians the restructuring of the outstanding stock of external debt.

4. Following the formal presentation of the banks' proposal, the Brazilian delegation departed for Brasilia without making any comments on it. The delegation is expected to return to New York for more discussions early next week. Meanwhile, the IMF has not changed its position with regard to the Stand-by Arrangement. It will not proceed with Board presentation until it is satisfied with the progress made on the debt negotiations.

cc: Messrs./Mmes.: Khanna, Sandstrom (EXC), Husain (LACVP) (o/r), Choksi (LA1DR (o/r), Kashiwaya (CFSVP), Bock (OPNSV), Shilling (CFSFA)
LA1 Management Team

SVatnick

Attachment

MAIN ELEMENTS OF BRAZIL'S PROPOSAL TO ITS COMMERCIAL CREDITORS

1. Arrears to commercial banks accruing through December 31, 1990 or until a new agreement becomes effective, would be paid with the proceeds of a bridge financing provided by those creditors. The amount of the bridge financing would be included in the debt to be restructured. Brazil will make interest payments of $427 million in 1991, and $154 million in 1992 for this brigde. Should Brazil generate additional resources from the World Bank or IDB, it would increase interest payments by that amount. In his speech to the Advisory Committee, Mr. Dauster mentioned that should Brazil negotiate a sectoral adjustment loan with the Bank in 1991, the proceeds of that loan would be made available to finance the bridge loan for the arrears.

2. Short Term External Debt: Trade and Interbank Lines of Credit will become voluntary at the expiration, in March 1991, of the 1988 Trade Commitment and Interbank Commitment Letters, provided that a satisfactory solution is found for the funding of foreign branches and agencies of Brazilian banks abroad.

3. Menu of Options: Three options are included:

   (a) Zero Coupon Bonds: 45 year zero coupon bonds issued by the government in bearer form without collateral or guarantee, with an implicit interest rate of 9% per year. Redemption of the bonds will be based on Brazil's ability to pay (defined as contingent on the fiscal performance) and will take place through government held quarterly auctions at a discount. In case creditors do not make any bids or the bids submitted do not cover the full amount allocated for redemption, bonds to be redeemed will be selected by lottery. Contingent enhancement would be made available for redemption of the zero coupon bonds if (1) Brazil's quarterly GDP grows at least at a 7% annual equivalent rate for two succesive quarters; and (2) Brazil's international reserves (cash concept) exceed five times the monthly average amount of total imports in the preceding 12 months.

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WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
Mr. B. Conable (E-1227)	11/09/90

SUBJECT:

Document From: Mr. Stern
To: bbc
Dated: 11/08/90 Reference No.: EXC901109011

Topic: Note -- re loans to Brazil.

ACTION INSTRUCTIONS: | DUE DATE:

_____ HANDLE
_____ REVIEW AND RECOMMEND
__XXX__ FOR YOUR INFORMATION 11/09/90
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
_____ PREPARE RESPONSE FOR _____ SIGNATURE
_____ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: cc: ĂK/SŠ

Linda —

Ms. Malan informed me at 3:00 pm today that they are working on it and that they hope to resolve it by cob today.

I'll keep you posted.

Nowrie 11/9.

November 8, 1990

Mr. Conable

Barber -

As promised, I have spoken with Nigel Wicks. My understanding from him is that the emerging G-7 consensus is to not oppose the loans in the Board but to make some strong statements. David Mulford had talked to Nigel and, apparently, my conversation with David had some effect. Efforts are now directed at getting adequate message to the Brazilians rather than trying to suspend the loans. However, if Brazil remains behind in their payments, we will apply the usual rule---which is not to take the loans to the Board.

Ernest Stern

DECLASSIFIED

OCT 20 2023

WBG ARCHIVES

The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: 07-Nov-1990 01:04am GMT

TO: OLIVIER LAFOURCADE (OLIVIER LAFOURCADE àA1àPARIS)

FROM: Anupam Khanna, EXC (ANUPAM KHANNAàA1àVAX12)

EXT.: 81140

SUBJECT: Brazil Loans

The following is a transcript of a STRICTLY CONFIDENTIAL memo to Mr. Conable from Mr. Stern dated November 3, 1990. Quote:

As I reported to you, Mr. Mulford called Mr. Wapenhans on Wednesday, October 31, and asked about the two loans to Brazil which are scheduled for Board discussion on November 13. He indicated that the US would not want these loans to be considered on that date and asked us to delay issuance of documents if they had not been issued and/or otherwise withdraw the loans from the agenda. The reason for the US concern is Brazil's apparent lack of seriousness in its negotiations with the commercial banks. He did not want our lending to be a signal that we would continue to lend into arrears when there is an unwillingness to have good faith negotiations.

After I discussed this with you by phone on Thursday, November 1, I spoke with Mr. Mulford. I described the two loans at issue and our general position vis-a-vis Brazil along the lines of the attached note. I argued that to delay these routine projects at this time could only serve to inflame Brazilian political attitudes on debt. Given the fact that they paid us $750 million net last year, a fact they have been very conscious of, there was a high probability that they would suspend payments to the Bank if the loans were delayed. Not only would the resulting arrears complicate the debt negotiations immensely, but since they would mount rapidly, it would complicate any financial work-out program. If Brazil reached non-accrual status, this would require $1 billion of provisioning per year, plus loss of $650 million in interest income. This is roughly twice our projected total net income. Management could not take administrative action which could have such consequences. If shareholders felt that, contrary to our advice, these routine operations should not be approved, then this should be on the basis of a full discussion of the likely consequences, since it involves substantial risks to shareholders' capital.

I do not believe that Mr. Mulford had had all of the potential ramifications spelled out for him, and at the end of the conversation, he seemed to accept that management would not

withdraw the loans from the Board agenda. We also agreed to inform the Brazilian authorities of their concern. Mr. Mulford called in the Brazilian Ambassador on Thursday, October 31. I discussed the matter with Mr. Malan, who already knew about it because the US had made a similar approach to the IDB.

In the IDB, a loan which parallels our loan for Private Sector financing, was scheduled for Friday, November 2. However, in the IDB, the US Executive Director has the possibility of deferring loan for up to two months. This has been done and so the IDB will await the outcome of discussions in the Bank.

I subsequently spoke with Mr. Husain in Brazil to inform him of these developments and also to make sure that the Brazilian authorities understood the importance we attach to the speedy initiation of good faith negotiations. However, Mr. Husain had already completed his meetings with the authorities and had already made those points.

Mr. Mulford had also indicated that he might seek G-7 support, since the G-7 Ministers had made an official statement on the subject during the Annual Meetings.

There were no further developments until late Friday afternoon when Mr. Coady called a G-7 meeting at short notice. From what I have learned, it appears that Japan strongly supported the US position; the UK leaned in that direction, and three continental Europeans, plus Canada, thought the approach was undesirable. They agreed to consult their capitals over the weekend. A G-7 Deputies meeting had been scheduled previously for Monday, November 5. Undoubtedly, the matter will be raised there.

I had spoken to a few of the G-7 EDs before any G-7 meeting of EDs had been called to convey to them the magnitude of the potential consequences and to give them our assessment that the possibility of adverse Brazilian reaction was very high.

In talking to the UK Executive Director, it turned out that the UK Treasury had already, on its own initiative, raised the issue with Mr. Peretz. They had not yet decided what to do, if anything, but were distressed by the Brazilian negotiating position. I discussed the likely consequences, left a copy of the attached note, and urged great caution while emphasizing that the approximate $100 million of disbursement in the first year could not possibly undermine the debt negotiations. As it turned out, this may have helped to keep the UK position undecided when the G-7 EDs met.

Whatever happens at the G-7 Deputies Meeting, we should stand firm in our refusal to withdraw the loans. In view of the risk, the management cannot take the responsibility for such potentially damaging consequences to the Bank. The Board is the only proper forum for this, so that responsibility will be clear

if our prognosis proves correct.

DECLASSIFIED

OCT 20 2023

WBG ARCHIVES

ATTACHMENT
CONFIDENTIAL

Loans to Brazil - Some Relevant Facts

1. Two loans are scheduled for discussion on November 13:

Private Sector Finance - $300 million
Science Research & Training - $150 million

2. The Science Research Loan is expected to disburse over 6 years, with about $110 million disbursed by end FY93.

3. The Private Sector Finance Loan is expected to disburse over 4 years, with 50% expected to be disbursed by the end of FY92. Once $150 million has been committed to sub-loans, a review of performance is required before the balance can be committed.

4. The Bank's outstanding portfolio to Brazil at the end of FY90 is $8.1 billion, representing 9.22% of total outstanding and disbursed loans.

5. Commitments to Brazil in FY90 were $1.6 billion. Gross disbursements were $968 million. Repayment of principal amounted to $1,045 million and interest payments to $647 million.

6. As of September 30, 1990, Brazil had payments overdue of more than 30 days of $190 million. Should Brazil go into protracted arrears to the Bank, provisioning policy would require a 1% provision per month of the affected portfolio, or about $80 million---about $1 billion on an annual basis. In addition, there would be an annual loss of income of about $630 million.

Unquote.

THE FOLLOWING IS A FURTHER UPDATE FROM MR. STERN DATED NOVEMBER 6, 1990. HE ALSO PLANS TO CALL MR. CONABLE FROM LONDON ON WEDNESDAY, NOVEMBER 7.

Quote:

1. As expected, the G-7 Deputies discussed Brazil at their meeting in Rome. The US position was strongly supported by Japan and, surprisingly, by France. Demurrals came from the UK and Germany, with Canada also insisting for more time for consideration; Italy seems undecided. (This represents a different view from what the UK Treasure view had been; perhaps, our interactions paid off or merely wiser heads prevailed). It was left that further consultation would take place in the course

of this week to see if a consensus could be forged. (It is not clear whether the objective is a further demarche to Management or a common front in the Board.)

2. I had a long conversation with Mr. Shiratori who expressed very strong views about the non-responsiveness of the Brazilians and had no doubt that this should be met by a much stronger reaction from the World Bank. He strongly supported the proposed US approach and could not understand why we could not accommodate the G-7 by taking the initiative in withdrawing the loans. In the course of the conversation, he also expressed doubts about Bank management's sincerity in trying to get the debt problem resolved and criticized a recent press report commenting on our future lending program in Brazil.

3. I explained to Mr. Shiratori that the Bank's management has a very strong and long record of trying to facilitate serious debt negotiations, and any questions about our position was surely unfounded. I explicitly drew his attention to the fact that the Bank had been, for some years now, in a very sensitive relationship with Brazil. We have had to cut back our lending program because of absence of satisfactory economic management; we have had to go through a major restructuring of our support for the power sector; and we have had to weather difficult problems relating to the environment. All this during a period when Brazil made substantial net payments to the Bank and our exposure was shrinking. In the context of this set of relationship, we deserved his support rather than his criticism as we tried to stay on a very fine course. Discussions of our intended project pipeline should be seen in that context.

4. I then drew his attention to the financial consequences of payment suspension by Brazil to the World Bank along the lines of the note you have seen. I told him that if overdues evolved into a non-accrual position, the Bank will be very seriously affected in the market, and there would be a real risk--if the problem is not resolved quickly--to our triple A rating. I pointed out that it is for that reason that Management could not take the initiative to withdraw the loans from the Board. The financial consequences are so large that it would be fiduciarily irresponsible if we took the action based on an informal request. The proper way to handle such an issue is for the shareholders to discuss this explicitly in the Board.

5. At the end of an hour, Mr. Shiratori acknowledged that these arguments put his original view on a somewhat different perspective and that he would, despite his earlier recommendations, re-open discussion on the issue with Tokyo.

6. I also spoke with the MD, who things that any additional pressure on Brazil is unnecessary at this stage; that the US Treasury should be patient and see what the Brazilians bring to the table; and that the risks involved in the Mulford strategy are out of proportion to the possible benefits. He promised to

call Mr. Trichet and to convey his views to his G-7 EDs. He is also scheduled to see Mr. Brady some time next week and will take the same line if the issue is raised.

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8. I also spoke with Mr. Landau. In view of Mr. Trichet's position, he did not know yet what kind of instruction he would get. I asked him to convey my views to Jean-Claude immediately that the proposed approach has a high probability of creating a major disaster for the World Bank. I gave him a copy of the note on Brazil. I also urged him to talk to the MD.

9. I have also been in touch with a few others in the US Government to make sure that everyone understands the financial risk of the proposed approach compared to the marginal impace it would have on the Brazilian strategy.

10. A Brazilian negotiating team is arriving in New York today for discussions on Wednesday and Thursday. The agenda only calls for a discussion of the report of the Economic Sub-Committee of the commercial banks' Advisory Committtee and a counter-proposal by the banks to the previous Brazilian suggestions. Actually the counter-proposal is very creative, particularly given the extreme nature of the original Brazilian suggestions. I hope that the attitude being created by the Treasury initiative will not prevent the banks from making the proposal to which agreement was obtained only with great difficulty. Despite the limited agenda, this meeting will nonetheless be an opportunity for Brazil to change the atmosphere of skepticism and distrust about the seriousness of their negotiating objectives. The results of the meeting will no doubt be an important factor in the kind of pressure we can expect between now and the 13th. Unquote

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The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: 07-Nov-1990 01:04am GMT

TO: OLIVIER LAFOURCADE (OLIVIER LAFOURCADE àA1àPARIS)

FROM: Anupam Khanna, EXC (ANUPAM KHANNAàA1àVAX12)

EXT.: 81140

SUBJECT: Brazil Loans

The following is a transcript of a STRICTLY CONFIDENTIAL memo to Mr. Conable from Mr. Stern dated November 3, 1990. Quote:

As I reported to you, Mr. Mulford called Mr. Wapenhans on Wednesday, October 31, and asked about the two loans to Brazil which are scheduled for Board discussion on November 13. He indicated that the US would not want these loans to be considered on that date and asked us to delay issuance of documents if they had not been issued and/or otherwise withdraw the loans from the agenda. The reason for the US concern is Brazil's apparent lack of seriousness in its negotiations with the commercial banks. He did not want our lending to be a signal that we would continue to lend into arrears when there is an unwillingness to have good faith negotiations.

After I discussed this with you by phone on Thursday, November 1, I spoke with Mr. Mulford. I described the two loans at issue and our general position vis-a-vis Brazil along the lines of the attached note. I argued that to delay these routine projects at this time could only serve to inflame Brazilian political attitudes on debt. Given the fact that they paid us $750 million net last year, a fact they have been very conscious of, there was a high probability that they would suspend payments to the Bank if the loans were delayed. Not only would the resulting arrears complicate the debt negotiations immensely, but since they would mount rapidly, it would complicate any financial work-out program. If Brazil reached non-accrual status, this would require $1 billion of provisioning per year, plus loss of $650 million in interest income. This is roughly twice our projected total net income. Management could not take administrative action which could have such consequences. If shareholders felt that, contrary to our advice, these routine operations should not be approved, then this should be on the basis of a full discussion of the likely consequences, since it involves substantial risks to shareholders' capital.

I do not believe that Mr. Mulford had had all of the potential ramifications spelled out for him, and at the end of the conversation, he seemed to accept that management would not

withdraw the loans from the Board agenda. We also agreed to inform the Brazilian authorities of their concern. Mr. Mulford called in the Brazilian Ambassador on Thursday, October 31. I discussed the matter with Mr. Malan, who already knew about it because the US had made a similar approach to the IDB.

In the IDB, a loan which parallels our loan for Private Sector financing, was scheduled for Friday, November 2. However, in the IDB, the US Executive Director has the possibility of deferring loan for up to two months. This has been done and so the IDB will await the outcome of discussions in the Bank.

I subsequently spoke with Mr. Husain in Brazil to inform him of these developments and also to make sure that the Brazilian authorities understood the importance we attach to the speedy initiation of good faith negotiations. However, Mr. Husain had already completed his meetings with the authorities and had already made those points.

Mr. Mulford had also indicated that he might seek G-7 support, since the G-7 Ministers had made an official statement on the subject during the Annual Meetings.

There were no further developments until late Friday afternoon when Mr. Coady called a G-7 meeting at short notice. From what I have learned, it appears that Japan strongly supported the US position; the UK leaned in that direction, and three continental Europeans, plus Canada, thought the approach was undesirable. They agreed to consult their capitals over the weekend. A G-7 Deputies meeting had been scheduled previously for Monday, November 5. Undoubtedly, the matter will be raised there.

I had spoken to a few of the G-7 EDs before any G-7 meeting of EDs had been called to convey to them the magnitude of the potential consequences and to give them our assessment that the possibility of adverse Brazilian reaction was very high.

In talking to the UK Executive Director, it turned out that the UK Treasury had already, on its own initiative, raised the issue with Mr. Peretz. They had not yet decided what to do, if anything, but were distressed by the Brazilian negotiating position. I discussed the likely consequences, left a copy of the attached note, and urged great caution while emphasizing that the approximate $100 million of disbursement in the first year could not possibly undermine the debt negotiations. As it turned out, this may have helped to keep the UK position undecided when the G-7 EDs met.

Whatever happens at the G-7 Deputies Meeting, we should stand firm in our refusal to withdraw the loans. In view of the risk, the management cannot take the responsibility for such potentially damaging consequences to the Bank. The Board is the only proper forum for this, so that responsibility will be clear

if our prognosis proves correct.

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ATTACHMENT
CONFIDENTIAL

Loans to Brazil - Some Relevant Facts

1. Two loans are scheduled for discussion on November 13:

Private Sector Finance - $300 million
Science Research & Training - $150 million

2. The Science Research Loan is expected to disburse over 6 years, with about $110 million disbursed by end FY93.

3. The Private Sector Finance Loan is expected to disburse over 4 years, with 50% expected to be disbursed by the end of FY92. Once $150 million has been committed to sub-loans, a review of performance is required before the balance can be committed.

4. The Bank's outstanding portfolio to Brazil at the end of FY90 is $8.1 billion, representing 9.22% of total outstanding and disbursed loans.

5. Commitments to Brazil in FY90 were $1.6 billion. Gross disbursements were $968 million. Repayment of principal amounted to $1,045 million and interest payments to $647 million.

6. As of September 30, 1990, Brazil had payments overdue of more than 30 days of $190 million. Should Brazil go into protracted arrears to the Bank, provisioning policy would require a 1% provision per month of the affected portfolio, or about $80 million---about $1 billion on an annual basis. In addition, there would be an annual loss of income of about $630 million.

Unquote.

THE FOLLOWING IS A FURTHER UPDATE FROM MR. STERN DATED NOVEMBER 6, 1990. HE ALSO PLANS TO CALL MR. CONABLE FROM LONDON ON WEDNESDAY, NOVEMBER 7.

Quote:

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of this week to see if a consensus could be forged. (It is not clear whether the objective is a further demarche to Management or a common front in the Board.)

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4. I then drew his attention to the financial consequences of payment suspension by Brazil to the World Bank along the lines of the note you have seen. I told him that if overdues evolved into a non-accrual position, the Bank will be very seriously affected in the market, and there would be a real risk--if the problem is not resolved quickly--to our triple A rating. I pointed out that it is for that reason that Management could not take the initiative to withdraw the loans from the Board. The financial consequences are so large that it would be fiduciarily irresponsible if we took the action based on an informal request. The proper way to handle such an issue is for the shareholders to discuss this explicitly in the Board.

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AK
SS
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✓

STRICTLY CONFIDENTIAL

November 6, 1990

Briefed by phone

Mr. Conable

Barber

Brazil - Further Update

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Ernest Stern

cc: Mr. Qureshi

BY MESSENGER

Z-64070

1) ~~AK~~
~~2) SS~~
O/R
~~MS~~

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

TO:	DATE:
3) Mr. B. Conable (E-1227)	11/05/90

Briefed by phone and EM / SS

SUBJECT:

Document From: Mr. Stern
To: bbc
Dated: 11/03/90 Reference No.: EXC901105001

Topic: Status Report on Brazil Loans as of November 3, 1990.

ACTION INSTRUCTIONS: DUE DATE:

_____ HANDLE
_____ REVIEW AND RECOMMEND
__XXX__ FOR YOUR INFORMATION 11/05/90
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
_____ PREPARE RESPONSE FOR _____ SIGNATURE
_____ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: _____
note: copied to Messrs. Qureshi, Husain
_____

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WBG ARCHIVES

STRICTLY CONFIDENTIAL

November 3, 1990

Mr. Conable

Barber -

Status Report on Brazil Loans as of November 3, 1990

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Ernest Stern

cc: Mr. Qureshi o/r
Mr. Husain o/r

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WBG ARCHIVES

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BY MESSENGER

Z-64070

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

10/24
9:00 am

DATE: October 22, 1990

TO: Mr. Barber B. Conable

THROUGH: Mr. Edward V.K. Jaycox, Acting Senior Vice President, OPNSV

FROM: S. Shahid Husain, Vice President, LAC

EXTENSION: 39001

SUBJECT: BRAZIL- Visit of Mr. Ibrahim Eris, President of the Brazilian Central Bank

1. Mr. Ibrahim Eris, President of the Central Bank of Brazil, will be visiting you on Wednesday, October 24, to discuss his Government's proposal for settling Brazilian foreign debt. Please find attached a brief note that the Department had prepared last week on the Brazilian Government's position and the response of the commercial banks.

2. You may also wish to discuss the issue of overdue payments at this time. Brazil had improved its payments record to the Bank under the Collor Administration. However, in recent weeks, late payments have again been approaching and even exceeding the 60-day mark. Furthermore, last weekend, Mr. Jorio Dauster, Brazil's chief debt negotiator, made a public statement that if the IMF Board did not approve the Stand-by Agreement with Brazil soon, only the IMF would be paid, as there would be no funds available to pay other creditors. You may wish to ask Mr. Eris what steps are being undertaken to improve the late payments situation and whether his Government intends to suspend payments to the Bank if the IMF program is not approved, as stated by Mr. Dauster.

3. Also attached is a biography of Mr. Eris.

Attachments

cc: Messrs. Choksi (LA1DR), Papageorgiou (LA1CO)

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: October 16, 1990

TO: Mr. S. Shahid Husain

THROUGH: Armeane M. Choksi, Director, LA1

FROM: Demetris Papageorgiou, Division Chief, LA1CO

EXTENSION: 31910

SUBJECT: Brazil - Status of Negotiations with Commercial Creditors

1. Brazil resumed formal external debt negotiations with its commercial creditors in New York on October 10-12. The Government presented to the Banks' Advisory Committee a proposal for the renegotiation of Brazil's public sector external debt to commercial banks named "Brazil's Public Sector Debt Restructuring Plan" (attached). The details of the proposal were announced simultaneously in Brasilia by the Minister of the Economy in a meeting with the Ambassadors of the G-7 countries, and in New York by the Debt Negotiator and the Secretary of Economic Policy of the Ministry of the Economy. The commercial banks' response to the proposal is that it does not represent a basis for negotiations.

2. The Brazilian proposal recognizes Brazil's intention and, over the long term, its capacity to pay its external debt, but it it also takes into account the fiscal constraints the country now faces. Therefore, the Government argues, that the annual payment on debt service would be linked to the primary surplus. The thrust of the proposal is the transformation of the outstanding medium-and long-term external debt to commercial banks (approximately US$60 billion, which includes fully capitalized arrears) into bonds with maturities up to 45 years. Maturing private sector external debt (approximately US$6 billion) would not be part of the negotiations. Private debtors would negotiate their external debt directly with foreign commercial banks, and payments could be resumed as soon as the negotiations are completed. The Brazilian delegation mentioned that the Government will seek additional funds from the World Bank for the next two fiscal years.

3. The following are the main elements of Brazil's proposal:

   a. Arrears to commercial banks accruing through December 31, 1990, or until a new agreement becomes effective, would be paid with the proceeds of a bridge loan from the banks. The amount of the bridge financing will be included in the debt to be restructured. The Government intends to make interest payments of US$427 million in 1991, and US$154 million in 1992. Should Brazil's primary surplus generate additional resources, payments on interest will be increased up to US$1 billion for each of these two years.

b. Short Term External Debt: Trade and Interbank Lines of Credit will become voluntary at the expiration, in March 1991, of the 1988 Trade Commitment and Interbank Commitment Letters, if an agreement is reached for the funding of foreign branches and agencies of Brazilian banks.

c. Menu of Options. Three options are included:

(i) Zero Coupon Bonds: 45 year zero coupon bonds issued by the Government in bearer form without collateral or guarantee, with an implicit interest rate of 9% per year. Redemption of the bonds will be based on Brazil's ability to pay (linked to the fiscal performance) and will take place through government held quarterly auctions at a discount. In case creditors do not make any bids or the bids submitted do not cover the full amount allocated for redemption, bonds to be redeemed will be selected by lottery. Additional funds would be made available for redemption for these bonds if (1) Brazil's GDP grows at least at a 7% annual rate for two succesive quarters; and (2) Brazil's international reserves (cash concept) exceed five times the monthly average amount of total imports in the preceding 12 months.

(ii) Interest Reduction Bonds: 25 year, bullet maturity bonds issued by the Government in bearer form without collateral or guarantee, with a 1.23% interest rate in the first year increasing to a 7% in the tenth year, after which it remains constant.

(iii) Exit Bonds: 15 year, bullet maturity bonds issued by the Government in bearer form without collateral or guarantee, with a 1.23% interest rate in the first year, increasing through the fourth year when it stabilizes at 3% per annum.

All these instruments could be used in Brazil's Privatization Program. Their eligibility for other types of conversions, e.g., debt for equity, debt for export, debt for nature, will be analyzed in the negotiation process.

4. The commercial banks responded to the Brazilian debt restructing plan with their "Principles of Negotiations" (attachment), in which, inter alia, they state that Brazil's proposal is unacceptable for negotiations. The commercial banks will be sending an economic mission to Brazil in the next few days to assess the assumptions under which the Brazilian Delegation presented alternative scenarios of the country's ability to pay in the future. The mission will then make its own projections about Brazil's ability to, and extent of servicing its debt. No dates for resumption of the negotiations have as yet been agreed.

5. As a result of the above, the IMF has postponed indefinitely Board discussions of Brazil's stand-by program (about US$2.0 billion). The new Board date will be linked to the IMF's determination that there is satisfactory progress in the debt negotiations. In the meantime, the IMF management will decide on whether it will issue the Board paper.

Attachments

cc: Messrs./Mmes.: Selowsky (LACCE), Kashiwaya (CFSVP); Elwan (CFSPS); Bock (OPNSV); Garcia (o/r), Vatnick (LA1CO); Shilling (CFSFA); LA1 Management Team; Debt Task Force.

The following are the main elements of Brazil's proposal:

1) Private sector external debt will be excluded from the debt to be restructured. Accordingly, as soon as possible, principal and interest on private sector external debt will be freely remitted abroad;

2) At the expiration of the "1988 Trade Commitment Letter" and the "1988 Interbank Commitment Letter," the short-term lines (trade and interbank) will become voluntary, provided a satisfactory solution is found for the funding of the foreign branches and agencies of Brazilian banks;

3) Interest owing to commercial bank creditors and accruing through December 31, 1990, or such later date in 1991 on which a new agreement becomes effective, and which has been or will be deposited at the Central Bank under Resolution 1564/89, will be paid with the proceeds of a bridge financing provided by such creditors. The amount of the bridge financing will be included in the debt to be restructured. Prepayments in 1991 in the amount of $427 million and in 1992 in the amount of $154 million may be supplemented by up to $1.0 billion of additional payment capacity not included in current projections of resources from external sources.

FAX TRANSMITTAL MEMO

TO: Antonio Pimenta Neves

DEPT: [redacted] FAX #:

FROM: [redacted] PHONE:

NO. OF PAGES

4) Menu of Options. The following options are consistent with the principle of payment only to the extent of real payment capacity. Brazil is interested in exploring with its bank creditors other options which are consistent with this principle.

I) <u>Brazil Zero Coupon Bond</u>

Debt available for exchange:
up to US$ 60.0 billion

Tenor: 45 years

Implicit interest rate:
9.0% p.a.

Form: bearer

Collateral: none

Redemption: The defined annual capacity to pay will be used to redeem bonds. Redemption will take place at quarterly auctions. If there are no bids or the bids submitted do not utilise the full amount available for redemption, bonds will be selected by lot for redemption.

Enhancement: If (i) GDP grows by 7% or more per quarter for two successive quarters and (ii) international reserves (cash concept) exceed 5 times the monthly average amount of imports in the preceding 12 months, such excess will be used for redemption of the Brazil zero coupon bonds at the succeeding quarterly auction.

(2)

OCT 16 '90 14:58

II) Interest Reduction Bond

Amount of debt available for exchange at par: up to US$ 60.0 billion

Tenor: 25 years, bullet

Interest Rate: Increasing through the 10th year when it stabilizes at the level of 7% p.a.

Form: bearer

Collateral: none

III) Exit Bond

Amount of debt available for exchange at par: up to US$ 60.0 billion

Tenor: 15 years, bullet

Interest Rate: Increasing through the 4th year when it stabilizes at the level of 3% p.a.

Form: bearer

Collateral: none

All instruments will be eligible for use in the National Privatization Program. The Brazilian government will issue specific rules to deal with other possible types of conversion (e.g. debt-to-equity, debt for export, debt for nature). The eligibility of debt instruments for use in these programs is a matter for discussion.

(3)

OCT 16 '90 14:58

BRAZIL EXIT BOND

Interest Rates

1991	1.23%
1992	1.38%
1993	2.75%
1994	3.00%
-	-
-	-
-	-
2005	3.00%

Amount: Up to U.S. $60 Billion
Tenor: 15 Years, Bullet
Form: Bearer

4

OCT 16 '90 14:58

BRASIL INTEREST REDUCTION BOND

Interest Rates

1991	1.23%
1992	1.38%
1993	2.75%
1994	3.88%
1995	4.63%
1996	5.00%
1997	5.00%
1998	6.00%
1999	6.25%
2000	7.00%
-	-
-	-
-	-
2012	7.00%

Amount: Up to U.S. $60 Billion
Tenor: 25 Years, Bullet
Form: Bearer

(5)

OCT.16 '90 14:59

Bankers Trust Company
280 Park Avenue, New York, New York 10017

Mailing Address:
P.O. Box 318, Church Street Stat
New York, New York 10015

COMPANY NAME:	World Bank
CONTACT NAME:	Dmitrios Papageyis
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10. 15. 90 02:24PM *BT CREDIT POLICY P01

The Bank Advisory Committee welcomes Brazil's decision to meet formally to discuss Brazil's commercial bank external indebtedness.

The Committee recognizes the importance of the substantial economic reforms undertaken by Brazil's new democratic administration. Nevertheless, the Committee, in its role as advisor to Brazil and representative of the International Financial Community believes that Brazil's initial proposal does not represent a basis for negotiation because it does not satisfy the principles set forth below:

Ultimate Objective

Any future negotiation should have as its primary goal the restoration of Brazil's creditworthiness and its early return to the international financial markets. It is only through access to the voluntary capital markets that Brazil will achieve its investment and growth objectives.

Normalization

Prompt action to regularize the payment of interest going forward and an acceptable resolution to the interest arrears are prerequisites to substantive discussions between Brazil and the Committee.

Any proposal which simply capitalizes interest arrears into the stock of debt is not acceptable.

The Committee believes that negotiations should proceed in a manner consistent with the G-7 expectation that Brazil will resolve "its arrears problems with its external creditors in the context of the adoption of a formal IMF agreement".

Economic and Market Reality

Brazil must recognize what is viable in the marketplace. Although the Committee recognizes the need to understand Brazil's economic situation, the banking community cannot accept any financial plan whether or not derived from Brazil's "capacity to pay," wherein the financing, in its various forms, of Brazil's economic program is not shared by all of Brazil's creditor groups in an equitable manner.

Within the framework of the above principles, a marketable, voluntary restructuring of Brazil's external indebtedness would include a menu of options composed of, among other things, new money and debt and debt service reduction with the appropriate collateral. Such a package would enhance the value of Brazil's commercial bank debt.

Finally, any transaction must include satisfactory resolution of outstanding issues under the 1988 Agreements including, but not limited to, the payment of expenses and the waivers and amendments necessary for the privatization program.

The Committee looks forward to entering into discussions shortly with the Brazilian Delegation on the basis of these principles.

10. 15. 90 02:24PM *BT CREDIT POLICY P02

BRAZILIAN EXTERNAL DEBT

(BY CREDITOR GROUP, AS OF DEC.90)

International Entities

World Bank, IFC	
stock of debt	$8,306
interest	$715
principal payments	$1,338
IMF	
stock of debt	$1,887
interest	$186
principal payments	$752
IDB	
stock of debt	$2,396
interest	$177
principal payments	$244

Commercial Banks

Foreign Banks		
Non-affected debt		
stock of debt	$1,367	
interest	$144	
amortizations	$386	
MYDFA		
stock of debt	$22,600	
interest	$2,082	
amortizations	$0	
Public Sector		
stock of debt	$18,000	
interest	$1,658	
amortizations	$0	
New Money 88		
stock of debt	$3,900	
interest	$359	
Private Sector		
stock of debt	$800	
interest	$74	
Arrearages		
amount	$7,150	
interest	$606	
Brazilian Banks		
Non-affected debt		
stock of debt	$344	
interest	$35	
amortizations	$61	
MYDFA + Public Sector		
stock of debt	$6,500	
interest	$599	
amortizations	$0	
Arrearages		
amount	$850	
penalty interest	$67	

Paris Club & Governm.Agencies

stock of debt	$12,125
interest	$1,071
Arrears (to Paris Club)	
principal	$2,850
interest	$1,580
Trade Lines - PS	
outstanding	$10,800
interest	$1,029

Non Financial Institutions

Import Financing	
stock of debt	$4,0
interest	$34
amortizations	$75
Currency Loans	
stock of debt	$2,0
interest	$1
amortizations	
Other	
Currency Loans	
stock of debt	$3
interest	$
amortizations	$
Bonds	
stock	$1,9
interest	$1
amortizations	$1

TOTAL $97,375

Assumptions:

a. stocks of debt and outstandings are estimates for Dec.90.
b. interest are estimates for the year of 1990
c. principal payments and amortizations for the year of 1990
d. arrearages ($ Bill) on MYDFA, Public Sector and New Money 88 are estimated as of Dec.90.
e. interest on arrears include 1989 and 1990 estimates.
f. according to old Paris Club agreements, 70% of the interest arrea will be rescheduled and 30% will be paid during 1990 and 1991.

INTEREST PAYMENTS ON THE BRAZILIAN EXTERNAL DEBT
(ESTIMATED THROUGHOUT 1990)

World Bank, IFC	$715
IMF	$186
IDB	$177
Foreign Banks	
MYDFA	$2,082
Public Sector	$1,658
New Money 88	$359
Non-affected debt	$144
Private Sector	$74
Brazilian Banks	
MYDFA + Public Sector	$599
Non-affected debt	$35
Paris Club & Governm.Agencies	$1,071
Trade Lines - P3	$1,029
Non Financial Institutions	
Import Financing	$346
Currency Loans	$184
Other	
Currency Loans	$33
Bonds	$152
TOTAL	$8,843

10. 15. 90 02:24PM *BT CREDIT POLICY P04

IBRAHIM ERIS

President of the Central Bank

Mr. Ibrahim Eris, 45 years old, was born in Turkey and is now a naturalized Brazilian. He has been appointed President of the Central Bank of Brazil and is one of the primary authors of President Collor's economic plan.

Mr. Eris was a professor at Vanderbilt and Rice Universities before he moved to Brazil in 1973 and became a professor of economics at the University of Sao Paulo. From 1973 to 1981 he was a senior economist with the National Economic Research Foundation (FIPE), and from 1979 to 1981 he served as an adviser to then-Minister of Planning Antonio Delfim Netto. Mr. Eris left the government in 1981 to work as consultant on the financial market for various companies. He has also published numerous articles on taxes and public finance.

Mr. Eris received a bachelor's degree from the Middle East University in Ankara. He holds a master's degree and a doctorate from Vanderbilt University.

file: bios
5/4/90

Res Rep: Mr. Papadopoulos
(First Name: George)

Country: BRAZIL ***Delegation: Ms. Zelia Cardoso de MELLO, Min. of Economy**
September 23 at 4:30 P.M. **Mr. Ibrahim ERIS, President, Central Bank**
Mr. Jorio DAUSTER, Spec. Amb., Ext. Debt Matters

BACKGROUND

- Upon taking office in March 1990, the Collor government introduced a major stabilization program and structural reforms to attack hyperinflation and chronic economic deficiencies. Radical monetary contraction was key--over 67% of broad money supply, including outstanding domestic public debt, was frozen.
- Other measures included new taxes, higher public sector prices, subsidy cuts, dismissal of 200,000 civil servants, and a privatization program.
- In June, trade and industrial policy reforms to dismantled non-tariff barriers.
- Overall very positive impact. Monthly inflation reduced from 84% in March to 12% in July. Operational deficit should be zero in 1990 (10% deficit in 1989).
- IMF Standby for 18 months, $2.1 billion agreed on Sept. 14. Conditions for Board (October): begin negotiation with commercial banks, commit to regular payments and start making them.

POINTS TO MAKE TO DELEGATION

1. Collor Plan. Congratulate Government for its commitment to an ambitious, far-reaching and well-conceived economic program. Bank is impressed with evolving macroeconomic situation which should no longer obstruct our lending program.

   We welcome opportunity to assist analytically, especially in other areas, e.g. education, health, energy, and infrastructure.

2. Invite Minister to brief you on their agreement with IMF and their debt strategy.

3. Bank Lending Pipeline has been adversely affected by COFIEX's slow process of priority determination and review of previously approved projects, including those under preparation. this process must be accelerated to enable viable lending programs for FY91 and 92.

   As we demonstrated last year in other countries, the Bank will not compromise project quality, or substitute new loans to compensate for slippages. Nor will we substitute adjustment loans for slipped investment projects.

   Also, our Board limits the elapsed time between reforms undertaken and loans made in their support. (This is relevant for possible trade adjustment loan).

4. Human resources and Poverty: Bank has a strong commitment to these areas which must surely be high on Brazil's priorities. Personally would like to be involved in these sectors. Hope COFIEX's difficulties can be resolved.

5. Power Sector Tariffs have not been adjusted since March to account for inflation. they are 30% below levels needed for effectiveness of an approved project and negotiations of another power loan. Public sector tariffs are not under anti-inflation control. Bank is still awaiting response to our queries.

6. Overdue Payments: Appreciate improvement in situation due to recent measures. Still not on time though.

7. Environment: We await Government proposal for Bank role in pilot program for preserving rain forests of Brazil as requested of us by G-7 at Houston.

PLEASE DO NOT RAISE THIS YOURSELF

IF THE DELEGATION MENTIONS:

1. **Adjustment Loan in support of trade policy reform**

   YOU SHOULD INDICATE our appreciation of the strong trade liberalization measures taken and the importance of such a loan. It would depend on the macroeconomic program, particularly the inflation rate (10-12%) which needs reduction.

   Shahid Husain should discuss this further when he visits in October/November.

Estimated GDP Growth: **-2.0% (1990)** FY90 Commitments: **$1,569m**
Lending Program: **$3,662m (FY91-92)** Disbursements: **$968m**

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* **OTHER DELEGATION MEMBERS:**

Mr. Marcos GIANNETTI DA FONSECA, National Secretary for Planning
Mr. Clodoaldo Hugueney FILHO, Director of Intl. Affairs, Ministry of Economy
Mr. Antonio KANDIR, Special Secretary for Economic Policy
Mr. Eduardo Marco MODIANO, President, National Development Bank

BRAZIL - Briefing Update for the Annual Meetings

- IMF Stand-by Arrangement. After an IMF mission was in Brazil for the month of August, the Government of Brazil and the IMF reached agreement on a new 18-month Stand-by Arrangement for about $2.1 billion on September 14. The IMF targets for the operational deficit are a surplus of a 0.5% of GDP for 1990 and a balance in 1991. These figures exclude any revenues from privatization that could amount to about 1% of GDP. The inflation projections that underlie the IMF targets are 5% per month by December 1990 and 25% for the calendar year 1991. Prior to presentation to the IMF Board (expected in the second half of October), the Government of Brazil must: a) begin negotiations with the commercial banks; b) commit to making regular payments to these banks; and c) start making those payments. The amount of those payments was negotiated directly by Mr. Camdessus and the President of the Central Bank and is still unknown.

Key Issue likely to be raised by the Delegation

- Adjustment Lending. It now appears likely that the Brazilian delegation may request from the Bank an adjustment loan for trade policy reform. You may wish to mention to the Brazilian delegation that we have taken notice of the strong trade liberalization measures implemented by the Government and that we understand the importance of such a loan for the country. The loan would be crucially dependent on the macroeconomic program; in particular, the rate of inflation which, at the current level of 10-12% per month, is too high and must be reduced prior to Board presentation of this loan. You may wish to let them know that during Mr. Husain's visit to Brazil in October/November to review the economic program, further discussions on adjustment operations will be held after which a final decision will be made.

- Human Resources and Poverty. Recent decisions by COFIEX have indicated some difficulties with project approvals in the areas of poverty and human development. You may wish to express to the Brazilians the strong commitment on the part of the Bank to operations directed toward human resource development and poverty alleviation.

ANNUAL MEETING BRIEF

Name of Country: BRAZIL

Meeting With: Ms. Zelia Cardoso de Mello, Economy Minister
Mr. Ibrahim Eris, President of the Central Bank
Mr. Jorio Dauster, Special Ambassador for External Debt Matters
Mr. Marcos Giannetti da Fonseca, National Secretary of Planning
Mr. Clodoaldo Hugueney Filho, Director of Intenational Affairs, Department of the Ministry of Economy
Mr. Antonio Kandir, Special Secretary for Economic Policy
Mr. Eduardo Marco Modiano, President of the National Development Bank

Population: 144.37 million (1988)
GNP per capita: $2160 (1988)

Est. Population Growth Rate: 2.0 (1988)

Total Commitments to 6/30/90:	17,136.0	FY90: Commitments:	1,569
of which:		Disbursements:	968
Bank	17,136.0	Amortization:	1,045
IDA	0.0		
Total Undisbursed	5,317.0		
Lending Program: FY91-92	3,662.0		

Summary Data	Average 1985-1989	Est. 1990	
GDP growth (%)	4.5	-2.0 to -3.0	
Export growth (%)	0.8	2.0	Aid Group Meeting: n.a.
Import growth (%)	4.6	20.0	Last meeting: n.a.
Current Account Deficit/GDP	-0.001	-0.006	IMF Stand-by:
Debt Service Ratio	67.1	45.9	Arrangement expected
Annual Inflation Rate (%)	435.7	1,150.0	in October 1990

Background: In March 1990, upon taking office, President Collor introduced a stabilization program and structural reforms to overcome the sources of Brazil's hyperinflation and chronic economic deficiencies. The key to the plan was a radical monetary contraction, freezing over 67% of the broad money supply including outstanding public domestic debt. Other measures included new taxes, higher public sector prices, limited private sector price and wage controls, a flexible exchange rate, cuts in subsidies, a reduction of government bureaucracy--for instance, by firing about 200,000 civil servants-- and a privatization program. Also, in June, a trade and industrial policy reform was introduced which would dismantle non-tariff barriers to outside competition. Overall, the impact of the Plan has been very positive. Its continued successful implementation could increase the likelihood of a switch from the current base case lending program to a "high case" scenario for the Bank's lending in Brazil. In 1990, the operational deficit should be roughly balanced, in contrast to a 10% deficit in 1989. Monthly inflation has declined from 84% in March to around 12% in July, and may stabilize around 5% soon. The plan led to a recession. GDP may decline by as much as 3% in 1990 but a recovery is likely next year. The parallel market premium has dropped. The real interest rate is still high, but lower than before the plan. The government has taken no position on a foreign debt repayment and is expected to await an agreement with the IMF, which may come as early as this fall. When negotiations with the commercial banks start, the Brazilian government will likely call on the Bank for assistance under the Brady Plan.

Issues likely to be raised by the delegation	Issues to be raised by Bank Management
1. Increasing the size of Bank's transfers	1. Collor Plan
2. Eligibility under Brady Plan	2. Improvement on late payments
3. Concessionary loans for social sectors	3. Importance of pipeline
4. The Rondonia project	4. Power tariffs
	5. G-7 recommendations on environment

Issues likely to be raised by the Delegation

1. **Increasing the Size of the Bank's Transfers to Brazil**. Negative net transfers, beginning in 1987, have been a recurring theme on the Brazilian agenda for annual meetings. The issue has become more pressing over the last two years. In FY89, IBRD net disbursements to Brazil were negative for the first time in 25 years and they remained negative in FY90. This new trend is an inevitable outcome of the long relation between Brazil and the Bank over the last 40 years. Currently, the lending program assumes that net transfers should remain negative for the next 4 years but decreasingly so, with average disbursements around $1.4 billion. However, as the Bank's lending program to Brazil is based on a graduated response, the more policies Brazil puts into effect in agreement with the Bank, the higher the level of our lending program could be. You may wish to mention that in view of the degree of commitment of the Government to the March Economic Plan and in view of its first indications of success, the current lending projections--around $1.8 billion/year--could be increased to a high lending scenario--$2.5 to $3 billion/year if the economic program remains on track. Under this scenario, between FY91 and FY95, net transfers would average to zero. In this case, the lending program could combine adjustment loans to support Brazil's stabilization and structural reform program, if the Brazilians so request, with investment loans to support Brazil's medium-term development objectives. However, for risk management reasons, the volume of adjustment loans should not exceed 50% of investment loans in each FY.

2. **The Bank's Role in Debt Reduction**. Brazil's eligibility for support for debt and debt service reduction depends primarily on the existence of a macroeconomic and structural adjustment program, and on coherent debt strategy. Currently, debt strategy remains unclear. The Minister of Economy has already made public statements on Brazil's inability to make external payments in 1990 above $5 billion. Out of that amount, $4 billion would be for Multilaterals. Only $1 billion would be for commercial creditors, in spite of arrears of over $6 billion. Implementation of any financing package for Brazil that includes debt and/or debt service reduction will depend on credit enhancement from the Bank, IMF and other sources. The specific contribution of the Bank will be determined after Brazil has reached an agreement with its commercial creditors and has obtained a Stand-by arrangement from the IMF. Consistent with the guidelines approved by the Board, a total amount of up to $2 billion could be available to support the reduction of Brazil's public external debt with commercial banks. The specific amounts of Bank support will depend on the sustainability of the adjustment program, the structure of the financing package negotiated with the commercial banks, and the expected benefit of the operation.

3. **Concessionary Loans for Social Sectors**. In recent meetings with the Bank, Brazilian Officials have stated that they are reluctant to borrow on standard Bank terms for projects in education, health and nutrition, etc., because these projects have long payoff periods and the benefits accrue to individuals, rather than to the government or to corporations which can be easily taxed. You may wish to remind the delegation that the Bank's instruments are not tailored to different sectors of the Economy.

4. **The Rondonia Project**. The Brazilian delegation may wish to discuss the future of this project. The Rondonia environmental project was approved by COFIEX a year ago. It has been negotiated, off and on, since early January 1990. However, disputes between the federal and the state government and within the federal government bureaucracy on the design and desirability of the project have stalled any further progress. Furthermore, the most likely winner for governor of the state of Rondonia in the October elections is now campaigning against the project. All of these indicate a considerable lack of commitment to the project by the federal and state governments. You may wish to inform the Brazilian Delegation that even if a political compromise were to emerge before the election and we were asked to finance the project, we would have to reassess it thoroughly before we commit ourselves to its financing.

Issues to be raised by Bank Management

1. **The Collor Plan**. You may wish to endorse and congratulate, once more, the government's commitment to its economic program. The Plan's targets and ambitions are far-reaching and its design is well conceived. The Department is very impressed with the current evolution of the macroeconomic situation. If the intensity of the government's commitment to this program is unaltered and the early positive results are confirmed, the macroeconomic situation should not be an obstacle to our lending program. Also, the Bank welcomes any opportunity to contribute to the government's thinking and to offer our assistance in the design of policies in other areas, such as education, health, energy and infrastructure.

2. **Status of Overdue Payments**. You may also wish to express our appreciation for the improvement in the late payments situation. Although the payments are not yet received on time, they are no longer very late as a result of the implementation of the recommendations of a committee in the Ministry of Economy that looked into this problem. One of the reasons for the delays was the centralization of all foreign currency payments in the Central Bank. As of June 1, payments to the Bank are no longer centralized and this seems to have helped. You may wish to impress upon them the importance of the Bank receiving payment on time.

3. **Importance of Pipeline**. You may wish to mention that the Department's lending program for FY91 and beyond is being adversely affected by the Ministry's slow process for determining the priorities of externally financed projects. A committee, COFIEX, reviews all projects proposed for foreign financing and must grant its approval before any preparation can begin and before the operation can be appraised. In addition to establishing the new administration's priorities, COFIEX is now reviewing all loans which it already approved under the previous government as well as those under preparation. We welcome the government's objective of establishing its own priorities, but COFIEX's process must be accelerated if we are going to have viable lending programs for FY91 and 92. The process remains very slow. We will do our best to maintain our lending to Brazil, but these delays in setting priorities have already resulted in slippages and are adding to the negative transfers problem. You may wish to mention that the Bank will not compromise project quality by hastening the processing of operations late in the FY to meet lending targets, nor will it substitute new loans for loans which slip because the government has not defined its priorities on time. Similarly, the Bank will not be prepared to substitute adjustment lending for slipped investment projects. You may also wish to mention that, in our current view, the most likely possibilities for adjustment lending are a trade policy loan and a privatization loan. On this matter you may wish to clarify to the delegation that the eligibility of these loans for Board presentation is subject to a "statute of limitations" from the time the reforms were implemented. For instance, because of the lapsed time, we would not be able to present to the Board an adjustment loan on trade policy in June of 1991 on the basis of reforms implemented in the summer of 1990.

4. **Power Sector Tariffs**. After an initial increase of 32% on March 15 as part of the Macroeconomic Plan, the new administration has failed to make any further adjustment in power sector tariffs to compensate for inflation. As a result, real power tariffs have fallen from 92% (for the month of April) to about 70% (for July) of the level specified as a condition of effectiveness of the Electricity Transmission and Conservation Project (US$385 million), approved by the Board on June 14, and as a condition of negotiation for the Electricity Distribution and Conservation Project (US$300 million). You may wish to remind the Brazilian delegation that we have asked the government about their plans to correct this but have received no reply to date. The Secretary of Planning has informed us that public sector tariffs were not being controlled as an anti-inflationary measure. The Minister of Infrastructure announced recently that power sector tariffs were adequate but gave no evidence to substantiate his claim. This situation puts the future of the above loans in doubt and, in our view, the financial prospects of the power sector as well.

5. **G-7 Recommendations on Environment**. In their Houston communique of July 10, 1990, the G-7 welcomed the commitment of the new Government of Brazil to help stop the destruction of the country's tropical forest and to provide sustainable forest management. They asked the World Bank to prepare, in cooperation with the European Economic Communities and the Brazilian Government, a pilot program to preserve the rain forests of Brazil. This program should be presented to the G-7 at their next Economic Summit at the latest, in June of 1991. If, by the time of the Annual Meeting, we have not received the Government's proposal for the Bank's role in the pilot program, you may wish to urge the Brazilian delegation to present us with one as soon as possible, to facilitate the implementation of the recommendations of the G-7.

Latin America and the Caribbean Region

Country: BRAZIL
FIVE YEAR LENDING PROGRAM: FY90-94
AS OF 07/31/90

SECTOR			FY90	FY91	FY92	FY93	FY94	FY90-94
Agriculture	PA240-NE IRRIG I	L	210.0	.0	.0	.0	.0	210.0
	PA254-AG RESEARCH III	L	47.0	.0	.0	.0	.0	47.0
	PA260-LND MGMT II	L	33.0	.0	.0	.0	.0	33.0
	PA291-ITAPARICA SUPPLEM	M	100.0	.0	.0	.0	.0	100.0
	PA292-MATO GROSS NAT RES M	L	.0	.0	150.0	.0	.0	150.0
	PA236-IRRG SUBSCTR II	S	.0	.0	200.0	.0	.0	200.0
	PA241-RONDONIA NTRL RESOUR	S	.0	.0	167.0	.0	.0	167.0
	PA206-RURAL FIN REFORM	S	.0	.0	.0	300.0	.0	300.0
	PA261-LND MGMT III	S	.0	.0	.0	75.0	.0	75.0
	PA262-LND TENURE IMPRV II	L	.0	.0	.0	.0	100.0	100.0
	PA286-NTL FORSTRY DEV/CONS	S	.0	.0	.0	.0	120.0	120.0
	PA287-IRRI SUBSCTR III	S	.0	.0	.0	.0	200.0	200.0
	Sub-total Agriculture		390.0	.0	517.0	375.0	420.0	1702.0
Trade, Fin + Ind	PA191-ELEC TRNS&CONSRVTN	L	385.0	.0	.0	.0	.0	385.0
	PA250-ELEC DISTR & CONS.	L	.0	300.0	.0	.0	.0	300.0
	PA279-HYDROCARBN TRNSP/PRO	L	.0	260.0	.0	.0	.0	260.0
	PA295-STEEL CO. PRIVATIZN	L	.0	.0	100.0	.0	.0	100.0
	PA296-IND PRIVATZTN ADJ	L	.0	.0	300.0	.0	.0	300.0
	PA282-NTL IND POLL CONTRL	S	.0	.0	150.0	.0	.0	150.0
	PA315-PRIVATE SCTR PWR DEV	L	.0	.0	.0	200.0	.0	200.0
	PA211-ENVIRON REF/ENERGY C	S	.0	.0	.0	100.0	.0	100.0
	PA307-ELEC TRNSM II	S	.0	.0	.0	.0	375.0	375.0
	Sub-total Trade, Fin + Ind		385.0	560.0	550.0	300.0	375.0	2170.0
Infrastructure	PA231-HWY MGMT	L	310.0	.0	.0	.0	.0	310.0
	PA288-MUN DEV (RIO GRANDE)	L	100.0	.0	.0	.0	.0	100.0
	PA313-RURAL WTR SUPPLY/SAN	L	.0	200.0	.0	.0	.0	200.0
	PA165-STATE HWY MGMT	S	.0	.0	200.0	.0	.0	200.0
	PA289-STATE WTR SEC-PARANA	S	.0	.0	70.0	.0	.0	70.0
	PA166-URBAN TRNSPRT	L	.0	.0	.0	200.0	.0	200.0
	PA184-TRNSPRT SCTR REF	L	.0	.0	.0	350.0	.0	350.0
	PA234-PORTS SCTR	L	.0	.0	.0	200.0	.0	200.0
	PA202-TELECOM REFORM	S	.0	.0	.0	200.0	.0	200.0
	PA223-URB SEC II (NE CIT)	L	.0	.0	.0	.0	250.0	250.0
	PA293-NATURL GAS II	L	.0	.0	.0	.0	125.0	125.0
	PA155-W&S SEC III(SOLID W	S	.0	.0	.0	.0	200.0	200.0
	Sub-total Infrastructure		410.0	200.0	270.0	950.0	575.0	2405.0
Human Resources	PA190-NE BASIC HLTH II	L	267.0	.0	.0	.0	.0	267.0
	PA270-SCIENCE RESEARCH&TRN	L	.0	150.0	.0	.0	.0	150.0
	PA267-QUALITY ASSURNCE/HLT	L	.0	.0	100.0	.0	.0	100.0
	PA151-INNOV BASIC ED	S	.0	.0	245.0	.0	.0	245.0
	PA214-NE BASIC ED II	S	.0	.0	150.0	.0	.0	150.0
	PA258-METRO HLTH II	L	.0	.0	.0	200.0	.0	200.0
	PA312-EARLY CHILD	L	.0	.0	.0	125.0	.0	125.0
	PA304-METRO HLTH III	L	.0	.0	.0	.0	250.0	250.0
	PA239-NE BASIC ED III	S	.0	.0	.0	.0	100.0	100.0
	Sub-total Human Resources		267.0	150.0	495.0	325.0	350.0	1587.0
Other	PA233-ENVIRONMTL PRJ	L	117.0	.0	.0	.0	.0	117.0
	PA284-PRIVATZN CPTL MRKT R	L	.0	300.0	.0	.0	.0	300.0
	PA298-PRIVATE SCTR FIN	L	.0	300.0	.0	.0	.0	300.0
	PA316-PRIVATIZATN T. A.	L	.0	20.0	.0	.0	.0	20.0
	PA142-FIN REFORM	S	.0	.0	200.0	.0	.0	200.0
	PA299-ENVIRON PROJ II	L	.0	.0	.0	.0	100.0	100.0
	Sub-total Other		117.0	620.0	200.0	.0	100.0	1037.0
	*TOTAL BRAZIL		1569.0	1530.0	2032.0	1950.0	1820.0	8901.0

MMcCarthy\AChung, LACCA
08/29/90

ZELIA CARDOSO DE MELLO

Minister of the Economy

Ms. Zelia Cardoso de Mello was born in Sao Paulo in 1953. She was a close economic advisor to President Collor de Mello throughout the campaign, and is now Minister of the Economy in the new administration.

Ms. Cardoso has worked as an economic analyst and consultant since 1976 when she joined the State Company for Public Housing (CECAP). She has since worked for the Sao Paulo Auxillary Bank, the Dummont Advisory and Planning Agency, and the Brazilian embassy in London. She has served as a member of the Sao Paulo Power Company Fiscal Council (1983-87) and as a Financial Director of the Housing Development Company in Sao Paulo (1984-86). Most recently, Ms. Cardoso has worked for the Ministry of Finance (1986-87), under Minister Dilson Funaro, with the Secretariat for Public Sector Finance Control in the Treasury, where she was closely involved in renegotiation of state debts to the federal government and banking reform issues. After leaving the federal government, Ms. Cardoso formed her own consulting firm, ZLC, through which she advised Collor when he was governor of the state of Alagoas.

Since 1977, Ms. Cardoso has been teaching in the economics department of the University of Sao Paulo. She has also worked on economic research projects with the University and various government institutions.

Ms. Cardoso holds both a bachelors' degree and a doctorate in economics from the University of Sao Paulo.

file:bios
5/3/90

IBRAHIM ERIS

President of the Central Bank

Mr. Ibrahim Eris, 45 years old, was born in Turkey and is now a naturalized Brazilian. He has been appointed President of the Central Bank of Brazil and is one of the primary authors of President Collor's economic plan.

Mr. Eris was a professor at Vanderbilt and Rice Universities before he moved to Brazil in 1973 and became a professor of economics at the University of Sao Paulo. From 1973 to 1981 he was a senior economist with the National Economic Research Foundation (FIPE), and from 1979 to 1981 he served as an adviser to then-Minister of Planning Antonio Delfim Netto. Mr. Eris left the government in 1981 to work as consultant on the financial market for various companies. He has also published numerous articles on taxes and public finance.

Mr. Eris received a bachelor's degree from the Middle East University in Ankara. He holds a master's degree and a doctorate from Vanderbilt University.

file: bios
5/4/90

JORIO DAUSTER MAGALHAES e SILVA

Special Ambassador for External Debt Matters

Ambassador Jorio Dauster Magalhaes e Silva was born in Rio de Janeiro in 1937. He is now serving as the Special Ambassador for External Debt Matters.

Ambassador Dauster began his diplomatic career in 1961. From 1965 to 1968 he served as Vice-Counsel in Montreal and from 1968 to 1972 as Secretary in Prague. He returned to Brazil from 1972 until 1979, first as Subsecretary for Technology Transfer in the Ministry of Industry and Commerce, and then serving in the Basic Products division of the Ministry of External Relations. Ambassador Dauster then went to London as Special Representative for Brazil from 1979 to 1985, and as President of the Producers Group of the International Coffee Organization from 1979 to 1987. In 1985 he became the head of the London office of the Brazilian Coffee Institute and in 1987 went to Brasilia as the President of the Brazilian Coffee Institute. He held this position until his recent appointment as Special Ambassador under President Collor de Mello.

file: bios
5/4/90

Mr. MARCOS GIANNETTI DA FONSECA

Secretary of the Secretary of Planning, Ministry of Economy

Mr. Marcos Giannetti Da Fonseca was born in São Paulo in 1948. He is currently Secretary of the Secretary of Planning in the Ministry of Economy.

Mr. Fonseca combines an academic career with an active participation in the management of major banks of the state of São Paulo. He has been a professor at the University of São Paulo between 1976 and 1987. He was visiting professor in 1978 at Washington University, Saint Louis, Missouri. Between 1983 and 1985, he served as a board member of two states banks for the State of São Paulo: the Development Bank of the State of São Paulo and of the State Bank of São Paulo. During the same period, he was Chairman of the Board at the "Caixa Economica" of the State of São Paulo. Between 1987 and 1988, he was coordinator of the Amparo Foundation Research Institute. Between 1988 and 1990, he was vice-president of a financial consulting firm, SILEX.

Mr. Fonseca holds a B.A in Economics from the University of São Paulo. In 1978, he completed a Ph.D. in Economics at Yale University.

MR. CLODOALDO HUGUENEY FILHO

Director of the Department of International Affairs, Ministry of Economy

Mr. Clodoaldo Hugueney Filho was born in the city of Rio de Janeiro in 1943. He is currently the Director of the Department of International Affairs in the Ministry of Economy.

Mr. Hugueney has made his career in the foreign service since 1966, beginning as Assistant to the Adjunct General Secretary for Western European, African and Near Eastern Affairs. Between 1969 and 1975 he served in Santiago, as Adjunct Counsel and Commissioner, and in Washington at the OAS as Second Secretary and Chief Negotiator. In 1975, Mr. Hugueney became Assistant to the Chief of the Department of Commercial Promotion and from 1977 to 1979 he served as Advisor to the Chief of the Economics Department in the Foreign Affairs Ministry. He was Counsel in London from 1979 to 1982. In 1983, he attained the position of Minister in the diplomatic corps, ranking immediately below ambassador. From 1988 until Collor's inauguration, he served as Secretary of International Affairs with the Ministry of Planning.

In addition, Mr. Hugueney has served as a member and a delegate at numerous international organizations and meetings, including UNCTAD, CEPAL, the OAS, the Special Commission for Restructuring the Interamerican System, CIECC, the Tokyo and Uruguay Rounds of GATT, and several Brazilian negotiating teams.

Mr. Hugueney holds a degree in law from the Catholic University of Rio de Janeiro, and a Masters in Economics from the University of Chile.

ANTONIO KANDIR

Special Secretary for Economic Policy

Mr. Antonio Kandir was born in Sao Paulo in 1953. He is now Special Secretary for Economic Policy in the Ministry of Economy.

Mr. Kandir has worked as a researcher and consultant for a number of government institutions. From 1976 to 1978 he was researcher with the Research Institute of the Planning Ministry (IPEA/SEPLAN), and from 1980 to 1989 he was with the Brazilian Center for Planning and Analysis (CEBRAP). He was a consultant for the Ministry of Economy and Planning of the State of Sao Paulo from 1983 to 1989 and for the President of State Bank of Sao Paulo (BANESPA) from 1985 to 1986. In 1987 he was appointed a faculty fellow of the Kellogg Institute of the University of Notre Dame, and he has published a book on inflation.

Mr. Kandir received his doctorate in economics in 1988 from the State University of Campinas, Brazil.

file:bios
8/22/90

EDUARDO MARCO MODIANO

President, National Bank for Economic and Social Development

Dr. Eduardo Marco Modiano was born in 1952. He is now President of the National Bank for Economic and Social Development (BNDES).

Dr. Modiano has made his career as a professor of economics. He began teaching in 1978 as a visiting professor at the Alfred P. Sloan School of Management of MIT. He returned to Brazil in 1979 and began teaching at the Catholic University of Rio de Janeiro in the economics department. Since 1984 Dr. Modiano has been an associate professor and, since 1987, he has also served as director of the economics department.

Dr. Modiano's publications include several books and numerous articles, many dealing with the Brazilian economy and inflation.

Dr. Modiano holds bachelors' degrees in engineering and economics from the Catholic University of Rio de Janeiro and the Faculty of Sciences, Politics and Economics in Rio. He received a masters degree in administration and an interdepartmental doctorate from the Alfred P. Sloan School of Management of MIT.

file:bios
5/4/90

1990 ANNUAL MEETING BRIEF - IFC

BRAZIL

(Member since 1956)

Date/Time: Wednesday, September ~~26~~ 23, 1990
~~12:00~~ 4:30 Noon

Place: Washington Sheraton Hotel - Room 5045

1. Representing Brazil

Zelia Cardoso de Mello	Minister of Economy
Ibrahim Eris	President of Central Bank

2. Representing IFC

Messrs. Ryrie, Parmar, Kaffenberger, Santos, Alland

3. Background

(i) Country Outlook and IFC Strategy. In March 1990, upon taking office, President Collor introduced a stabilization program and structural reforms to overcome the sources of Brazil's hyperinflation and chronic economic deficiencies. The key to the Plan was a radical monetary contraction, freezing over 67% of the broad money supply including outstanding public domestic debt. Other measures included new taxes, higher public sector prices, limited private sector price and wage controls, a flexible exchange rate, cuts in subsidies, a reduction of government bureaucracy -- for instance, by firing about 200,000 civil servants -- and a privatization program. In June, a trade and industrial policy reform was introduced which dismantled non-tariff barriers to outside competition.

Overall, the impact of the Plan has been very positive. In 1990, the Government's operational deficit should be roughly balanced, in contrast to a 10% deficit in 1989. Monthly inflation has declined from 84% in March to around 12% in July, and may stabilize around 5% soon. The Plan has however led to a recession. GDP may decline by as much as 3% in 1990 but a recovery is likely next year. The parallel market premium has dropped. The real interest rate is still high, but lower than before the Plan. To date, the government has taken no position on a foreign debt repayment and is expected to await an agreement with the IMF, which may come as early as this fall.

Given the apparent success of the Collor Plan and that IFC remains the only significant source of new long-term foreign funds to the Brazilian private sector, demands for IFC funding is expected to remain strong. However, in view of the fact that Brazil already represents 12% of IFC's held portfolio,

and our largest market, annual approvals will be maintained at the US$150-200 million level. The solid demand will permit IFC to focus on projects based on Brazil's comparative advantages and backed by first rate sponsors thus strengthening the quality of our portfolio. A second objective is to broaden the scope of our activities to concentrate more than in the past on the facilitation of the flow of "new money" to Brazil through the promotion of international equity, convertibles and/or straight debt issues by Brazilian companies, to play a significant role in the Collor administration's privatization program and to continue to seek advisory services contracts particularly in the area of financial restructurings.

(ii) FY90 Results. US$115.5 million including US$25.0 million in equity for 5 projects representing (on a $ volume basis) 7.7% of IFC's FY90 approvals. (See Annex I for historical approvals and details on portfolio.)

(iii) FY91 Pipeline. In view of the strong pipelines of both the Investment Department (ID) and the Capital Market Department (CMD), it is anticipated that FY91 approvals in Brazil will be in the order of US$200 million. ID presently has a pipeline of 20 potential projects for a total US$250 million of which US$80 million is in equity. This total includes US$15 million in loans for the Votorantim syndication but does not include the Riocell syndication (US$15 million for IFC) nor the US$3 billion debt-for-equity privatization fund. (These three projects are being undertaken jointly by ID, CMD and Corporate Financial Services (CFS).) CMD is also working on (a) a syndicated guarantee facility for Brazilian exporters of capital goods and services; (b) a privatization fund using the portfolio of BNDES, the federal development bank; (d) a venture capital fund and (e) a facility for the securitization of export receivables of Brazilian banks and industrial groups.

(iv) Mobilization of Funds/Loan Syndications. Although about US$0.5 billion of the US$1.3 billion of investments committed by IFC in Brazil over the last 25 years were syndicated loans, there has been a dearth of Brazilian syndications since the debt crisis. Last year, IFC arranged a US$5 million syndication with a German commercial bank for Copene, a petrochemical cracker and a US$5 million syndication with French banks for the Santa Marina project (a Saint Gobain subsidiary). Recently, IFC was approached by Votarantim S.A., the largest privately-held group of companies in Brazil, for about US$125 million help for finance the group's investment program. Given our ceiling constraints in Brazil, we are looking into syndicating this loan. In addition, we will try

to syndicate US$60 million for financing the cost overrun in Bahia Sul, a pulp and paper project, and US$100 million for Copene's (a petrochemical cracker) investment program. This is an ambitious program and we do not know whether we will be successful. Our success will depend on how flexible the Central Bank will be on interest rates and fees and whether the banks will require enhancements, such as direct access to export revenues of the companies (see Paragraph 4(a)). IFC can also be helpful in attracting financing from national investment institutions such as DEG, FMO. IFC recently was instrumental in attracting from DEG DM30 million for the Copene petrochemical project and we are currently talking to DEG about involvement in Bahia Sul and Eucatex (a wood products project).

(v) IFC assistance to Companies Wishing Access to International Capital Markets. In addition to loan syndications, we are also seeking to help Brazilian companies to mobilize funds in international equity markets. We are currently working with Riocell S.A. (owned by BNDESPAR and RIV Participacoes S.A. (Klabin, Iochpe and Votarantim)) to help that company raise on the international market US$150 million in equity for an US$800 million expansion of a bleached pulp mill in Rio Grande do Sul.

(vi) Portfolio Sales. For FY91, we anticipate that we will be selling our shareholdings in CODEMIN (nickel mining) and TRIUNFO (petrochemical) for an estimated capital gain of US$10-15 million. In FY90, IFC sold its participations in Volvo do Brasil (acquired in 1979) and Ciminas (acquired in 1972). The capital gain of these sales was US$18.9 million. However it should be noted the Ciminas shares were sold to an off-shore entity (Holderbank) and did not, therefore, represent a foreign outflow from Brazil. It should be clear for Brazil that these sales are part of the normal, ongoing process of revolving IFC's portfolio whereby our more mature holdings are sold in order to make room for new investments. In the case of Brazil, IFC has been adding such new investments at a significant and increasing rate. Finally, while such portfolio sales represent a major source of capital gains for IFC, they provide an important demonstration effect to other foreign investors on the attractiveness of equity investments in Brazil.

(vii) Advisory Services and Technical Assistance. Due to the liquidity crisis and recession caused by the Collor Plan, many Brazilian companies with sound underlying businesses are experiencing severe financial difficulties. ID/CFS have already been approached by several companies requesting financial restructuring advisory services. In addition in FY91, CMD expects to provide technical assistance to the Brazilian Securities Commission in promoting and, as needed, in improving the regulatory framework to facilitate foreign issues of Brazilian debt and equity securities.

4. Objectives of IFC's Meetings with the Brazilian Delegation.

(a) Privatization. From the beginning the Collor administration has emphasized the importance of privatization in reforming the Brazilian economy. The Minister of Infrastructure has announced that private investment will be welcome in several areas that have traditionally been state monopolies such as highways, railroads, electric power generation, telecommunications and steel. The first nine candidates for privatization have been identified. They are primarily in the steel (Usiminas and Tubarao), the petrochemical (Copene and Copesul crackers) and the fertilizer sector. Building on our solid knowledge of the Brazilian private sector, our close relationship with many of the large Brazilian industrial groups, and our experience in privatization and funds, IFC is interested in playing several roles in this initiative. We are currently developing a US$3.0 billion debt-for-equity fund. Secondly, we have submitted preliminary documentation to qualify to provide advisory services to the Government on the sell-side. We are focusing these efforts on the sale of state steel and fertilizer companies and are considering working on a case-by-case basis with a local group and/or international bank. While our expertise/knowledge is best in the petrochemical sector, acting as advisor to the Government on the sale of Copene and Copesul could pose potential conflicts of interest, since we are shareholders and lenders to many of the likely buyers. We are also seeking buy-side mandates, and in this regard, have already received some expressions of interest from Oderbrecht and Ipiranga concerning the acquisition of petrochemical assets and from Camargo Correa on Tubarao.

(b) Greater Flexibility on Loan Pricing and Fee. Our ability to mobilize a substantial amount of syndicated funds for Brazil and to broaden the range of services we offer to our clients is constrained by the lack of flexibility of the Central Bank. With regard to margins, in January 1989, we reached an agreement with the Central Bank concerning a schedule of indicative margins over LIBOR for IFC loans. At that time, it was also agreed that for projects which represented higher risks spreads above LIBOR plus 1-1/2% would be appropriate. In practice, however, in our day-to-day contacts with the Central Bank, it has been clear that getting a transaction with a margin above 1-1/2 would be extremely difficult and entail unreasonable delays. We believe that without more flexibility on margins, we will not be able to mobilize the substantial funds from the commercial banks for the Brazilian projects in our pipeline. On the second item, lack of Central Bank flexibility and timeliness in approving fees associated with particularly complex IFC loans or advisory services is constraining our ability to broaden the range of activities we provide our clients.

5. Issues Likely to be Raised by the Brazilian Delegation

Net Flow of Funds. In the past, the Brazilian Delegation has expressed concern about the net flow of funds between IFC and Brazil. IFC has been a net contributor of funds to Brazil. Over the past 10 years, the net flow of funds from IFC to Brazil has been over $570 million, in calendar year 1989 alone the net flow to Brazil was US$70 million.

BRAZIL

IFC BOARD APPROVALS (FY 81-89)
(US$000's)

	Date Approved	IFC
FY 1981		
Cosigua	7-15-80	3,727
Brasilpar	11-18-80	1,500
Triunfo	2-10-81	19,000
Cobrape	3-16-81	8,500
Itaisa	5-26-81	10,000
PPH	6-04-81	12,000
Ciminas	6-23-81	33,500
Total		88,227
FY 1982		
Caue	7-21-81	25,000
Pisa	12-31-81	31,000
Fosfatados	3-30-82	15,000
Volvo	5-21-82	2,000
Iochpe	5-25-82	10,450
Atlas	5-27-82	10,000
CRP	6-10-82	1,000
Codepa	6-10-82	6,100
Total		100,550
FY 1983		
Cimag	1-25-83	30,000
Codemin	2-24-83	400
Cosigua	5-05-83	643
Sococo	3-29-83	5,500
Sotave	4-07-83	21,000
Total		57,543
FY 1984		
Alquim	7-19-83	24,000
Cimetal	9-13-83	1,380
Copener	2-14-84	20,000
Quimica da Bahia	5-29-84	4,800
Pisa II	6-27-84	-
Polisul	6-28-84	2,000
Total		52,180

BRAZIL

IFC BOARD APPROVALS (FY 81-89)
(US$000's)

	Date Approved	IFC	
FY 1985			
Cosigua	2-05-85	3,000	
Cimetal	2-26-85	1,050	
Morro Verde	3-12-85	30,175	
Nitroclor	5-30-85	8,000	
Total		42,225	
FY 1986			
Cimag	7-16-85	-	a/
Nitriflex	7-16-85	14,000	
Perdigao	12-05-85	25,000	
Cosigua	12-10-85	5,120	b/
Ciminas	12-19-85	10,000	
Volbras	3-20-86	2,100	
Caue	4-03-86	3,950	
Oxiteno	5-20-86	-	c/
Pisa	6-28-86	30,900	
Total		91,070	
FY 1987			
FCC	6-11-87	20,500	
MBR	6-11-87	20,000	
Perdigao	6-18-87	20,000	
Triunfo	4-23-87	50	
Polisul	2-06-87	1,000	
PPH	6-11-87	12,400	
Spasa	4-02-87	30,000	
Duratex	6-25-87	7,370	
Amcel	10-09-86	14,000	
Total		125,320	

a/ IFC's loan of US$20.0 million to Cimag was cancelled before the end of the fiscal year and is thus not counted in the program.

b/ IFC sold its Cosigua shares for US$20.3 million payable over 7 years. Only the portion of the receivable in excess of the original cost of IFC's investment is shown here. This is equivalent to the capital gain on IFC's sale.

c/ IFC sold its Oxiteno shares for US$20.0 million. Since this was a cash transaction with the investment being removed from IFC's books, no figure is recorded here.

BRAZIL

IFC BOARD APPROVALS (FY 81-89)
(US$000's)

	Date Approved	IFC
FY 1988		
Banco Itau, Unibanco Banco Bozano Simonsen	8-27-87	80,000
Brazil-Private Placement Fund	8-27-87	17,500
Nitroclor	12/08/87	700
Cebrace	12/22/87	45,000
Santista	02/09/88	19,300
PPH	02/26/88	3,600
CPC	03/24/88	45,000
Equitypar-Debt Conversion Fund	05/17/88	10,000
Total		221,100
FY 1989		
Papel Catarinense IV	08-25-88	15,000
Copene	08-25-89	45,000
Eluma	09-14-88	15,000
Aracruz	03-09-89	20,000
Politeno	03-09-89	25,000
Adiboard	06-01-89	7,500
		127,500

Brazil Approvals FY90

	Gross IFC			Net IFC			
	Loan	Equity	Total	Loan	Equity	Total	#
Bahia Sul (Pulp and Paper)	40.0	15.0	55.0	40.0	15.0	55.0	1
Santa Marina (Fiberglass)	20.0	5.0	25.0	15.0	5.0	20.0	2
Ripasa (Paper)	20.0	5.0	25.0	20.0	5.0	25.0	3
Engepol (Plastics)	3.5*	-	3.5	3.5	-	3.5	4
Minuano (Agri-business)	7.0*	-	7.0	7.0	-	7.0	5
Total	90.5	25.0	115.5	85.5	25.0	110.5	

* Quasi-equity.

BRAZIL
IFC Portfolio as of June 30, 1990
(US$'000)

Obligor	Type of Business	Original Commitments		Investments Held by the Corporation (including undisbursed balanc		
		Total IFC	Total Syndications	Loans	Equity (at Cost)	Total Lo and Equi
Amapa Florestal e Celulose	Wood products	14,000	-	14,000	-	14,000
Bahia Sul	Pulp + paper products	55,000		40,000	15,000	55,000
Banco Bozano Simonsen de Investimento S.A.	Development Finance	20,000	-	20,000	-	20,000
Banco Itau S.A.	Development Finance	30,000	-	30,000	-	30,000
Brasilpar Comercio E. Participacoes S.A.	Money & Capital Market	1,500	-	-	1,185	1,185
Brasital S.A. Para A Indu e o Comercio		100	-	100	-	100
Cebrace - Companhia Brasileira de Cristal	Float Glass	45,000	-	40,000	5,000	45,000
Cimento Caue S.A.	Cement & Construction	25,000	20,000	10,759	3,255	14,014
Ciminas - Cimento Nacional de Minas S.A.	Cement and Construction Material	71,135	134,756	13,333	6,619	13,333
Companhia Alcoolquimica Nacional - Alcoolquimica	Chemicals & Petrochemicals	24,000	-	5,147	3,719	8,866
Companhia Brasileira de Agropecuaria - Cobrape	Food and Food Processing	8,500	-	4,500	3,000	7,500
Copene	Chemicals & Petrochemicals	45,000	5,000	45,000	-	45,000
Dende do Para S/A - Denpasa - Agricultura, Industria E Comercio de Oleaginosas	Palm Oil	4,500	-	722	1,000	1,722
Duratex S.A.	Particle Boards	7,370	-	7,370	-	7,370
Eluma	Chemicals & Petrochemicals	15,000	-	15,000	-	15,000
Empresa de Desenvolvimento de Recursos Minerais "Codemin" S.A.	Mining	39,740	54,000	-	4,340	4,340
Equity Fund of Brazil	Capital Markets	20,445	-	-	16,254	16,254
Fabrica Carioca de Catalisadores	Chemical	20,500	-	20,500	-	20,500
Fabrica de Tecidos Tatuape	Textiles & Fibers	16,550	23,250	8,800	-	8,800
Hering do Nordeste S.A. - Malhas	Ready-made Garments	2,000	-	1	-	1
Agrileasing S/A - Arrendamento Mercantil	Money and Capital Market	27,000	3,450	2,000	-	2,500
Mineracoes Brasileiras Reunidas S.A.	Mining	20,000	-	20,000	-	20,000
Nitroclor	Chemicals & Petrochemicals	8,700	-	1,200	5,700	6,900
Perdigao S.A. Comercio e Industrias	Food Processing	20,000	-	20,000	-	20,000
Petroquimica Triunfo S.A.	Chemicals & Petrochemicals	35,175	14,931	3,561	3,066	6,627
Pisa - Papel de Imprensa	Pulp and Paper Products	58,800	31,670	22,000	7,200	29,200
Polisul Petroquimica S.A.	Chemicals & Petrochemicals	21,000	28,000	4,000	5,999	9,999
Politeno	Chemicals & Petrochemicals	25,000	-	18,500	6,500	25,000
PCC	Pulp and Paper Products	13,879	8,313	15,000	-	15,000
PPH - Companhia Industrial de Polipropileno	Chemicals & Petrochemicals	33,000	-	16,009	1,643	17,651
Quimica da Bahia	Chemicals & Petrochemicals	5,286	-	231	1,800	2,031
S.A. Moinho Santista Industrias Gerais	Textiles & Fibers	4,000	-	4,000	-	4,000
Santista Industria Textil Sergipe S.A.	Textiles & Fibers	4,500	-	3,200	1,300	4,500
Sao Paulo Alpargatas S.A.	Textiles	30,000	-	30,000	-	30,000
Sococo S.A.	Food and Food Processing	5,500	-	-	2,500	2,500
Sotave Amazonia Quimica e Mineral S.A.	Fertilizers	41,000	-	14,200	-	14,200
Tecanor S.A/ Textil Catarinense do Nordeste	Textiles & Fibers	16,200	-	3	-	3
Toalia S.A. Industria Texil	Textiles & Fibers	1,900	-	1,900	-	1,900
Unibanco - Uniao de Banco Brasileiros S.A.	Development Finance	30,000	-	30,000	-	30,000
Villares Industrias de Base S.A. - Vibasa	Iron and Steel	5,000	-	417	-	417
TOTAL		871,280	323,370	481,453	88,461	569,913

ANNEX II

BRAZIL PIPELINE (FY91)

Under Appraisal/Awaiting Negotiations		New IFC Loan	New IFC Equity	Total	#
Silocaf	Coffee Processing	2.7	1.3	4.0	1
		2.7	1.3	4.0	
Awaiting IPR					
Oxiteno	Acrylic Acid	23.2	5.6	28.8	2
Inga	Zinc Mining & Refining	23.0	7.0	30.0	3
Ipiranga/Rhodia	Phenol Acetone	30.0	10.0	40.0	4
Bahia Sul	Pulp & Paper	0	23.0	23.0	5
Tupy	Foundry	20.0	5.0	25.0	6
Cotenor	Textiles	22.0	15.0	37.0	7
Votorantim	Corporate Loan	15.0	0	15.0	8
		133.2	65.6	198.8	8
High to Medium Probability					
Cooperseda	Sericulture	9.0	3.0	12.0	9
Multisilicon	Ferrosilicon	12.0	3.0	15.0	10
		21.0	6.0	27.0	
GRAND TOTAL		156.9	72.9	229.8	10

BRAZIL

MIGA - ANNUAL MEETINGS BRIEFS

The following issues related to MIGA, which you may wish to raise in your meetings with delegations. In summary:

(a) Non-member countries would be encouraged to sign and/or ratify the MIGA Convention;

(b) Some countries would be asked to complete their subscription payments promptly; and

(c) Other countries would be asked to give favorable considerations to facilitate MIGA operations.

LAC: Brazil and Mexico

Have not signed the Convention. MIGA staff, including myself, have tried to persuade both countries to join MIGA on various occasions. These countries could benefit enormously from MIGA's services -- both Guarantee Program and Policy and Advisory Service. We understand they have a legal difficulty but are willing to discuss with them how to overcome it.

C. F.

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 90/07/09 DUE DATE : 00/00/00
LOG NUMBER : 900710006 FROM : M. Qureshi
SUBJECT : BRAZIL: Mtg. on July 11 with Secretary of Planning Mr. Marcos Fonseca and Min. of Interna'l. Affairs Mr. Clodoaldo Hugueney.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
_____ PLEASE HANDLE
_____ FOR YOUR INFORMATION
_____ FOR YOUR REVIEW AND RECOMMENDATION
_____ FOR THE FILES
_____ PLEASE DISCUSS WITH _____
_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS :cc: Messrs. Sandstrom, Khanna
J. Volk (FF)

THE WORLD BANK

July 10, 1990

Mr. Conable

This is a good note in explaining our current position and dialogue with Brazil. However, I would be more flexible in regard to para. 21, i.e. our expectations regarding satisfactory progress regarding debt negotiations. We cannot allow the Banks to have a veto on our actions.

MOEEN A. QURESHI
Senior Vice President, Operations

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: July 9, 1990

TO: Mr. Barber B. Conable
(Through: Mr. Moeen A. Qureshi)

FROM: Armeane M. Choksi, Acting Vice President, LACVP

EXTENSION: 31811

SUBJECT: **BRAZIL - Meeting on July 11 with Secretary of Planning Mr. Marcos Fonseca and Minister of International Affairs Mr. Clodoaldo Hugueney.**

Mr. Conable.
This is a good note in explaining our current position and dialogue with Brazil. However, I would be more flexible in regard to Para 21, i.e our expectations regarding satisfactory progress regarding debt negotiations we cannot allow the Banks to have a veto on our actions
AWC
7/10.

1. On Wednesday, July 11 you will meet with Secretary of Planning Mr. Marcos Fonseca and Minister Clodoaldo Hugueney, who is in charge of International Affairs, under Mr. Fonseca. Mr. Fonseca is one of the three secretaries of the Ministry of Economy. He is an economist with private sector experience and is very well disposed towards the World Bank. Mr. Hugueney is a member of Itamarati, the Diplomatic Corps of Brazil. He appears to have a strong nationalistic attitude and to be suspicious of multilateral organizations including the World Bank. He seems to be concerned with the potential infringement of national sovereignty by such organizations. The purpose of their mission is to discuss the lending program of the World Bank to Brazil. We expect them to raise issues on both adjustment and investment lending.

An Update of the "Collor Plan"

2. By July 11th, it will be almost four months since the new administration announced its new plan. Its current status is analyzed below under nine separate policy headings.

3. **Monetary Policy**. After the initial freeze and elimination of most of the money when the Plan was introduced (March 16, 1990), the quantity of money about doubled within two months. This has led to renewed inflationary expectations. Since mid-May, however, and particularly towards the end of the month, the Central Bank has introduced measures which have granted it an effective control over monetary policy; and has announced targets for monetary expansion which, if fulfilled, would make monetary policy highly restrictive (e.g., a targeted increase of the money supply of about nine percent for the second half of 1990--roughly an annual rate of 20 percent). Partial information shows that this change in trend has indeed been started: during the first three weeks of June, money supply (M_1) and the monetary base remained practically unchanged. If maintained persistently, this policy--together with an appropriate fiscal stance--should lead to a significant deceleration of inflation within a few months.

4. **The Fiscal Stance**. A new budget for 1990--in effect, a budget for the second half of the year--should be submitted to Congress very shortly; but information about it is not yet available. Preliminary evidence suggests that since the implementation of the Plan, a budgetary cash surplus has been realized; but this may turn soon to become a cash deficit, for a variety of reasons: much of the increase in government revenues has originated from one-shot taxes; revenues are expected to decline due to

lower economic activity; and prices of public-sector goods and services, which were increased by 40% on average on March 16th, have been maintained at a constant nominal level since then. The latter phenomenon, in particular, is a source of concern. The reduction of public-sector employment, which will be noted shortly, is not expected to be large enough in monetary terms to offset these factors. Nevertheless, the budget for the rest of 1990, as well as for 1991, may be expected to be roughly balanced (the operational balance may be within the range of a one percent surplus to a two percent deficit). This compares with 10-12% deficit in 1989. If this materializes, it will represent a change in the fiscal position of the Government of about 10 percent of GDP. This would be a significant accomplishment. Such a budgetary stance should be consistent with a major reduction in the inflation rate.

5. **Prices**. Prices did not increase at all for the first few weeks following the implementation of the Plan. Since mid-April, however, some inflation has reappeared, with the rate of increase of prices rising from 3 to 4 percent per month in the second half of April to 9 to 10 percent in the second half of June. No general price controls have been introduced; but the Government has made various announcements which may indicate a consideration of such measure. It is possible, indeed, that some of the acceleration of price increases may be attributed to the fears of such an event, which leads to preemptive price hikes. Due to the rapid increase in liquidity in May, further price increases may be seen in July. After which, if the fiscal and monetary policies are properly implemented, inflation should start on a downward trend.

6. **Wages**. Wage developments, as well as the government's wage policy, are now in a flux. Several measures which were designed by the administration to ensure a minimal increase of wages have been rebuffed by Congress and by the courts. While the adjustment of wages has apparently left average wages on at least the real level of the day of introduction of the Plan, it is likely that a substantial reduction of real wages had materialized during the period of rapid acceleration of inflation prior to the introduction of the Plan. Consequently--and combined with the renewed inflationary expectations--labor is demanding (and, in the private sector, to some extent has realized) large nominal wage increases. It is likely that wages will increase in the next two to three months considerably more than in the last two months.

7. **Foreign-Trade Regime**. A major trade liberalization has been introduced. First, all prohibitions which had prevented the importation of goods have been eliminated (the single exception is the law of Informatics). Second, as of the end of last week, rationing of imports through licensing and the allocation of foreign exchange has been abolished. Thus, as of July 1, all QRs of imports have been eliminated. Imports now face only tariffs, which will be gradually lowered and collapsed, within four years, to a system of three low tariff levels. The law of informatics will also be phased out within two years. The complete removal of all QRs is a revolutionary development in the context of Brazil and Latin America, it is an act of trade liberalization with very few parallels in recent history, the only obvious case that compares is that of Chile.

8. **The Foreign-Exchange Rate**. The foreign-exchange rate, presumably free, is in effect determined by the Government (through the size of its net purchase of foreign exchange in the market). This is a managed-float exchange-rate regime. The level of the rate was around 60 cruzeiros per dollar at the end of June. This represented a depreciation of about 17-18 percent during June, following a depreciation of some 20 percent during May. The cumulative depreciation since the second half of March thus exceeds significantly the rate of domestic price increases. Nevertheless, the real exchange rate is still lower by some 20 percent than its level in 1987-88. The level of the parallel-market rate has remained practically unchanged, during June--at about 87 to 88 cruzeiros per dollar. The parallel-market premium has thus declined from about 70 to just over 45 percent.

9. **Public Sector Employment**. A large reduction of the public-sector labor force has been announced as a target of the Plan upon its introduction. By mid-May, a concrete level had been determined: a reduction of some one-fifth of the labor force--360,000 employees altogether. By the second half of June, large-scale firing had actually taken place. Around 150,000 employees have been removed from their positions. Of these, about two-thirds--over 100,000--have actually been fired; whereas the rest are mostly tenured employees, which have been relegated to a "pool." The Government intended to pay the "pool" employees only a fraction of their normal salaries, but this has been ruled unconstitutional by the Supreme Court. The total budgetary saving of the labor-force reduction thus far is not overwhelming --it is within the range of 1-1.5 percent of GDP; but the implementation of this large-scale dismissal is of crucial importance for the Plan's credibility and for the reduction of the government's share in economic activity.

10. **Privatization**. The privatization of state enterprises is one of the cornerstones of the Plan. The administrative machinery for implementation of liberalization has been established, and from all indications the Government is committed to carrying out a large-scale privatization program within a period of several years. First in line will be enterprises in the steel and petrochemical sectors. Part of the financing of privatization will be made through "Certificates of Privatization"--an involuntary bond to be bought by financial institutions, with a total value of US$7 billion. Legislation to that effect has been passed, but the sale of the Certificates has not yet been carried out. Longer term privatizations will include railways, ports, and the power sectors.

11. **Overall Evaluation**. The Plan's targets and ambitions are far-reaching, and its design well conceived. Errors in implementation--particularly in the monetary sphere--have delayed its success. Nevertheless, we believe that the probability of the Plan's eventual sustainability is high. This belief originates from the degree of commitment of the Government--primarily President Collor--has demonstrated with regard to all the important components of the Plan; and from the fact that--although the evidence about this is incomplete and applies to only a short recent period--monetary expansion has been brought under control. What may be expected now are some months of stagflation--a reduction of activity, possibly even severe, together with inflation in the range of 10 percent per month. Beyond that time, inflation should subside significantly; and, probably a year from now, growth should be resumed,

gathering momentum as time goes by. The issue is whether the stagflation and, in particular, the recession will undermine support for this program. Congressional and gubernatorial elections in October, during the period of stagflation, may lead to a new congress opposed to the President, thus undermining his authority.

Lending Program

12. The Department's lending program for FY91 and beyond is being adversely affected by the Ministry of Economy's slow process for determining the priority of externally financed projects. A committee, COFIEX, chaired by Mr. Fonseca reviews all projects proposed for foreign official financing, and must grant its approval before project preparation can begin, and before the operation can be appraised. In addition, in order to establish the new administration's priorities, COFIEX is now reviewing all externally financed loans that are under preparation, but have not yet been signed.

13. We agree in principle with the objectives of the Ministry of Economy in establishing government investment priorities to combat fiscal deficits and inflation. We have requested, however, that COFIEX handle the review process in a speedier manner not to impede unduly Bank's operations. To that effect, we have asked COFIEX to establish a three-year term pipeline of projects, so that we can work with them with little bureaucratic interference so that we reach the stage of appraisal and negotiations rapidly. The Ministry has agreed with this proposal; COFIEX is now meeting once a week to establish its priorities.

14. In its meetings, COFIEX is also reviewing the technical aspects of appraised projects, especially those which have been opposed by the old Planning Ministry staff. As a result, there have been delays in establishing clear guidelines and in determining priorities for project approval. It appears that some COFIEX members voice nationalistic concerns in these meetings toward multilateral and foreign commercial banks, presumably because of fears that these institutions would attempt to impose their own policy agenda on Brazil.

15. Of the nine FY91 (actual and standby) operations for $1.84 billion that we had planned, we had appraised seven for $1.62 billion. The two remaining loans are a recently identified privatization technical assistance operation and a trade reform adjustment loan based on the announced reforms. Of these nine operations only one, Hydrocarbon Transport, has been approved unconditionally by COFIEX. We expect three others totalling $750 million to be approved shortly; of the remaining appraised operations, one is being held up subject to the negotiation of an acceptable guarantee with the borrower, the State of Sao Paulo, and two have been held up by policy issues raised by COFIEX. For the two unappraised operations we await COFIEX's approval to proceed with their processing.

16. Of the loans that have been already approved by the Board two--Northeast Irrigation and the Itaparica Supplemental loan--have not yet been approved by COFIEX, because of technical and budget issues. We do not know when COFIEX will take up these loans. COFIEX has requested a reformulation of the Highway Management Loan--which has been approved by

our Board--to eliminate the highway construction component and channel all resources to rehabilitation. We have no objection to this and are waiting to hear whether they wish to make this change prior or subsequent to loan signing.

17. The preparation of most of our FY92 program was started prior to the new COFIEX procedures and is well underway but, again, we have not received any approvals from COFIEX, and this has substantially delayed our work. Three appraisal missions and a number of preparation missions were postponed in June because of lack of COFIEX approval.

18. You may wish to remind Secretary Fonseca of our request that the COFIEX process be accelerated as much as possible, and that, while we will do our best to maintain our lending to Brazil, delays in government's decision making have already resulted in slippage. You may wish to mention to Secretary Fonseca that we will not compromise project quality by hastening the processing of undeveloped operations late in the FY to meet lending targets, or to substitute new loans for loans which slip because the Government has not defined its priorities on time. Similarly, we do not intend to substitute adjustment lending for slipped investment lending. You may wish to emphasize that our ability to increase our lending in any FY will depend not only on the Brazilian economic program, but also on the procedures being established in COFIEX. At the current rate, we will lend less to the Collor Government in FY91 than we did to the Sarney Government in FY90 ($1.57 billion); the level could even drop to below that of FY90 ($707 million). In any event, our resources are limited; the slippage of the June missions was unfortunate as it will be costly for us to replace those operations in FY91. Furthermore, COFIEX must decide now on investment priorities if the FY92 program is not to be jeopordized. You may wish to recommend that in order to maintain smooth operations, the Government and the Bank should agree now on a three year lending pipeline.

Adjustment Lending

19. We expect that Secretary Fonseca will formally request at least one adjustment operation for this fiscal year. The most likely candidate would be one for trade policy reforms. Although we strongly believe that Brazil's recent announcements of trade policies are extraordinary in scope and speed of implementation, our involvement in such an operation would depend on the fulfillment of several other conditions which have been officially communicated to the Government. It would help if you reinforced our messages.

20. First, we would require a fully satisfactory macro-economic environment before we embark on formal discussions with the Government on any adjustment loan. This would imply that there be an IMF standby program in effect and that our own macroeconomic assessment has been completed and indicates a satisfactory macroeconomic environment. We expect now that an IMF mission will visit Brazil on July 15, while we plan our own assessment mission for August 6.

21. Second, we would expect that there would be satisfactory progress in their negotiations with the international banking community regarding their foreign debt.

22. Finally, we expect that we would need to have fully satisfactory sectoral agreements. In the case of the trade adjustment loan, we do not foresee any problems.

23. We have also explained to the Brazilians that it would be unlikely that the Bank would handle more than two adjustment loans in any fiscal year. Furthermore, we have informed them that the size of the total adjustment program in Brazil in any fiscal year will not exceed one third of the total lending program.

24. As we expect the Brazilians to present us with a formal request for a trade adjustment loan, you may wish to inform them that we would be prepared to start discussing trade policy issues in a preliminary and exploratory way, for example, reviewing the effectiveness of the measures that they have implemented on trade, while our more substantive involvement must await our macroeconomic mission's satisfactory evaluation of the economy. In this way, we may avoid resurrecting past Brazilian disappointments with the Bank for withholding adjustment operations, notwithstanding strong sectoral agreements, because of unfavorable macroeconomic conditions.

Status of Overdue Payments

25. We are continuing to receive payments steadily but late. The situation seems to have improved in the last couple of weeks. Certain borrowers seem to have problems with obtaining funds, and the problem appears to be mainly in the Treasury which supplies the funds to the borrowers for their repayments to the Bank.

26. As of today, payments due through May 1, 1990 have been received. The total amount outstanding for May 15, 1990 is about US$2.7 million. However, there remains an accumulation of late payment charges (interest on principal amounts received late for the previous payment period) on certain loans totalling about US$80,000 equivalent. The payment periods in question are March 1, April 1 and 15, and May 1.

27. About six weeks ago, Minister Zelia Cardoso de Mello established a committee in the Ministry of Economy, to look into the late payments situation, identify reasons for delays, and ultimately make recommendations for facilitating the payment process. Although we have now been informed that the committee has concluded its work, we have not received any word on the committee's findings or recommendations.

28. One of the reasons for the delays in the payment was the centralization of all foreign currency payments in the Central Bank of Brazil, which went into effect June 30, 1989. This action was taken by the Government in order to maintain their foreign reserves at desired level. In an effort to assist in the reduction of delays, the President of the Central Bank, Mr. Ibrahim Eris, officially announced that as of June 1, 1990, payments to the World Bank would no longer be centralized, and this seems to have helped.

29. Concerning the accumulation of late charges, we have been informed that Minister Clodoaldo Hugueney Filho, Director of International Affairs in the Ministry of Economy, in a meeting last week with the Central Bank requested that this matter be cleared up as soon as possible.

30. You may wish to emphasize the importance of making payments to the Bank on time.

cc: Mr. S. Shahid Husain (o/r); Brazil Management Team.

Mr. MARCOS GIANNETTI DA FONSECA

Secretary of the Secretary of Planning, Ministry of Economy

Mr. Marcos Giannetti Da Fonseca was born in São Paulo in 1948. He is currently Secretary of the Secretary of Planning in the Ministry of Economy.

Mr. Fonseca combines an academic career with an active participation in the management of major banks of the state of São Paulo. He has been a professor at the University of São Paulo between 1976 and 1987. He was visiting professor in 1978 at Washington University, Saint Louis, Missouri. Between 1983 and 1985, he served as a board member of two states banks for the State of São Paulo: the Development Bank of the State of São Paulo and of the State Bank of São Paulo. During the same period, he was Chairman of the Board at the "Caixa Economica" of the State of São Paulo. Between 1987 and 1988, he was coordinator of the Amparo Foundation Research Institute. Between 1988 and 1990, he was vice-president of a financial consulting firm, SILEX.

Mr. Fonseca holds a B.A in Economics from the University of São Paulo. In 1978, he completed a Ph.D. in Economics at Yale University.

MR. CLODOALDO HUGUENEY FILHO

Director of the Department of International Affairs, Ministry of Economy

Mr. Clodoaldo Hugueney Filho was born in the city of Rio de Janeiro in 1943. He is currently the Director of the Department of International Affairs in the Ministry of Economy.

Mr. Hugueney has made his career in the foreign service since 1966, beginning as Assistant to the Adjunct General Secretary for Western European, African and Near Eastern Affairs. Between 1969 and 1975 he served in Santiago, as Adjunct Counsel and Commissioner, and in Washington at the OAS as Second Secretary and Chief Negotiator. In 1975, Mr. Hugueney became Assistant to the Chief of the Department of Commercial Promotion and from 1977 to 1979 he served as Advisor to the Chief of the Economics Department in the Foreign Affairs Ministry. He was Counsel in London from 1979 to 1982. In 1983, he attained the position of Minister in the diplomatic corps, ranking immediately below ambassador. From 1988 until Collor's inauguration, he served as Secretary of International Affairs with the Secretary of Planning.

In addition, Mr. Hugueney has served as a member and a delegate at numerous international organizations and meetings, including UNCTAD, CEPAL, the OAS, the Special Commission for Restructuring the Interamerican System, CIECC, the Tokyo and Uruguay Rounds of GATT, and several Brazilian negotiating teams.

Mr. Hugueney holds a degree in law from the Catholic University of Rio de Janeiro, and a Masters in Economics from the University of Chile.

WORLD BANK OFFICE TRACKING SYSTEM
OFFICE OF THE PRESIDENT
Routing and Action Transmittal Sheet

File
Brazil

TO:	DATE:
Mr. B. Conable (E-1227)	10/23/90

SUBJECT:

Document From: Mr. Husain (EVKJ)
To: bbc
Dated: 10/22/90 Reference No.: EXC901023017

Topic: BRIEFING: meeting with Mr. Ibrahim Eris, President of the Brazilian Central Bank on Wed. Oct. 24, 1990 @ 9:00am

ACTION INSTRUCTIONS: | DUE DATE:

_____ HANDLE
_____ REVIEW AND RECOMMEND
__XXX__ FOR YOUR INFORMATION
_____ DISCUSS WITH _____
_____ AS WE DISCUSSED
_____ PREPARE RESPONSE FOR _____ SIGNATURE
_____ FOR YOUR FILES
_____ RETURN TO _____
_____ OTHER: _____

Remarks: BBC has the original.
cc: AK/SS/JWS

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

10/24
9:00 am

DATE: October 22, 1990

TO: Mr. Barber B. Conable

THROUGH: Mr. Edward V.K. Jaycox, Acting Senior Vice President, OPNSV

FROM: S. Shahid Husain, Vice President, LAC

EXTENSION: 39001

SUBJECT: BRAZIL- Visit of Mr. Ibrahim Eris, President of the Brazilian Central Bank

1. Mr. Ibrahim Eris, President of the Central Bank of Brazil, will be visiting you on Wednesday, October 24, to discuss his Government's proposal for settling Brazilian foreign debt. Please find attached a brief note that the Department had prepared last week on the Brazilian Government's position and the response of the commercial banks.

2. You may also wish to discuss the issue of overdue payments at this time. Brazil had improved its payments record to the Bank under the Collor Administration. However, in recent weeks, late payments have again been approaching and even exceeding the 60-day mark. Furthermore, last weekend, Mr. Jorio Dauster, Brazil's chief debt negotiator, made a public statement that if the IMF Board did not approve the Stand-by Agreement with Brazil soon, only the IMF would be paid, as there would be no funds available to pay other creditors. You may wish to ask Mr. Eris what steps are being undertaken to improve the late payments situation and whether his Government intends to suspend payments to the Bank if the IMF program is not approved, as stated by Mr. Dauster.

3. Also attached is a biography of Mr. Eris.

Attachments

cc: Messrs. Choksi (LA1DR), Papageorgiou (LA1CO)

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: October 16, 1990

TO: Mr. S. Shahid Husain

THROUGH: Armeane M. Choksi, Director, LA1

FROM: Demetris Papageorgiou, Division Chief, LA1CO

EXTENSION: 31910

SUBJECT: Brazil - Status of Negotiations with Commercial Creditors

1. Brazil resumed formal external debt negotiations with its commercial creditors in New York on October 10-12. The Government presented to the Banks' Advisory Committee a proposal for the renegotiation of Brazil's public sector external debt to commercial banks named "Brazil's Public Sector Debt Restructuring Plan" (attached). The details of the proposal were announced simultaneously in Brasilia by the Minister of the Economy in a meeting with the Ambassadors of the G-7 countries, and in New York by the Debt Negotiator and the Secretary of Economic Policy of the Ministry of the Economy. The commercial banks' response to the proposal is that it does not represent a basis for negotiations.

2. The Brazilian proposal recognizes Brazil's intention and, over the long term, its capacity to pay its external debt, but it it also takes into account the fiscal constraints the country now faces. Therefore, the Government argues, that the annual payment on debt service would be linked to the primary surplus. The thrust of the proposal is the transformation of the outstanding medium-and long-term external debt to commercial banks (approximately US$60 billion, which includes fully capitalized arrears) into bonds with maturities up to 45 years. Maturing private sector external debt (approximately US$6 billion) would not be part of the negotiations. Private debtors would negotiate their external debt directly with foreign commercial banks, and payments could be resumed as soon as the negotiations are completed. The Brazilian delegation mentioned that the Government will seek additional funds from the World Bank for the next two fiscal years.

3. The following are the main elements of Brazil's proposal:

a. Arrears to commercial banks accruing through December 31, 1990, or until a new agreement becomes effective, would be paid with the proceeds of a bridge loan from the banks. The amount of the bridge financing will be included in the debt to be restructured. The Government intends to make interest payments of US$427 million in 1991, and US$154 million in 1992. Should Brazil's primary surplus generate additional resources, payments on interest will be increased up to US$1 billion for each of these two years.

b. Short Term External Debt: Trade and Interbank Lines of Credit will become voluntary at the expiration, in March 1991, of the 1988 Trade Commitment and Interbank Commitment Letters, if an agreement is reached for the funding of foreign branches and agencies of Brazilian banks.

c. Menu of Options. Three options are included:

(i) Zero Coupon Bonds: 45 year zero coupon bonds issued by the Government in bearer form without collateral or guarantee, with an implicit interest rate of 9% per year. Redemption of the bonds will be based on Brazil's ability to pay (linked to the fiscal performance) and will take place through government held quarterly auctions at a discount. In case creditors do not make any bids or the bids submitted do not cover the full amount allocated for redemption, bonds to be redeemed will be selected by lottery. Additional funds would be made available for redemption for these bonds if (1) Brazil's GDP grows at least at a 7% annual rate for two succesive quarters; and (2) Brazil's international reserves (cash concept) exceed five times the monthly average amount of total imports in the preceding 12 months.

(ii) Interest Reduction Bonds: 25 year, bullet maturity bonds issued by the Government in bearer form without collateral or guarantee, with a 1.23% interest rate in the first year increasing to a 7% in the tenth year, after which it remains constant.

(iii) Exit Bonds: 15 year, bullet maturity bonds issued by the Government in bearer form without collateral or guarantee, with a 1.23% interest rate in the first year, increasing through the fourth year when it stabilizes at 3% per annum.

All these instruments could be used in Brazil's Privatization Program. Their eligibility for other types of conversions, e.g., debt for equity, debt for export, debt for nature, will be analyzed in the negotiation process.

4. The commercial banks responded to the Brazilian debt restructing plan with their "Principles of Negotiations" (attachment), in which, inter alia, they state that Brazil's proposal is unacceptable for negotiations. The commercial banks will be sending an economic mission to Brazil in the next few days to assess the assumptions under which the Brazilian Delegation presented alternative scenarios of the country's ability to pay in the future. The mission will then make its own projections about Brazil's ability to, and extent of servicing its debt. No dates for resumption of the negotiations have as yet been agreed.

5. As a result of the above, the IMF has postponed indefinitely Board discussions of Brazil's stand-by program (about US$2.0 billion). The new Board date will be linked to the IMF's determination that there is satisfactory progress in the debt negotiations. In the meantime, the IMF management will decide on whether it will issue the Board paper.

Attachments

cc: Messrs./Mmes.: Selowsky (LACCE), Kashiwaya (CFSVP); Elwan (CFSPS); Bock (OPNSV); Garcia (o/r), Vatnick (LA1CO); Shilling (CFSFA); LA1 Management Team; Debt Task Force.

The following are the main elements of Brazil's proposal:

1) Private sector external debt will be excluded from the debt to be restructured. Accordingly, as soon as possible, principal and interest on private sector external debt will be freely remitted abroad;

2) At the expiration of the "1988 Trade Commitment Letter" and the "1988 Interbank Commitment Letter," the short-term lines (trade and interbank) will become voluntary, provided a satisfactory solution is found for the funding of the foreign branches and agencies of Brazilian banks;

3) Interest owing to commercial bank creditors and accruing through December 31, 1990, or such later date in 1991 on which a new agreement becomes effective, and which has been or will be deposited at the Central Bank under Resolution 1564/89, will be paid with the proceeds of a bridge financing provided by such creditors. The amount of the bridge financing will be included in the debt to be restructured. Prepayments in 1991 in the amount of $427 million and in 1992 in the amount of $154 million may be supplemented by up to $1.0 billion of additional payment capacity not included in current projections of resources from external sources.

FAX TRANSMITTAL MEMO

TO: Antonio Pinheiro Neto

DEPT: [redacted] FAX #:

FROM: [redacted] PHONE:

NO. OF PAGES

consistent with the principle of payment only to the extent of real payment capacity. Brazil is interested in exploring with its bank creditors other options which are consistent with this principle.

I) Brazil Zero Coupon Bond

Debt available for exchange:
up to US$ 60.0 billion

Tenor: 45 years

Implicit interest rate:
9.0% p.a.

Form: bearer

Collateral: none

Redemption: The defined annual capacity to pay will be used to redeem bonds. Redemption will take place at quarterly auctions. If there are no bids or the bids submitted do not utilise the full amount available for redemption, bonds will be selected by lot for redemption.

Enhancement: If (i) GDP grows by 7% or more per quarter for two successive quarters and (ii) international reserves (cash concept) exceed 5 times the monthly average amount of imports in the preceding 12 months, such excess will be used for redemption of the Brazil zero coupon bonds at the succeeding quarterly auction.

(2)

OCT 16 '90 14:58

II) Interest Reduction Bond

Amount of debt available for exchange at par: up to US$ 60.0 billion

Tenor: 15 years, bullet

Interest Rate: Increasing through the 10th year when it stabilizes at the level of 7% p.a.

Form: bearer

Collateral: none

III) Exit Bond

Amount of debt available for exchange at par: up to US$ 60.0 billion

Tenor: 15 years, bullet

Interest Rate: Increasing through the 4th year when it stabilizes at the level of 3% p.a.

Form: bearer

Collateral: none

All instruments will be eligible for use in the National Privatization Program. The Brazilian government will issue specific rules to deal with other possible types of conversion (e.g. debt-to-equity, debt for export, debt for nature). The eligibility of debt instruments for use in these programs is a matter for discussion.

(3)

OCT 16 '90 14:58

BRAZIL EXIT BOND

Interest Rates

1991	1.23%
1992	1.38%
1993	2.75%
1994	3.00%
-	-
-	-
-	-
2005	3.00%

Amount: Up to U.S. $60 Billion
Tenor: 15 Years, Bullet
Form: Bearer

4

OCT 16 '90 14:58

BRADIL INTEREST REDUCTION BOND

Interest Rates

1991	1.23%
1992	1.38%
1993	2.75%
1994	3.88%
1995	4.63%
1996	5.00%
1997	5.00%
1998	6.00%
1999	6.25%
2000	7.00%
-	-
-	-
-	-
2012	7.00%

Amount: Up to U.S. $60 Billion
Tenor: 25 Years, Bullet
Form: Bearer

(5)

OCT.16 '90 14:59

Bankers Trust Company
280 Park Avenue, New York, New York 10017

Mailing Address:
P.O. Box 318, Church Street Station
New York, New York 10015

COMPANY NAME:	World Bank
CONTACT NAME:	Dmitrios Papageyis
FAX NUMBER:	202, 676-1691

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P01 BT CREDIT POLICY *02:24PM 90 15. 0

The Bank Advisory Committee welcomes Brazil's decision to meet formally to discuss Brazil's commercial bank external indebtedness.

The Committee recognizes the importance of the substantial economic reforms undertaken by Brazil's new democratic administration. Nevertheless, the Committee, in its role as advisor to Brazil and representative of the International Financial Community believes that Brazil's initial proposal does not represent a basis for negotiation because it does not satisfy the principles set forth below:

Ultimate Objective

Any future negotiation should have as its primary goal the restoration of Brazil's creditworthiness and its early return to the international financial markets. It is only through access to the voluntary capital markets that Brazil will achieve its investment and growth objectives.

Normalization

Prompt action to regularize the payment of interest going forward and an acceptable resolution to the interest arrears are prerequisites to substantive discussions between Brazil and the Committee.

Any proposal which simply capitalizes interest arrears into the stock of debt is not acceptable.

The Committee believes that negotiations should proceed in a manner consistent with the G-7 expectation that Brazil will resolve "its arrears problems with its external creditors in the context of the adoption of a formal IMF agreement".

Economic and Market Reality

Brazil must recognize what is viable in the marketplace. Although the Committee recognizes the need to understand Brazil's economic situation, the banking community cannot accept any financial plan whether or not derived from Brazil's "capacity to pay," wherein the financing, in its various forms, of Brazil's economic program is not shared by all of Brazil's creditor groups in an equitable manner.

Within the framework of the above principles, a marketable, voluntary restructuring of Brazil's external indebtedness would include a menu of options composed of, among other things, new money and debt and debt service reduction with the appropriate collateral. Such a package would enhance the value of Brazil's commercial bank debt.

Finally, any transaction must include satisfactory resolution of outstanding issues under the 1988 Agreements including, but not limited to, the payment of expenses and the waivers and amendments necessary for the privatization program.

The Committee looks forward to entering into discussions shortly with the Brazilian Delegation on the basis of these principles.

10. 15. 90 02:24PM *BT CREDIT POLICY P02

P03
A POLICY
URGENT * BT
10. 15. 90 02:24PM

BRAZILIAN EXTERNAL DEBT

(BY CREDITOR GROUP, AS OF DEC.90)

International Entities

World Bank, IFC

stock of debt	$8,306
interest	$715
principal payments	$1,338

IMF

stock of debt	$1,887
interest	$186
principal payments	$752

IDB

stock of debt	$2,396
interest	$177
principal payments	$244

Commercial Banks

Foreign Banks

Non-affected debt	
stock of debt	$1,367
interest	$144
amortizations	$386
MYDFA	
stock of debt	$22,600
interest	$2,082
amortizations	$0
Public Sector	
stock of debt	$18,000
interest	$1,658
amortizations	$0
New Money 88	
stock of debt	$3,900
interest	$359
Private Sector	
stock of debt	$800
interest	$74
Arrearages	
amount	$7,150
interest	$686

Brazilian Banks

Non-affected debt	
stock of debt	$344
interest	$35
amortizations	$61
MYDFA + Public Sector	
stock of debt	$6,500
interest	$599
amortizations	$0
Arrearages	
amount	$850
penalty interest	$67

Paris Club & Governm.Agencies

stock of debt	$12,125
interest	$1,071
Arrears (to Paris Club)	
principal	$2,850
interest	$1,580

Trade Lines - PS

outstanding	$10,800
interest	$1,029

Non Financial Institutions

Import Financing

stock of debt	
interest	
amortizations	

Currency Loans

stock of debt	
interest	
amortizations	

Other

Currency Loans

stock of debt	
interest	
amortizations	

Bonds

stock	
interest	
amortizations	

TOTAL $97,375

Assumptions:

a. stocks of debt and outstandings are estimates for Dec.90.
b. interest are estimates for the year of 1990
c. principal payments and amortizations for the year of 1990
d. arrearages ($ Bill) on MYDFA, Public Sector and New Money 88 are estimated as of Dec.90.
e. interest on arrears include 1989 and 1990 estimates.
f. according to old Paris Club agreements, 70% of the interest ar will be rescheduled and 30% will be paid during 1990 and 1991.

INTEREST PAYMENTS ON THE BRAZILIAN EXTERNAL DEBT
(ESTIMATED THROUGHOUT 1990)

World Bank, IFC	$715
IMF	$186
IDB	$177
Foreign Banks	
MYDFA	$2,082
Public Sector	$1,658
New Money 88	$359
Non-affected debt	$144
Private Sector	$74
Brazilian Banks	
MYDFA + Public Sector	$599
Non-affected debt	$35
Paris Club & Governm.Agencies	$1,071
Trade Lines - P3	$1,029
Non Financial Institutions	
Import Financing	$346
Currency Loans	$184
Other	
Currency Loans	$33
Bonds	$152
TOTAL	$8,843

15. 80 02:24PM *ST CREDIT POLICY P04

IBRAHIM ERIS

President of the Central Bank

Mr. Ibrahim Eris, 45 years old, was born in Turkey and is now a naturalized Brazilian. He has been appointed President of the Central Bank of Brazil and is one of the primary authors of President Collor's economic plan.

Mr. Eris was a professor at Vanderbilt and Rice Universities before he moved to Brazil in 1973 and became a professor of economics at the University of Sao Paulo. From 1973 to 1981 he was a senior economist with the National Economic Research Foundation (FIPE), and from 1979 to 1981 he served as an adviser to then-Minister of Planning Antonio Delfim Netto. Mr. Eris left the government in 1981 to work as consultant on the financial market for various companies. He has also published numerous articles on taxes and public finance.

Mr. Eris received a bachelor's degree from the Middle East University in Ankara. He holds a master's degree and a doctorate from Vanderbilt University.

file: bios
5/4/90

BBC

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

April 3, 1990

Dear Mr. President:

I have learned of your appointment as Alternate Governor for Brazil on the Boards of Governors of The World Bank Group. I realize this is incident to your responsibilities in your own Government, but I hope you will be in a position to actively participate in the affairs of the Bank Group, as well.

The Executive Directors, Officers and Staff of The World Bank Group believe very strongly in its development mission and in the battle against poverty. We look forward to working with you to make the Bank Group even more effective during the coming years. Congratulations on your appointment and thank you for your willingness to take on this additional responsibility.

I look forward to meeting you in the near future and send my best personal wishes.

Sincerely,

(Signed) Barber B. Conable

Mr. Ibrahim Eris
President
Banco Central do Brasil
Caixa Postal 04.0170
70074 Brasilia (DF), Brazil

cc: Mr. Wiesner

Mr. Choksi
Mr. Santos

ETSanidad/sar

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90 MAR 27 PM 2:26
OFFICE OF THE SECRETARY
AND SECRETARY

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EX MACHINE 612098 BCBR BR OU 611299 BCBR BR REF:DEORI/90008878-001.

FROM : BANCO CENTRAL DO BRASIL DEORI/90008878-00
1
TO : INTL.BK RECONSTRUCTION DEVELOPMENT

ATTN.MR. T.T.THAHANE - SECRETARY

DEORI/GABIN-90/027 - MARCH 26, 1990

I AM PLEASED TO INFORM YOU THAT HIS EXCELLENCY THE PRESIDENT OF THE REPUBLIC HAS APPOINTED MS. ZELIA MARIA CARDOSO DE MELLO, MINISTER OF

ECONOMY, FINANCE AND PLANNING, TO ACT AS GOVERNOR FOR BRAZIL BEFORE THE WORLD BANK GROUP AND MR. IBRAHIM ERIS, PRESIDENT OF CENTRAL BANK OF BRAZIL, TO ACT AS ALTERNATE GOVERNOR FOR BRAZIL BEFORE THE WORLD BANK GROUP.

SINCERELY YOURS,
CARLOS ALBERTO AMORIM JR.
HEAD OF THE DEPARTMENT FOR INTERNATIONAL
ORGANIZATIONS ANS AGREEMENTS - DEORI.
BANCENTRAL

BANCENTRAL
CXOE END OF MESSAGE

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ALT RTD FROM:SCGP

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TO- Executive Director
Country Director, Bank
Investments Director, IFC
File Credential

FROM - E. T. Sanidad
SECRETARY'S DEPARTMENT

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

April 3, 1990

Dear Madam Minister:

I was pleased to meet you yesterday in Montreal and to congratulate you personally on your appointment as Governor for Brazil on the Board of Governors of The World Bank Group. I realize this is incident to your responsibilities in your own Government, but I hope you will be in a position to actively participate in the affairs of the Bank Group as well.

The Executive Directors, Officers and Staff of The World Bank Group believe very strongly in its development mission and in the battle against poverty. We look forward to working with you to make the Bank Group even more effective during the coming years, and thank you for your willingness to take on this additional responsibility.

I hope to see you again at our Annual Meetings in September.

Best personal wishes.

Sincerely,

Barber Conable

Her Excellency
Zelia Maria Cardoso de Mello
Minister of Economy, Finance and Planning
Ministerio de Economia, Fazenda e Planejamento
Bloco P - 6 andar
70048 Brasilia (DF)
Brazil

copy of telex sent 1/5
BBC approved 1/4
file

WORLDBANK TMSS

WORLDBANK TMSS

ZCZC L1CC0115 L1RS0138
WDIAL
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-SUBJECT: CONGRATULATORY MESSAGE
-DRAFTED BY: ARMEANE M. CHOKSI EXT: 31811
-AUTHORIZED BY: BARBER B. CONABLE

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391 613382 =
-PRESIDENT-ELECT MR. FERNANDO COLLOR DE MELLO
-BRASILIA, BRAZIL
IBRDBRA
-GEORGE PAPADOPOULOS, RESIDENT REPRESENTATIVE
-BRASILIA, BRAZIL
BT
WASHINGTON DC - 4-JAN-90
ADDRESSED TO PRESIDENT-ELECT MR. FERNANDO COLLOR DE MELLO. ON BEHALF OF THE WORLD BANK, I WOULD LIKE TO CONGRATULATE YOU FOR YOUR VICTORY IN THE ELECTIONS FOR THE PRESIDENCY OF THE REPUBLIC OF BRAZIL. I WISH YOU EVERY SUCCESS IN THE CHALLENGING TASK YOU FACE TO SOLVE THE ECONOMIC AND SOCIAL PROBLEMS OF BRAZIL. THE WORLD BANK IS READY TO ASSIST YOU AND YOUR GOVERNMENT WITH THE DESIGN AND IMPLEMENTATION OF POLICY REFORMS AND LENDING OPERATIONS AIMED AT RESUMING BRAZIL'S ECONOMIC GROWTH. WITH BEST REGARDS, BARBER B. CONABLE, PRESIDENT, WORLD BANK.

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WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/05/05 DUE DATE : 00/00/00
LOG NUMBER : 890505004 FROM : E. Stern
SUBJECT : BRAZIL: Follow up to this morning's meeting (May 5).

OFFICE ASSIGNED TO FOR ACTION : (2) Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
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_____ PLEASE DISCUSS WITH _____
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__✓__ AS WE DISCUSSED
_____ RETURN TO (3) MF- file

COMMENTS :

May 5, 1989

Mr. Conable

Barber -

To follow-up on our conversation of this morning, regarding the Brazil project. What is at stake here is very simple and does not depend on whether the project design needs modification.

What is at stake is our whole system of policy-based lending. For many years, we made project loans without regard to the macro-economic framework, although we learned that the results of such projects were less than expected, we maintained the proposition that an excessively tight link to a satisfactory macro-economic performance, would penalize potentially useful operations in sectors less directly impacted by macro-economic distortions. However, at the same time, we decided that we would insist on improvements in macro-economic performance and the tools were policy-based lending. When we introduced sector loans, and we recently reaffirmed, that sector policy reforms could not stand by themselves. Quick disbursing financing in the absence of a sound macro-economic framework is unjustified.

To make an exception to this policy, will in effect eliminate the policy. On this point we ought to be clear. There is no discernible difference between a quick disbursing loan for, say, education reform in Egypt and what we are proposing to do in Brazil. Once we have established that sector lending can be disconnected from macro-economic performance, and that quick disbursing assistance can be provided explicitly to offset economic mismanagement, we have made every country eligible regardless of the performance. The consequences of this, for our credibility in the debt strategy, in the markets, and, in the long-term, with our borrowers is incalculable. It may make everyone feel better for the moment, but in the longer-term we will have taken ourselves out as an effective player.

Ernest Stern

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/05/05 DUE DATE : 00/00/00
LOG NUMBER : 890505003 FROM : Stanley Fischer
SUBJECT : Note - re Brazil's meeting of May 5.

OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

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_____ FOR YOUR REVIEW AND RECOMMENDATION
_____ FOR THE FILES
_____ PLEASE DISCUSS WITH _____
_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS :

The World Bank
Washington, D.C. 20433
U.S.A.

STANLEY FISCHER
Vice President Development Economics
and Chief Economist

DECLASSIFIED

OCT 20 2023

WBG ARCHIVES

Confidential.

May 5 1989

Mr. Barber Conable.

Mr. Conable:

Reflecting on this morning's meeting, it becomes clearer that if we let this loan go, we will be opening the door to many more such loans in which we lend into an inadequate macroeconomic environment.

Brazil's current very poor macroeconomic situation is bound to worsen, because they are holding the exchange rate down to keep inflation relatively low. The exchange rate is becoming progressively overvalued and will have to be devalued. At that point the inflation rate will jump. It will take a major new stabilization effort by Brazil to straighten out. That effort is nowhere in prospect now.

If we make this loan, we will be saying that we in fact do not consider an adequate macroeconomic framework a prerequisite for rapidly disbursing lending--because there cannot be a clearer case of an inadequate macroeconomic framework.

It cannot be in the Bank's interest to send that signal at a time when lending for debt reduction is about to get under way. And even leaving that aside, we should not make this loan.

Stan

Stanley Fischer

cc: Moeen Qureshi

(1) MH

Brazil

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/04/20 DUE DATE : 00/00/00
LOG NUMBER : 890420018 FROM : Mr. S.S.Husain
SUBJECT : Brazil - Proposed Environmental Reform and Energy Conservation Loan.
OFFICE ASSIGNED TO FOR ACTION : (2) Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
_____ PLEASE HANDLE
_____ FOR YOUR INFORMATION
__✓__ FOR YOUR REVIEW AND RECOMMENDATION
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_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO (3) Maria - file

COMMENTS :

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: April 20, 1989

TO: Mr. Barber B. Conable

FROM: S. Shahid Husain, Acting Senior Vice President, Operations

EXTENSION: 39001

SUBJECT: BRAZIL - Proposed Environmental Reform and Energy Conservation Loan

1. As you know, this loan has evolved from the Second Power Sector Loan which we had been discussing with the Government for over two years. That loan became the symbol of our relationship with Brazil which had deteriorated significantly--since we were seen as being inflexible and interfering in their domestic affairs. It was, therefore, vital to defuse this issue while preserving the gains made in the environmental area. The Brazilian Government has now agreed to substitute this Environmental Reform and Energy Conservation Loan for the Second Power Sector Loan. Thus, this loan is a transmutation of the Second Power Sector Loan which preserves some of its original components and characteristics including the quick-disbursing aspect. The latter is also justified on macro-economic and sectoral grounds. This loan package includes all of, and builds on the environmental provisions of the previous Second Power Sector Loan proposal, and has a much strengthened electricity conservation component. It therefore fully conforms to the guidelines and relevant parameters approved by the Regional Loan Committee in early September 1988 and the Operations Committee on October 19, 1988, when they cleared the loan package for the Second Power Sector Loan.

2. The principal objective of this loan is to continue improving the power sector's capability to address better, the environmental and sociological aspects of its investment program and to support the Government's priority for electricity conservation and distribution/loss reduction programs. This loan of US$325 million equivalent will, therefore, support the significant past efforts as well as the ongoing and future efforts by the Government in the implementation of sound environmental policies and energy conservation and demand management programs. The borrower would be the Federative Republic of Brazil; the implementing agencies would be ELETROBRAS and other Electric Power Companies.

3. The policy reforms under the proposed loan are an important precondition for rational investment decisionmaking in a sector where annual investments average around $5 billion. The environmental policy reforms to be undertaken are unique and unprecedented for any developing country, in terms of comprehensiveness as well as depth. The proposed loan (particularly its quick disbursing characteristic), will serve as a crucial bridge to maintain the momentum of past efforts undertaken by the Brazilian power sector in both the environmental and energy conservation areas. It will also enable the Government to implement on-going measures and maintain the necessary continuity of activity that will be picked up through planned future operations, including the proposed National Environment Loan, the

Electric Transmission and Conservation Loan and the Electric Distribution and Conservation Loan. The policy reforms and measures undertaken through this loan will significantly improve the efficiency of future investments in the power sector, and it would also come at a critical juncture when the Brazilian Government is prepared to assume the additional short-run costs of environmental protection and energy conservation despite the country's difficult economic and financial situation.

4. The proposed loan will make it possible for the Government to undertake a number of difficult and urgent policy adjustments and costly administrative and implementation measures on the environmental side, including: crucial studies that will influence imminent decisions on the next generation of large power projects in the "Plano 2010"; action plans to implement environmental and resettlement related mitigatory measures arising from several large hydroelectric dams that were built in the recent past; generally expand institutional capability to regulate, monitor and implement the Environmental Master Plan; support and facilitate the work of the newly created federal environmental agency, IBMA, in its role of monitoring and licensing power projects; and strengthen Government capability to deal with environmental and safety issues relating to the nuclear power program.

5. On the conservation side, the loan will consolidate the fundamental policy shift in the power sector that recognizes the critical role of demand management and conservation as a cost effective alternative to building new power supply facilities. Specific policy measures and actions to be supported by this loan under the Electricity Conservation Program (PROCEL) and the Distribution Rehabilitation and Loss Reduction Program (DRELOR), include: economically efficient levels and structure of tariffs; load management; industrial energy conservation; equipment performance, codes, standards and legislation; institutional strengthening and staffing for energy conservation research and development; educational and advertising campaign for energy conservation; and distribution rehabilitation and loss reduction.

6. The main quantifiable benefits attributable to this loan during the period 1989-92 arise from the implementation of the electric energy conservation policy measure and action plans included in the PROCEL and the Distribution Rehabilitation/Loss Reduction programs. Such implementation is expected to reduce sector financial requirements by about US$1.0 billion during each of the years under consideration. This is equivalent to approximately 0.3% of the 1988 GDP and 8% of the 1988 operational fiscal deficit. The main non-quantifiable benefits stem from environmental policy reforms and actions supported by the proposed loan. It is expected that such measures and actions will result in better use of natural resources, avoidance or reduction of environmental costs associated with power projects, and rationalization of the long-term power sector investment program averaging about $5 billion per year.

7. It is our view that the proposed loan is an important operation and the first of its kind--it will support fundamental policy and institutional reforms that would contribute to improving the quality and pattern of economic development. It would demonstrate quite visibly, that sound environmental policy measures and economic development are mutually

reinforcing. This loan, therefore, constitutes a major and radically different approach to environmental policy reform in Brazil and is a watershed in the Bank's relationship with Brazil on environmental issues. It is our view that we must make every effort to proceed with it. Otherwise we risk losing the confidence of the Brazilians who now wish to engage us in a wide variety of environmental policy changes and programs.

8. Like all other adjustment operations, the submission of this loan to the Board will be subject to the satisfactory performance of the Brazilian economy. We will continue to consult with the Fund and make a determination, closer to the date of Board Presentation, whether the macroeconomic situation warrants our moving forward with this operation.

cc: Mr. Moeen A. Qureshi, o/r

AMChoksi/MMunasinghe:sk

For May 5, 1989

Background Note: Brazil Environmental Reform and Energy Conservation Loan

Proposed Loan

$ 325 million quick disbursing in two equal tranches over six months period.

Loan would be disbursed against acceptable general imports.

Preliminary interest of Japan to cofinance $ 325 million.

On the environmental side, the loan would support the implementation of the Environmental Master Plan (EMP) as defined in the previous Second Power Loan. The difference is that counterpart funds would be available for the EMP instead of the financing of the Power Sector Rehabilitation Plan. This loan expands on the previous loan in terms of more specific conservation and loss reduction measures although the thrust of these actions was also contained in the Second Power Loan.

Government would make available necessary funds to implement electricity conservation program ($ 60 million), distribution loss reduction program ($ 70 million), resettlement activities ($ 145 million) and institutional strengthening ($ 195 million).

Main actions to be taken under loan include:

On environmental side

- strengthening of environmental staffing of Eletrobras, Federal Environmental Agency, and Indian Agency (FUNAI);
- EMP monitoring and evaluation system;
- satisfactory EMP implementation including funding of action programs of regional power companies;
- satisfactory implementation of indian components of power projects;
- studies and update of the EMP;
- strengthen capabilities to deal with environmental and safety aspects of nuclear program.

On electricity conservation side:

- progress on Integrated Energy Strategy Study;
- implementation of distribution and Loss Reduction program (DRELOR) and of conservation program (PROCEL);
- electricity priced at long run marginal cost.

Report argues that significant actions have been taken to date including institutional strengthening of Eletrobras and federal environmental agencies, environmental action plans by power companies, preparation of conservation program.

ANNEX I

May , 1989

From: Vice President and Secretary

NOTICE OF INVITATION TO NEGOTIATE

BRAZIL

ENVIRONMENTAL REFORM AND ENERGY CONSERVATION LOAN

The Bank is inviting the Government of Brazil to send representatives to Washington, D.C. to negotiate a proposed loan of US$325 million equivalent in support of the government's program of Environmental Reform and Energy Conservation.

The loan would be disbursed against acceptable general country imports.

Distribution

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council
Directors and Department Heads, Bank and IFC

For May 4, 1989

Brazil Environmental Reform and Energy Conservation Loan
Issues for Discussion

First In opening mention that three general issues must be addressed:

- The lack of a satisfactory macro-economic framework for a fast disbursing loan and the extent to which a Sector Adjustment Loan can be delinked from the macro-economic environment;

- Quick disbursing. Many of the activities involved in the operations require sustained implementation over a long period of time. Are the fully quick disbursing nature, the conditionality and the timing of the tranching (as little as 6 months) of the loan appropriate?

  Content. Does the content of the loan address appropriately major environmental policy issues?

Macro Issues

Second Ask Messrs. Qureshi, Stern and Fischer:

- under which circumstances could a sector adjustment loan go ahead in the absence of a satisfactory macro economic framework?

- What would be the precedent established for other countries if the proposed loan went ahead?

Third Ask Mr. Qureshi what has been implicitly agreed to date with the Brazilians?

Quick Disbursing

There has been progress in the implementation of the Environmental Master Plan even in the absence of the Second Power Loan (demand projections are being scaled down and some damaging power projects have been postponed or shelved through application of new environmental review process). It is also clear that the loan contains some important policy emphasis on electricity conservation rather than system expansion as in the previous loan. This, combined with some of the policy conditionality for the second tranche, could a priori justify a quick disbursing component to the loan.

However, a large part of the conditionality is associated with actions which require sustained implementation over a long period of time (such as institutional development, implementation of resettlement projects or the rehabilitation of the distribution loss reduction program).

Fourth - Are the timing and level of specificity of the tranches appropriate considering that most of the loan conditionality relates to implementation activities?

- To which extent would the impact of the loan be enhanced by being a hybrid loan rather than a fast disbursing loan? (NOTE: a hybrid loan would require similar fulfillment of macro conditionality as fully fast disbursing loan)

- How much time would be required to prepare a loan to finance a time slice of investments?

Content

This operation only addresses environmental issues associated with electricity generation. It is not a broad environmental reform loan as suggested by the title of the Operation, and it does not represent a significant departure in content from the previous loan. Considering time pressure, conditionality could expand to deal with regulatory and legislative aspects related to environmental impacts of alcohol program, Carajas iron ore, zoning and further strengthening of state level environmental agencies.

Fifth - Can the scope of the operation be broadened to cover a broader set of environmental policy conditions which would set more appropriately the stage for the upcoming National Environmental Loan?

The operation could adopt two positions in relation to the nuclear program: maintain distance or get involved into the definition of environmental safeguards. The operation has chosen the second course.

Sixth - To which extent could this lead to a Bank implicit endorsement of the environmental and safety aspects of the Angra I and II plants? Should the Bank get involved at all?

The actual implementation of the EMP depends on a large number of institutions, many of which are either new (such as the new Federal Environmental Agency) or have a poor track record to date (such as FUNAI). The loan document and conditionality do not provide sufficient criteria to assess satisfactory progress by these institutions.

Seventh - What can be done to strengthen Bank capacity to monitor appropriate implementation and institutional strengthening?

BBC

The World Bank
Washington, D.C. 20433
U.S.A.

Office of the President

May 3, 1989

Messrs. Hopper, Qureshi, Shihata, Stern & Fischer

I understand that the Operations Committee will meet on the Brazil Environmental Reform and Energy Conservation Loan on Friday afternoon, May 5.

I would appreciate an informal exchange of views, during our 3:00 p.m. meeting tomorrow (May 4), on a number of related issues which are also raised in the attached note from Mr. Qureshi:

(a) Under what circumstances can and should we go ahead with a Sector Adjustment Loan when a macro-economic framework satisfactory to us is not in place, nor is likely to be in place in the foreseeable future?

(b) To what extent must the Brazil Environmental Reform and Energy Conservation Loan be implemented as a fast-disbursing Sector Adjustment Loan, as compared to a hybrid or investment-type loan?

I believe that we should deviate from "an acceptable macro-economic framework" only under very exceptional circumstances and after both Operations and PPR have confirmed that the substance and importance of the sectoral measures being undertaken, both in the environmental and energy conservation field, are so substantial that they outweigh the lack of a macro-economic framework. I do not want to prejudge the Operations Committee discussion on this matter but would like you to address these issues in a general way.

Barber Conable

*MH

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/05/02 DUE DATE : 00/00/00
LOG NUMBER : 890503001 FROM : M. Qureshi
SUBJECT : BRAZIL: Environmental Reform and Energy Conservation Loan.

OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
_____ PLEASE HANDLE
_____ FOR YOUR INFORMATION
__✓__ FOR YOUR REVIEW ~~AND RECOMMENDATION~~
_____ FOR THE FILES
__*✓__ PLEASE DISCUSS WITH BBC for decision of approval.
_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS :Action needed on attached. MAQ would like to discuss w/BBC.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

Mr. Conable

Barber: Herewith some more information on the issues you had raised. We need your decision on how we should proceed. Could we discuss. Moeen 5/2

DATE: May 2, 1989

TO: Mr. Barber B. Conable

FROM: Moeen A. Qureshi

EXTENSION: 73665

SUBJECT: Brazil: Environmental Reform and Energy Conservation Loan

1. At the time the Second Power Sector Loan was first designed and prepared in 1986-87, the Bank's major concern about the sector was its financial capacity to carry out a major investment program. Emphasis was placed on the adequacy of tariffs, the development of a least cost investment program and the financing of that program. The Bank was also concerned about the environmental impact of power sector development in the context of the First Power Sector Loan and it had thus required the preparation of an Environmental Master Plan (EMP) for the sector and the start of institutional development programs. These reforms were to be continued as one of four elements of the Second Power Sector Loan; however, the principal emphasis of that operation was to financially rehabilitate the power sector and to equip it to undertake a large-scale new investment program. Now, in the Environmental Reform and Energy Conservation Loan, we are no longer giving priority to new generation but rather to policies and actions associated with crucial environmental issues and energy conservation designed to achieve much greater effective use of current generation capacity and to defer new investment.

2. The Environmental Reform and Energy Conservation Loan represents a significant reorientation of the Bank's approach to the power sector in Brazil. In the relatively short period of time since it was initiated, the EMP has grown from an ancillary program designed to protect against the adverse environmental and social impact of the power sector investment program, to--in this new loan--a substantial undertaking affecting all project selection, design and implementation decisions. It has moved from an exercise in the preparation of guidelines to a full-fledged over-arching policy framework in this loan which now includes the actual implementation of operational environmental and social programs. Making the policy framework of the environmental program the central focus of this operation has permitted us to increase--over what was in the Second Power Sector Loan--the depth, specificity and details associated with the environmental and social programs and their respective budgets for all power companies. This operation is now a far more effective instrument for supporting and monitoring the actual implementation of the environmental program than the Second Power Sector Loan. It will thus be the umbrella operation that will set the policy framework on environmental issues for all future investment made in the power sector not only by the Bank, but also by the Brazilians and the bilaterals (e.g., the Japanese).

3. To reenforce this change in emphasis and priority, the scope of the Environmental Reform and Energy Conservation Loan has been significantly modified from that of the Second Power Sector Loan. In addition to putting significantly greater emphasis on the environmental

component, a substantial and new conservation component has been added to the project with attendant conditionality; these were not in the Second Power Sector Loan. This strengthens the reorientation of our approach. This conservation component complements and supports the environmental protection program. A major part of the expansion program under the Second Power Sector Loan would have been some hydroelectric development in the Amazon; as a result of the conservation policy measures included in this loan, such new investments would have to be postponed or cancelled with substantial environmental benefits. The implementation of the conservation component will result in investment savings during the 1989-1992 period of about US$1.0 billion per year, or the equivalent of deferring the installation of 800 MW of additional generating capacity and corresponding transmission/distribution facilities in each of the above years.

4. The conservation component of this loan also includes a program for distribution rehabilitation and loss reduction. In addition to a variety of measures to strengthen the conservation and loss reduction programs, the Government actions to be undertaken include increased funding for these activities and raising tariffs to the level of long run marginal costs and improving their structure so as to promote energy conservation. The policy initiatives and programs supported by this operation will lay the necessary foundations for, and will be sustained in a planned series of appropriately designed conservation and investment loans to follow. This would not have been accomplished under the Second Power Sector Loan.

5. Because of the urgency of the environmental problems in the power sector, the proposed loan is virtually an emergency operation, necessary to regain momentum in ongoing environmental and conservation programs and to allow for their further expansion. This loan will also enhance the Bank's credibility in the areas of environmental and conservation reform.

cc: Messrs. Husain (o/r) (LACVP), Choksi (LA1DR), Weissman (LA1DR)
Munasinghe (LA1IE)
Ms. Koch-Weser (LA1CO)

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: April 21, 1989

TO: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 39001

SUBJECT: BRAZIL - Proposed Environmental Reform and Energy Conservation Loan: Green Cover Package

1. Please find attached for your review, the Green Cover Report and Recommendation of the President for the Environmental Reform and Energy Conservation Loan, for which a quick disbursing US$325 million loan to the Federal Government of Brazil is recommended. The draft Green Cover package was reviewed and cleared by the Regional Loan Committee on April 19, 1989. This Green Cover package has been revised to incorporate comments made at the Regional Loan Committee meeting. The report has been cleared by the regional procurement advisor, the environmental unit, and the Bank's lawyer and disbursement officer for Brazil. Our current timetable is to present this loan to our Board on June 8, assuming that we receive authorization to negotiate by May 1.

2. As you know, this loan has evolved from the Second Power Sector Loan which we had been discussing with the Government for over two years. That loan became the symbol of our relationship with Brazil which had deteriorated significantly, since we were seen as being inflexible and interfering in their domestic affairs. It was, therefore, extremely important to defuse this issue while preserving the gains made in the environmental area. The Brazilian Government has now agreed to substitute this Environmental Reform and Energy Conservation Loan for the Second Power Sector Loan. This operation is, therefore, a transmutation of the Second Power Sector Loan which preserves some of its original components and characteristics including the quick-disbursing characteristic. The latter is also justified on macro-economic and sectoral grounds (see paras. 4.04-4.07 in the report). This loan package includes all the environmental provisions of the previous Second Power Sector Loan proposal and a much strengthened electricity conservation component. It, therefore, fully conforms to the guidelines and the relevant parameters approved by the Operations Committee on October 19, 1988, when the loan package for the Second Power Sector Loan was cleared.

Current Macroeconomic Situation

3. The macroeconomic situation three months after the initiation of the Summer Plan is fragile. However, the Government began the second phase of the Plan on April 15th with the announcement of a midi-devaluation of 3.1%, and selected price adjustments of between 3% and 18%. The Government is also introducing a new index (BTN) which will be used to index selected financial instruments in order to maintain their value as at February 1, 1989. There is discussion of reindexing the exchange rate and financial instruments, although the full details are

yet to be announced. The Government has also proposed a wage adjustment of about 14% to offset real wage declines since the beginning of the Plan. These measures are broadly in line with the Government's commitment to undertaking mid-course corrections to ensure that the Summer Plan's principal objectives of controlling inflation are met, if also supplemented by additional fiscal measures which will strengthen the Plan's fundamentals. We expect these mid-course corrections to continue to be made in the coming weeks.

4. An IMF mission which was in Brazil evaluating the Government's 1989 program has just returned. It is expected to return to Brazil in 2-3 weeks after the Government announces some new measures. We will also be sending our own macroeconomic assessment mission to Brazil and we expect to have a view on the macroeconomic situation in May. The IMF's assessment of the macroeconomic situation will be an important element in our final judgment. We are coordinating and will continue to coordinate very closely with the IMF on the assessment of the macroeconomic situation. An IMF waiver of the current Stand-by Arrangement targets or approval of the 1989 program on the part of the IMF would be a necessary but not a sufficient condition for a positive evaluation on our part. We do not intend to present this loan to the Board until the Bank has determined that a satisfactory macroeconomic program is being implemented. However, in accordance with the latest agreement on Bank-Fund collaboration, we will coordinate our positions with the IMF on the macroeconomic program. The external financing program is attached (Table I). We will update the macroeconomic part of the report prior to Board presentation.

Loan Objectives

5. The principal objective of this loan is to continue improving the power sector's capability to address better, the environmental and sociological aspects of its investment program and to support the Government's priority for electricity conservation and distribution/loss reduction programs. This loan of US$325 million equivalent will, therefore, support the significant past efforts as well as the ongoing and future efforts by the Government in the implementation of sound environmental policies and energy conservation and demand management programs. The borrower would be the Federative Republic of Brazil; the implementing agencies would be ELETROBRAS and other Electric Power Companies.

6. This loan constitutes a major and radically different approach to environmental policy reform in Brazil and is a watershed in the Bank's relationship with Brazil on environmental issues. The policy reforms under the proposed loan are an important precondition for rational investment decision making in a sector where annual investments average around $5 billion. The environmental policy reforms to be undertaken are unique and unprecedented for any developing country, in terms of comprehensiveness as well as depth. They will demonstrate quite visibly that sound environmental policy measures and economic development are mutually reinforcing.

7. The proposed loan (particularly its quick disbursing characteristic), will serve as a crucial bridge to maintain the momentum

of past efforts undertaken by the Brazilian power sector in both the environmental and energy conservation areas. It will also enable the Government to implement on-going measures and maintain the necessary continuity of activity that will be picked up through planned future operations, including the proposed National Environmental Loan, the Electric Transmission and Conservation Loan, and the Electric Distribution and Conservation Loan. The policy reforms and measures undertaken through this loan will significantly improve the efficiency of future investments in the power sector. It would come also, at a critical juncture when the Brazilian Government is prepared to assume the additional short-run costs of environmental protection and energy conservation despite the country's difficult economic and financial situation.

8. The loan amount of $325 million is based on our estimate of the costs associated with the different components of the loan. It would be disbursed in two equal tranches of $162.5 million each, separated by an interval of at least six months.

Attachments

cc: Messrs./Mmes. S. Weissman (LA1DR); P. Bottelier (LA4DR); P-C. Loh (LA3DR);R. Steckhan, (LA2DR); E. Wessels (LATDR); E. Segura, M. Selowsky, M. Linder, C. Quijano, M. Garcia-Zamor, A. Pimenta-Neves, G. Dolenc (LACVP); R. Goodland, S. Davies (LATEN); R. Moscote, C. Khelil (LATIE); G. Nankani, M. Koch-Weser, R. Coutinho (LA1CO); N. Birdsall (LA1HR); P. Pomerantz (LA1AG); Papageorgiou (LA1TF); Papadopoulos (LA1BR); R. Bates o/r, J. Vietti, J. Larrieu o/r, C. Velez (LA1IE); E. Jaycox (AFRVP); A. Karaosmanoglu (ASIVP); W. Thalwitz (EMNVP); E. Stern (FINSV); D. Hopper (PPRSV); T. Baudon (OPNSV); J. Wood (FPRVP); I. Shihata (LEGVP); V. Rajagopalan (PREVP); M. Haug (EXC); S. Fischer (DECVP); T. Thahane (SECGE); S. Burmester (SECGE);F. Aguirre-Sacasa (EXTDR); R. Frank (CFPVP); J. Parmar (CIOVP); C. Sethness (CCMDR); E. Santos (CL2DR); V. Dubey (2), S. Rajapatirana (EAS); D. Bock (DFS); H. Vergin (OPNSV); A. Shakow (2) (SPRDR); D. Lee (CODDR); J. Holsen (3) (CECDR); J. Baneth (IECDR); A. Churchill (IENDR); D. C. Rao (2) (FRS); D. Goldberg (LEGOP); R. Barahona (LOAEL); J. F. Collell, E. Abbott (LEGLA); A. Steer (FRS); R. Liebenthal (SPRPA); R. Agarwala (AFTSE); Regional Staff, (IMF); LACIC: Internal Documents Unit (3)

AMChoksi/MMunasinghe:sk

TABLE 1

BRAZIL - BALANCE-OF-PAYMENTS PROJECTIONS (1989-1991)

(Policy Adjustment Scenario) /a

(US$ Billions)

	1989	1990	1991
Trade surplus	14.5	13.0	13.5
Gross interest payments	10.6	10.4	10.6
Current account	0.9	-0.6	-0.8
Direct Foreign Investment	1.0	1.1	1.4
Other Capital	-1.2	-1.2	-1.2
Net IMF/e	-0.9	-0.8	-0.6
Inc. Reserves	-1.2	-1.2	-1.3
(1) Net Borrowing /b	1.4	2.7	2.5
World Bank			
Disbursements	1.3	1.6	1.6
Amortization	1.1	1.2	1.3
Net	0.2	0.4	0.3
Other multilateral			
Disbursements	0.5	0.5	0.5
Amortization	0.3	0.3	0.3
Net	0.2	0.2	0.2
Bil. & Suppliers			
Disbursements	3.5	5.8	5.1
Amortization	3.9	5.5	4.8
Net	-0.4	0.3	0.3
Other			
Net	-0.6	-0.2	-0.1
Commercial Banks/d			
Disbursements	2.0	2.0	1.8
Amortization	0	0	0
Net	2.0	2.0	1.8
[Memo item Reserves/Imports ratio (months)]	5.4	5.6	5.5
Simulations			
(2) Additional financing needs due to:/c	.6	.7	.5
Increase in LIBOR (2 percentage points)	1.8	1.8	1.8
No Increase in reserves	-1.2	-1.1	-1.3
Reserves/Imports ratio (months)	4.7	4.4	3.9
Total Net Financing (1+2)	2.0	3.4	3.0

/a Mid-course macroeconomic policy adjustments undertaken shortly to shore up the Summer Plan, and maintain through 1991 and beyond.

/b Borrowing needed to complete balance of payments financing. Assumes refinancing of amortization payments due bilateral and suppliers. Includes the effects of the 1988 commercial banks financing package.

/c Increase in the financing gap due to a 2 percentage point rise in LIBOR partly compensated by no increase in reserves.

/d The 1989 disbursement of the second and third tranches of the commercial bank package will amount to US$1.2 billion.

/e Assumes no IMF program. An IMF program with net disbursements equal to scheduled amortization payments would reduce commercial banks net disbursements by the same amount.

WP#IBM-944/wlt
Legal Department
CONFIDENTIAL DRAFT
(Subject to Change)
EAbbott
April 24, 1989

DECLASSIFIED

OCT 26 2023

WBG ARCHIVES

LOAN NUMBER BR

LOAN AGREEMENT

(Environmental Reform and Energy Conservation Loan)

between

FEDERATIVE REPUBLIC OF BRAZIL

and

INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

Dated , 1989

LOAN AGREEMENT

AGREEMENT, dated _____, 1989, between FEDERATIVE REPUBLIC OF BRAZIL (the Borrower) and INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS (A) the Bank has received a letter dated _____, 1989 from the Borrower describing a program of actions, objectives and policies designed to achieve substantial improvements in the protection and preservation of the Borrower's environment and Amerindian population and to promote energy conservation (hereinafter called the Program), declaring the Borrower's commitment to the execution of the Program, and requesting assistance from the Bank in the financing of urgently needed imports required during such execution; and

(B) on the basis, inter alia, of the foregoing, the Bank has decided in support of the Program to provide such assistance to the Borrower by making the Loan in two tranches as hereinafter provided;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Loan and Guarantee Agreements" of the Bank, dated January 1, 1985, with the modifications thereof set forth below (the General Conditions) constitute an integral part of this Agreement:

(a) Section 2.01, paragraph 11, shall be modified to read:

"'Project' means the imports and other activities that may be financed out of the proceeds of the Loan pursuant to the provisions of Schedule 1 to the Loan Agreement.";

(b) Section 9.07 (c) shall be modified to read:

"(c) Not later than six months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Bank, the Borrower shall prepare and furnish to the Bank a report, of such scope and in such detail as the Bank shall reasonably request, on the execution of the program referred to in the Preamble to the Loan Agreement, the performance by the Borrower and the Bank of their respective obligations under the Loan Agreement and the accomplishment of the purposes of the Loan."; and

(c) The last sentence of Section 3.02 is deleted.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) "SITC" means the Standard International Trade Classification, Revision 3 (SITC, Rev. 3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev.3 (1986);

(b) "Angra Plants" means the nuclear power plants located in Angra dos Reis, State of Rio de Janeiro, and "Angra I" and "Angra II" mean the Angra Plants so designated by the Borrower;

(c) "CCMA" means Comite Consultivo de Meio Ambiente, ELETROBRAS' Environmental Advisory Committe;

(d) "CEAL" means Companhia Energerica de Alagoas;

(e) "CELPA" means Centraia Elétricas do Pará S.A.;

(f) "CELPE" means Companhia de Eletricidade de Pernambuco;

(g) "CEMAT" means Companhia Energética do _____;

(h) "CEMAR" means Centrais Elétricasdo Maranhao S.A.

(i) "COELCE" means Companhia de Elétricas do Maranhao S.A.

(j) "CEMIG" means Companhia Energética de Minas Gerais;

(k) "Central Bank" means Banco Central do Brasil;

(l) "PROCEL" means Energy Conservation Program set forth in the Borrower's Portaria Interministerial No. 1877, dated

December 30, 1985, and published in the Diario Oficial da União of December 31, 1985, as amended to the date of this Agreement;

(m) "CEPISA" means Centrais Eletricas do Piaui S.A.

(n) "CERON" means Centrais Elétricas de Rondônia S.A.;

(o) "CESP" means CESP-Companhia Energética de São Paulo;

(p) "ELETROPAULO" means Eletricidade de São Paulo S.A.;

(q) "CHESF" means Companhia Hidro Elétrica do São Francisco, a subsidiary of ELETROBRAS;

(r) "CNE" means Comissão Nacional de Energia, the Guarantor's National Energy Commission;

(s) "CEEE" means Companhia Estadual de Energia Elétrica;

(t) "Company" means any of the Electric Power Sector Companies referred to individually;

(u) "COMASE" means Comité Coordinador das Atividades de Meio Ambiente do Setor Elétrico, the Coordination Committee for Environmental Activities of the Electric Power Sector;

(v) "COPEL" means Companhis Paranaense de Energia;

(w) "LIGHT" means Light-Serviços de Eletricidade S.A.

(x) "COSERN" means Companhia de Serviços Elétricos do Rio Grande do Norte;

(y) "Cruzado Novo" and "NCZ$" mean the currency of the Borrower;

(z) "ELETROBRAS" means Central Eletricas Brasileiras S.A. - ELETROBRAS;

(aa) "SEMA" means Secretaria Especial do Meio Ambiente, the Guarantor's Special Secretariat for the Environment;

(bb) "DNAEE" means Departamento Nacional de Águas e Energia Elétrica, a department of the Borrower's Ministry of Mines and Energy;

(cc) "Electric Power Sector Companies" means all federal and state entities operating in the generation, transmission and distribution of electricity in Brazil, including ELETROBRAS but excluding Itaipú;

(dd) "ELETRONORTE" means Centrais Elétricas do Norte do Brasil S.A., a subsidiary of ELETROBRAS;

(ee) "ELETROSUL" means Centrais Elétricas do Sul do Brasil S.A., a subsidiary of ELETROBRAS;

(ff) "ENERSUL" means Empresa de Energia Elétrica do Mato Grosso do Sul S.A.;

(gg) "IAEA" means _____;

(hh) "Environmental Protection Master Plan" and "EMP" means the environmental protection master plan approved by ELETROBRAS on _____, ____ as amended to the date of this Agreement;

(ii) "FURNAS" means FURNAS-Centrais Elétricas S.A., a subsidiary of ELETROBRAS;

(jj) "FUNAI" means Fundação Nacional do Indio;

(kk) "IBDF" means _____;

(ll) "IESS" means the integrated energy strategy study being carried out by CNE under terms of reference dated _____;

(mm) "IBMA" means _____;

(nn) "ISP" means Institutional Strengthening Program, the Borrower's Program for strengthening certain capabilities of Federal and State level Environmental Agencies related to specific tasks of the Electric Power Sector, agreed upon between the Borrower and the Bank, as set forth in letter from the Borrower to the Bank dated _____, 1989;

(oo) "Loan No. 2138 BR" means the loan provided under Loan No. 2138 BR Agreement (ELETROBRAS I Power Distribution Project) entered into between the Bank and ELETROBRAS on May 12, 1982, such Loan Agreement, as amended, hereinafter called the "Loan Agreement No. 2138-BR";

(pp) "Loan No. 2364 BR" means the loan provided under Loan Agreement No. 2364 BR (Eletrobras II Power Distribution Project) entered into between the Bank and ELETROBRAS on December 14, 1983, such Loan Agreement, as amended, hereinafter called the "Loan Agreement No. 2364 BR";

(qq) "States" means, individually and collectively, any state of the Borrower;

(rr) "Environmental Commitment Letter" means the letter sent by each Company to ELETROBRAS in November 1988, setting their commitment to carry out the EMP and the specific environmental and Amerindian population protection plans and programs of each of such Companies;

(ss) "Itaparica Resettlement Project" means the project described in Schedule 2 to Loan Agreement No. 2883 BR between the Bank and ELETROBRAS, dated December 7, 1987, as such description may be amended from time to time by agreement between the Bank and ELETROBRAS;

(tt) "DRELOR" means the distribution network rehabilitation and loss reduction programs contained in the projects described in Loan Agreements No. 2138-BR and 2364-BR; and

(uu) "DRELOR Beneficiaries" means CERON, ELETRONORTE, CEMAR, CEPISA, CEAL, LIGHT, ELETROPAULO, COSERN, COELCE, CELPE, ENERSUL and CELPA, the Electric Power Sector Companies participating in the execution of DRELOR.

ARTICLE II

The Loan

Section 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Loan Agreement, various currencies that shall have an aggregate value equivalent to the amount of three hundred twenty five million dollars ($325,000,000), as the sum of withdrawals of the proceeds of the Loan with each withdrawal valued by the Bank as of the date of such withdrawal.

Section 2.02. The amount of the Loan may be withdrawn from the Loan Account in accordance with the provisions of Schedule 1 to this Agreement.

Section 2.03. The Closing Date shall be _____ or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower of such later date.

Section 2.04. The Borrower shall pay to the Bank a commitment charge at the rate of three-fourths of one percent (3/4 of 1%) per annum on the principal amount of the Loan not withdrawn from time to time.

Section 2.05. (a) The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time at a rate per annum for each Interest Period equal to one-half of one percent per annum above the Cost of Qualified

Borrowings for the last Semester ending prior to the commencement of such Interest Period.

(b) As soon as practicable after the end of each Semester, the Bank shall notify the Borrower the Cost of Qualified Borrowings for such Semester.

(c) For purposes of this Section:

(i) "Interest Period" means the six-month period commencing on each date specified in Section 2.06 of this Agreement, including the Interest Period in which this Agreement is signed.

(ii) "Cost of Qualified Borrowings" means the cost of the outstanding borrowings of the Bank drawn down after June 30, 1982, expressed as a percentage per annum, as reasonably determined by the Bank.

(iii) "Semester" means the first six months or the second six months of a calendar year.

Section 2.06. Interest and other charges shall be payable semiannually on _____ and _____ in each year.

Section 2.07. The Borrower shall repay the principal amount of the Loan in accordance with the amortization schedule set forth in Schedule 2 to this Agreement.

[Section 2.08. (a) Central Bank is designated as representative of the Borrower for the purposes of taking any action

required or permitted to be taken under the provisions of Section 2.02 of this Agreement and Article V of the General Conditions.

(b) Without limitation or restriction to the foregoing, the Borrower hereby entrusts Central Bank with responsibility for the preparation of withdrawal applications under the Loan and for the collection of the documents and other evidence to be furnished to the Bank in support of such applications; such withdrawal applications shall to the extent practicable be consolidated so as to apply for withdrawal of aggregate amounts of not less than $5,000,000 equivalent.

ARTICLE III

Particular Covenants

Section 3.01. (a) The Borrower and the Bank shall from time to time, at the request of either party, exchange views on the progress achieved in carrying out the Program and the actions specified in Schedule 4 to this Agreement.

(b) Prior to each such exchange of views, the Borrower shall furnish to the Bank for its review and comment a report on the progress achieved in carrying out the Program, in such detail as the Bank shall reasonably request.

Section 3.02. Except as the Bank shall otherwise agree, procurement of the goods to be financed out of the proceeds of the Loan shall be governed by the provisions of Schedule 3 to this Agreement.

Section 3.03. (a) The Borrower shall maintain or cause to be maintained separate records and accounts adequate to reflect in accordance with consistently maintained sound accounting practices the expenditures financed out of the proceeds of the Loan.

(b) The Borrower shall:

(i) have the records and accounts referred to in paragraph (a) of this Section for each fiscal year audited, in accordance with appropriate auditing

principles consistently applied, by independent auditors acceptable to the Bank;

(ii) furnish to the Bank as soon as available, but in any case not later than four months after the end of each such year, a certified copy of the report of such audit by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and

(iii) furnish to the Bank such other information concerning said records and accounts and the audit thereof as the Bank shall from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Loan Account were made on the basis of statements of expenditure, the Borrower shall:

(i) maintain or cause to be maintained, in accordance with paragraph (a) of this Section, records and accounts reflecting such expenditures;

(ii) retain, until at least one year after the Bank has received the audit report for the fiscal year in which the last withdrawal from the Loan Account was made, all records (contracts, orders, invoices,

bills, receipts and other documents) evidencing such expenditures;

(iii) enable the Bank's representatives to examine such records; and

(iv) ensure that such records and accounts are included in the annual audits referred to in paragraph (b) of this Section and that the report of such audit contains a separate opinion by said auditors as to whether the statements of expenditure submitted during such fiscal year, together with the procedures and internal controls involved in their preparation, can be relied upon to support the related withdrawals.

ARTICLE IV

Additional Event of Suspension

Section 4.01. Pursuant to Section 6.02 (k) of the General Conditions, the following additional event is specified, namely, that a situation has arisen which shall make it improbable that the Program, or a significant part thereof, will be carried out.

ARTICLE V

Effective Date; Termination

Section 5.01. The following events are specified as additional conditions to the effectiveness of the Loan Agreement within the meaning of Section 12.01 (c) of the General Conditions:

(a) that the Borrower, ELETROBRAS and the Electric Power Sector Companies are implementing the Environmental Protection Master Plan in a manner satisfactory to the Bank;

(b) that ELETROBRAS has initiated the hiring process to complete DEMA's staff, and has obtained the required governmental authorizations for the hiring of an additional 17 professionals and 8 support staff positions;

(c) that the Borrower has made, or cause to be made, adequate funding arrangements, satisfactory to the Bank, for the environmental action programs to be carried out by the Electric Power Sector Companies in 1989 pursuant to the Environmental Commitment Letter received by ELETROBRAS from ELETRONORTE, CHESF, FURNAS, ELETROSUL, CEEE, CESP, COPEL, CEMIG, CEMAT, CERON, and CELPA;

(d) that ELETROBRAS has approved drafts detailing CCMA and COMASE's internal procedures and work programs, and their schedules of meetings until June 30, 1990;

(e) that the Borrower has approved an adequate financing plan, satisfactory to the Bank, for the conclusion of the Itaparica Resettlement Project;

(f) that the Borrower has made adequate funding arrangements for the strengthening of IBMA's environmental licensing and monitoring capabilities, in accordance with the tasks and time-tables set forth in the ISP;

(g) that the updating process of the EMP is progressing in terms satisfactory to the Bank;

(h) that the Borrower has made, or cause to be made, adequate funding arrangements, satisfactory to the Bank, for the strengthening of environmental monitoring functions of the FEEMA, in connection with the Angra Plants, as set forth in the ISP;

(i) that CNE has achieved progress, satisfactory to the Bank, in the execution of the IESS;

(j) that the Borrower has approved an adequate financing plan, satisfactory to the Bank, for the DRELOR Beneficiaries, which includes adequate financial resources for the full execution of DRELOR; and

(k) that the Loan Agreement has been duly registered by Central Bank.

Section 5.02. The following are specified as additional matters, within the meaning of Section 12.02 (c) of the General

Conditions, to be included in the opinion or opinions to be furnished to the Bank:

(a) that the governmental authorizations referred to in paragraph (b) of Section 5.01 of this Agreement have been duly issued;

(b) that the funding arrangements referred to in paragraphs (c), (f) and (h) of Section 5.01 of this Agreement constitute valid and binding obligations of the entities providing such funding; and

(c) that the Loan Agreement has been duly registered by Central Bank.

Section 5.03. The date _____[1] is hereby specified for the purposes of Section 12.04 of the General Conditions.

1/ A date approximately 90 days after the date of this Agreement will be inserted here.

ARTICLE VI

Representative of the Borrower; Addresses

Section 6.01. Except as provided in Section 2.08 (a) of this Agreement, the Ministro da Fazenda of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministerio da Fazenda
Edificio Ministerio da Fazenda
Esplanada dos Ministerios
70048 Brasilia, D.F., Brazil

Cable address:	Telex:
MINIFAZ Brasilia, Brazil	611506 MFAZ BR

For the Bank:

International Bank for
Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:	Telex:
INTBAFRAD Washington, D.C.	440098 (ITT) 248423 (RCA) or 64145 (WUI)

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in the District of Columbia, United States of America, as of the day and year first above written.

FEDERATIVE REPUBLIC OF BRAZIL

By

Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By

Regional Vice President
Latin America and the Caribbean

SCHEDULE 1

Withdrawal of the Proceeds of the Loan

1. Subject to the provisions set forth or referred to in this Schedule, the proceeds of the Loan may be withdrawn from the Loan Account for expenditures made (or, if the Bank shall so agree, to be made) in respect of the reasonable cost of goods required during the execution of the Program and to be financed out of such proceeds.

2. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of:

(a) expenditures for goods included in the following SITC groups or sub-groups, or any successor groups or sub-groups under future revisions to the SITC, as designated by the Bank by notice to the Borrower:

Group	Sub-group	Description of Items
112	-	Alcoholic beverages
121	-	Tobacco, unmanufactured, tobacco refuse
122	-	Tobacco, manufactured (whether or not containing tobacco substitutes)
525	-	Radioactive and associated materials

Group	Sub-group	Description of Items
667	-	Pearls, precious and semi-precious stones, unworked or worked
718	718.7	Nuclear reactors, and parts thereof, fuel elements (cartridges), non-irradiated for nuclear reactors
897	897.3	Jewelry of gold, silver or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971	-	Gold, non-monetary (excluding gold ores and concentrates)

(b) expenditures in the currency of the Borrower or for goods supplied from the territory of the Borrower;

(c) payments made for expenditures prior to the date of this Agreement;

(d) expenditures for goods procured under contracts costing less than $10,000 equivalent;

(e) expenditures for goods supplied under a contract which any national or international financing institution or agency other than the Bank shall have financed or agreed to finance;

(f) expenditures for environmentally hazardous goods or goods intended for a military or para-military purpose or for luxury consumption; and

(g) expenditures in excess of an aggregate amount equivalent to $_____ for petroleum products and foodstuffs.

3. No withdrawal shall be made and no commitment shall be entered into to pay amounts to or on the order of the Borrower in respect of expenditures to be financed out of the proceeds of the Loan after the aggregate of the proceeds of the Loan withdrawn from the Loan Account and the total amount of such commitments shall have reached the equivalent of $162,500,000, unless the Bank shall be satisfied, after an exchange of views as described in Section 3.01 of this Agreement based on evidence satisfactory to the Bank: (a) with the progress achieved by the Borrower in the carrying out of the Program, (b) that the actions described in Schedule 4 to this Agreement have been taken; and (c) that the macro-economic policy framework of the Borrower is consistent with the objectives of the Program.

4. If, after the exchange of views described in paragraph 3 above, the Bank shall have given notice to the Borrower that the progress achieved and actions taken are not satisfactory or that the macro-economic policy framework is not consistent with the objectives of the Program and, within 90 days after such notice,

the Borrower shall not have achieved progress and taken actions satisfactory to the Bank, then the Bank may, by notice to the Borrower, cancel the unwithdrawn amount of the Loan or any part thereof.

SCHEDULE 2

Amortization Schedule

Date Payment Due	Payment of Principal (expressed in dollars)
On each [_____] and [_____] beginning [_____] through [_____]	[_____]
On [_____]	[_____]

---

* The figures in this column represent dollar equivalents determined as of the respective dates of withdrawal. See General Conditions, Sections 3.04 and 4.03.

Premiums on Prepayment

Pursuant to Section 3.04 (b) of the General Conditions, the premium payable on the principal amount of any maturity of the Loan to be prepaid shall be the percentage specified for the applicable time of prepayment below:

Time of Prepayment	Premium The interest rate (expressed as a percentage per annum) applicable to the Loan on the day of prepayment multiplied by:
Not more than three years before maturity	0.20
More than three years but not more than six years before maturity	0.40
More than six years but not more than eleven years before maturity	0.73
More than eleven years but not more than thirteen years before maturity	0.87
More than thirteen years before maturity	1.00

SCHEDULE 3

Procurement

1. Contracts for the procurement of goods estimated to cost the equivalent of $5,000,000 or more each shall be awarded through international competitive bidding in accordance with procedures consistent with those set forth in Sections I and II of the "Guidelines for Procurement under IBRD Loans and IDA Credits" published by the Bank in May 1985 (the Guidelines), subject to the following modifications:

(a) Paragraph 2.8 of the Guidelines is deleted and the following is substituted therefor:

"2.8 Notification and Advertising

The international community should be notified in a timely manner of the opportunity to bid. This will be done by advertising invitations to apply for inclusion in a bidder's invitation list, to apply for prequalification, or to bid; such advertisements should be placed in at least one newspaper of general circulation in the Borrower's country and, in addition, in at least one of the following forms:

(i) a notice in the United Nations publication, Development Business; or

(ii) an advertisement in a newspaper, periodical or technical journal of wide international circulation; or

(iii) a notice to local representatives of countries and territories referred to in the Guidelines, that are potential suppliers of the goods required."

(b) The following is added at the end of paragraph 2.21 of the Guidelines:

"As a further alternative, bidding documents may require the bidder to state the bid price in a single currency widely used in international trade and specified in the bidding documents."

(c) Paragraphs 2.55 and 2.56 of the Guidelines are deleted.

2. Contracts for goods estimated to cost the equivalent of less than $5,000,000 each shall be awarded on the basis of the normal procurement procedures of the purchaser of such goods.

3. With respect to each contract referred to in paragraph 1 of this Schedule, the Borrower shall furnish to the Bank, prior to the submission to the Bank of the first application for withdrawal of funds from the Loan Account in respect of such contract, two conformed copies of such contract, together with the analysis of the respective bids and recommendations for award, a description

of the advertising and tendering procedures followed and such other information as the Bank shall reasonably request.

4. With respect to each contract referred to in paragraph 2 of this Schedule, the Borrower shall furnish to the Bank, prior to the submission to the Bank of the first application for withdrawal of funds from the Loan Account in respect thereof, such documentation and information as the Bank may reasonably request to support withdrawal applications in respect of such contract.

5. The provisions of the preceding paragraphs 3 and 4 shall not apply to contracts on account of which the Bank has authorized withdrawals from the Loan Account on the basis of statements of expenditure.

SCHEDULE 4

Actions Referred to in Paragraph 3 (b)
of Schedule 1 to this Agreement

(a) that the Borrower, ELETROBRAS and the Electric Power Sector Companies, are implementing the EMP in a manner satisfactory to the Bank, and as set forth in the Environmental Commitment Letters, and especially that they have:

(i) achieved progress, satisfactory to the Bank, in the implementation of ongoing resettlement measures under the Itaparica, Tres Irmãos, Taquarucu and Samuel projects;

(ii) implemented, in a manner satisfactory to the Bank, the existing agreements between ELETROBRAS, the Electric Power Sector Companies, FUNAI and Indian communities on the procedures, schedules and programs (including budgetary needs) of Indian components for electric power projects (especially legal assistance and land demarcation activities);

(iii) implemented, in a manner satisfactory to the Bank, all existing agreements between ELETROBRAS and the Electric Power Sector Companies and IBMA, its predecessors, and/or State level environmental and forestry authorities.

(b) that the relevant Electric Power Sector Companies have prepared on a timely manner RIMAs, satisfactory to the Bank, for the following proposed electric generation and transmission projects (_____

_____

_____)

in strict adherence to pertinent national legislation, the Electric Power Sector's Environmental Manual, and EMP guidelines.

(c) that ELETROBRAS has updated the Environmental Master Plan, and furnished it for comments to the Bank, COMASE, CCMA, IBMA and FUNAI, such updated version of the EMP to include:

(i) the results of the latest studies on, and improved guidelines for, riverine population, coal fired plants, Indian populations, flora and fauna, and regional integration;

(ii) an amplified legal section, reflecting legislative changes following the enactment of the Borrower's 1988 Constitution;

(iii) an enhanced version of its Annex I, detailing the commitments of individual Electric Power Sector Companies;

(iv) adjustments resulting from the earlier comments and recommendations of CCMA, COMASE, SEMA, IBDF and FUNAI; and

(v) terms of reference for two follow-on complementary studies for the improvements of existing guidelines for (1) water quality, and (2) land tenure issues in resettlement;

(d) that ELETROBRAS has completed the strengthening and coordination of its environmental program through:

(i) completion of the hiring of the remaining additional higher-level staff (to complete additional 17 permanent professional positions with relevant technical qualifications and experience) and middle-level staff (to complete the additional 8 positions) for DEMA over the staff working in or assigned to DEMA as of April 1, 1989;

(ii) full functioning of the ELETROBRAS monitoring and evaluation system for the execution of the EMP at the level of the Power Sector Companies;

(iii) completion of the design and implementation in ELETROBRAS and its subsidiaries of a separate budgetary system for environmental and social programs starting in FY 1990;

(e) that adequate higher-level staffing and funding arrangements have been made by the Borrower for IBMA and FUNAI in accordance with the ISP, including task requirements under agreements entered into by IBMA, its predecessors, and FUNAI with Electric Power Sector Companies and their analysis of RIMAs of the Electric Power Sector.

(f) that progress, satisfactory to the Bank, has been made towards increased environmental safety under the nuclear power generation program, including furnishing to the Bank:

(i) the updated Operational Safety Review (OSAR) for Angra I carried out by IAEA;

(ii) copies of the review of regulatory practices and safety standards related to Brazil's nuclear power generation carried out by IAEA;

(iii) evidence that adequate funding, in terms satisfactory to the Bank, is available for CNEN, IBMA and FEEMA, for monitoring and licensing of environmental aspects of Brazil's nuclear power generation program; and

(iv) evidence that the studies on nuclear waste disposal, decommissioning of Angra I and II, and the RIMA of Angra II are being carried out

according to their respective schedules, furnished by the Borrower to the Bank on _____;

(g) that CNE has achieved progress, satisfactory to the Bank, in the execution of the IESS;

(h) that the Borrower has made available funds, in terms satisfactory to the Bank, to the Electric Power Sector Companies for the carrying out, in a manner satisfactory to the Bank, of the distribution/loss reduction subprojects financed under Loan 2138-BR and Loan 2364-BR and the electricity conservation program PROCEL during year 1989;

(i) that CCMA and COMASE are carrying out the work programs and activities referred in Section 5.01 (d) of this Agreement in a manner satisfactory to the Bank;

(j) that the Borrower has made available, on terms satisfactory to the Bank, funds equivalent to at least $70,000,000 to the DRELOR Beneficiaries, as provided in the financial plans referred to in Section 5.01 (j) of this Agreement;

(k) that the Borrower has made available, on terms satisfactory to the Bank, funds equivalent to at least $60,000,000 to the relevant Eletric Power Sector Companies for the carrying out of PROCEL, in a manner satisfactory to the Bank, during year 1989;

(l) that the Borrower and the relevant Electric Power Sector Companies have achieved progress, satisfactory to the Bank, in the execution of DRELOR;

(m) that the Bank is satisfied that the level and structure of prices for the sale of electricity charged by the Electric Power Sector Companies substantially reflect the long-run marginal costs of supply of electricity, calculated in accordance with a methodology satisfactory to the Bank;

(n) that the Electric Power Sector Companies have made progress, satisfactory to the Bank, in the execution of educational and advertising campaigns on energy conservation;

(o) that the Borrower has issued a progress report, satisfactory to the Bank, on its efforts to develop load management policies, analytical methodologies and technologies to promote the efficient supply and use of electric power;

(p) that the Borrower has made progress, satisfactory to the Bank, in the execution of programs of technical assistance to industrial consumers, manufacturers of electrical equipment and technical institutions, all satisfactory to the Bank, to promote and strengthen the institutions in charge of research and development of advanced conservation technologies; and

(q) that the Borrower has made progress (including amendments to relevant legislation and regulations), satisfactory

to the Bank, in the establishment of new or revised electric equipment performance, construction methods and standards for buildings, electric machinery and appliances requiring the use of more efficient technologies of energy use and conservation.

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REPORT AND RECOMMENDATION

OF THE

PRESIDENT OF THE

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

TO THE

EXECUTIVE DIRECTORS

ON A

ENVIRONMENTAL REFORM AND ENERGY CONSERVATION LOAN

IN AN AMOUNT EQUIVALENT TO US$325 MILLION

TO THE

FEDERATIVE REPUBLIC OF BRAZIL

April 24, 1989

GLOSSARY OF ACRONYMS

CCMA	Comite Consultivo de Meio Ambiente (Environmental Advisory Committee)
CHESF	Companhia Hidro Eletrica do Sao Francisco
COMASE	Comite Coordenador das Atividades de Meio Ambiente do Setor Eletrico (Coordination Committee for Environmental Activities in the Electric Power Sector)
CNE	Comissao Nacional de Energia (National Energy Commission).
CONAMA	Conselho Nacional de Meio Ambiente (National Environmental Council).
CONSERVE	Energy Conservation Fund.
DEMA	Departamento do Meio Ambiente, de ELETROBRAS
DNAEE	Departamento Nacional de Aguas e Energia Eletrica (National Department of Water and Electric Energy, electric sector regulatory agency).
DRELOR	Distribution Network Rehabilitation and Loss Reduction Program
ESCELSA	Centrais Eletricas Espirito Santo
ELETROBRAS	Centrais Eletricas Brasileiras S.A. (Federally-owned electric utility holding company).
ELETRONORTE	Centrais Eletricas do Norte do Brasil S.A.
ELETROSUL	Centrais Eletricas do Sul do Brasil S.A.
FEEMA	Fundacao Estadual de Engenharia de Meio Ambiente do Estado do Rio de Janiero (State Foundation of Environmental Engineering of Rio de Janiero)
FND	Fundo Nacional de Desenvolvimento (National Development Fund).
FUNAI	Fundacao Nacional do Indio (National Indian Foundation).
FURNAS	Furnas Centrais Eletricas S.A.
IBDF	Instituto Brasileiro de Florestas (Brazilian Forestry Institute).
IBMA	Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renovais (Brazilian Institute for Environment and Renewable Natural Resources).
IESS	Integrated Energy Strategy Study.
ISP	Institutional Strengthening Program.
JEX	The Export-Import Bank of Japan.
LIGHT	Light Servicos de Eletricidade S.A.
MIC	Ministerio de Industria e Comercio (Ministry of Industry and Commerce)
MOF	Ministerio de Financas (Ministry of Finance)
MME	Ministerio das Minas e Energia (Ministry of Mines and Energy).
EMP	Master Plan for Environmental Conservation and Recovery in the Works and Services of the Electric Power Sector
PETROBRAS	Petroleos Brasileiros S.A. (Federally-owned petroleum company).
PROCEL	National Program of Electric Energy Conservation.
PSRP	Power Sector Rehabilitation Plan.
RENCOR	Reserva Nacional de Compensacao de Remuneracao (National Compensation Reserve for Remuneration)

REVISE	Revisao Institucional do Setor Eletrico (Power Sector Institutional Structure and Policies Study).
RIMA	Relatorio de Impacto de Meio Ambiente (Environmental Impact Assessment).
SADEN	Secretaria de Assesoramiento da Defensa Nacional (Secretariat for the Advise in National Defense)
SEMA	Secretaria Especial do Meio Ambiente (Special Secretariat for the Environment).
SEPLAN	Secretaria do Planejamento (Secretariat of Planning).
SEST	Secretaria de Control de Empresas Estatais (Secretariat for the Control of Public Enterprises).
SISNAMA	National Environmental System.
SUDEPE	Superintendencia da Pesca (Superintendency for Fisheries).
SUDHEVEA	Federal Rubber Authority

REPORT AND RECOMMENDATION OF THE PRESIDENT

ENVIRONMENTAL REFORM AND ENERGY CONSERVATION LOAN

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BRAZIL

ENVIRONMENTAL REFORM AND ENERGY CONSERVATION LOAN

LOAN SUMMARY

Borrower: Federative Republic of Brazil

Amount: US$325 million equivalent

Terms: Repayment in 15 years, including five years of grace, with interest at the Bank's standard variable rate.

Objectives: The principal objective is to continue improving the power sector's capability to address properly the environmental and sociological aspects of its investment program; and to support electricity conservation and distribution network rehabilitation/loss reduction programs. This loan will prepare the ground also for subsequent power lending operations that will permit the Bank to continue to assist in the implementation of sound environmental and energy conservation policies.

Description: Environmental Program

The proposed loan would support the implementation of the Environmental Master Plan (EMP) by the Electric Power Sector. The EMP aims at minimizing adverse environmental and social impacts in the context of ongoing and future generation projects by (a) undertaking a large number of environmental studies and impact evaluations at the inventory and feasibility stages of planning for power projects; (b) identifying the least damaging environmental and social options; (c) excluding power projects with high environmental and social costs; and (d) assuring that the highest environmental and social standards are adhered to in those projects which are licensed for construction.

Through the EMP, the proposed loan would support: (a) preparation of Environmental Impact Reports, RIMAs, at the planning stage for power projects; (b) systematic and periodic updating of the EMP, including studies and guidelines on Riverine Populations, Coal-fired Plants, Indian Populations, Flora and Fauna, and Regional Integration; (c) an improvement of guidelines and procedures for the licensing of electric power sector projects; (d) commitment of Power Sector Companies to comply with the EMP, through specific environmental protection, resettlement and Indian protection programs; (e) adequate functioning of monitoring bodies, the Coordination Committee for Environmental Activities in the Electric Power Sector (COMASE) and of the ELETROBRAS' Environmental Advisory Committee (CCMA); (f) the strengthening of ELETROBRAS's Environment Department (DEMA); (g) establishment of a monitoring and evaluation system for the execution of the EMP; (h) satisfactory measures for the protection of Brazilian Indians; and, (i) strengthening of relevant environmental agencies.

Electric Energy Conservation Program

The proposed loan will support and consolidate the fundamental policy shift in the power sector, a shift which recognizes the importance of demand management and conservation as a cost effective alternative to building new power supply facilities. It would include the following components:

(a) National Program of Electric Energy Conservation (PROCEL). This program aims at rationalizing the use of electricity through the implementation of comprehensive policy measures, guidelines and action plans. The measures included in the Program would result in increased power system efficiency; reduced electricity waste and optimized resource allocation. Electricity conservation is to be pursued through a variety of mechanisms such as: economically efficient pricing, research and development, load management; improvement of equipment/construction standards, enhancement of industrial processes; power system loss reduction; and educational and advertisement campaigns.

(b) Distribution Network Rehabilitation-Loss Reduction Program (DRELOR).
This program would establish comprehensive policy measures covering commercial practices (electricity metering and billing); finance comprehensive studies and the development of corresponding guidelines; and provide technical and financial support to improve the overall management of various small state-owned distribution utilities located in the less-developed areas of Brazil. Substantial reduction of system power losses is to be pursued through the construction of new distribution lines to unload existing lines; reconductoring existing networks to reduce thermal losses of existing overloaded installations; installation of new distribution transformer banks to unload the existing ones; and installation/replacement of electricity meters to enhance accuracy of electricity metering and to reduce pilferage/ unaccounted electricity.

Benefits:

Quantifiable Benefits: The main quantifiable benefits attributable to this loan during the period 1989-92 arise from the implementation of the electric energy conservation policy measures and action plans included in the PROCEL and the DRELOR. Such implementation is expected to reduce sector financial requirements by about US$1.0 billion during each of the years under consideration. This is equivalent to approximately 0.3% of the 1988 GDP and 8% of the 1988 operational fiscal deficit.

Non-Quantifiable Benefits: The main non-quantifiable benefits stem from environmental policy reforms and related actions supported by the proposed loan. It is expected that such measures and actions will result in better use of natural resources, avoidance or reduction of environmental costs associated with power projects, and rationalization of the long-term power sector investment program which will average about $5 billion per year.

Risks

The main risks to the successful implementation of the EMP, PROCEL and DRELOR arise from the: (i) ability of the power sector to comply and implement in timely manner the different studies, works and other actions included in both programs; and (ii) capacity of the Government to provide the adequate financial resources required for the execution of the above undertakings. Close monitoring by the Bank of the implementation of the EMP, PROCEL and DRELOR and of the allocation of resources for this purpose would help substantially to reduce such risks.

Disbursements: The loan will be disbursed in two tranches over a 6-9 month period against acceptable general country imports. It is expected that US$162.5 million (first tranche) will be disbursed at effectiveness. The remaining US$162.5 million (second tranche) is expected to be released about six months after effectiveness and would be contingent upon satisfactory progress in the execution of the EMP, PROCEL and DRELOR.

REPORT AND RECOMMENDATION OF THE PRESIDENT
OF THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
TO THE EXECUTIVE DIRECTORS
ON A PROPOSED LOAN
TO THE FEDERATIVE REPUBLIC OF BRAZIL
FOR AN ENVIRONMENTAL REFORM AND ENERGY CONSERVATION LOAN

The following report and recommendation on a proposed loan to the Federative Republic of Brazil for an amount of US$325 million equivalent is submitted for approval. The proposed loan would be repayable over 15 years, including five years of grace, at the Bank's standard variable interest rate and charges. Cofinancing from the Export-Import Bank of Japan (JEX) amounting to US$325 million is under consideration.

PART I - THE ECONOMY

Macroeconomic Background

1.01 During the 1980s, macroeconomic policy concerns in Brazil were dominated by three major interlinked structural problems: (i) the rising inflation rate; (ii) the reduction in the public sector's savings capacity which led to high fiscal deficits; and (iii) the need to maintain a minimum growth rate and simultaneously service an external debt requiring a significant transfer of resources abroad. For the last several years, Brazil has not been successful at dealing simultaneously with these issues. The continuation of a reduction in external resources and persistently high fiscal deficit led to low growth and high inflation.

1.02 The 1980-83 period was characterized by efforts to restore external equilibrium in the context of economic stagnation and rising inflation. A significant fiscal adjustment was undertaken which reduced the operational deficit from 8.3% of GDP in 1982 to 4.8% in 1983. The domestic costs were large but the external adjustment was successfully completed. Between 1980-83, GDP per capita declined 11.7% but a trade surplus adjustment equivalent to 5.4% of GDP was achieved. However, a 30% real exchange rate devaluation, the increase in agricultural prices due to a poor harvest and cuts in subsidies, and adjustments in public sector tariffs raised inflation from an annual rate of 100% in 1982 to about 211% in 1983. Widespread indexation and monetary accommodation propagated the effects of these shocks and prevented the decline in demand from reducing inflation. Although growth resumed in 1984-85, Brazil was unable to achieve the necessary shift in the savings-investment balance that was required to offset the contraction in available external financing, particularly in the public sector. In spite of some reduction in the inflation-corrected deficit, continued borrowing from the monetary authorities and the pervasive effects of widespread indexation, coupled with successive economic shocks, brought the annualized inflation rate by the end of 1985 to over 300%.

The Cruzado and Bresser Plans

1.03 The 1986-87 period was dominated by two unsuccessful attempts to bring inflation to a substantially lower plateau: the Cruzado Plan (February 1986); and the Bresser Plan (June 1987). Both included some form of price controls and deindexation, to reduce the inertial component of inflation, as well as measures to address the fundamental inflationary forces, mainly the fiscal deficit. The two plans differed significantly with respect to their strategies to deal with inertial inflation. The Cruzado Plan fixed all prices including the exchange rate and abolished indexation for most financial instruments. Zero inflation became the official target. In contrast, the Bresser Plan did not abolish indexation but modified the indexing rules in an attempt to stabilize prices and wages. The price freeze was explicitly presented as a temporary measure (maximum 90 days), and backward-looking indexation rules were established to regulate price and wage adjustments in the post-freeze period. No exchange rate freeze was imposed. However, the fiscal effort for both the Cruzado and Bresser Plans was insufficient to bring aggregate demand to a level consistent with permanently lower inflation.

1.04 Initially, the Cruzado Plan led to a drastic decline in inflation. However, by July 1986, as a result of a larger than previously estimated public sector deficit and higher real wages it was clear that the economy was overheating. In November 1986, as regular minidevaluations of the cruzado were resumed and the price freeze was relaxed and then abandoned, inflation accelerated reaching almost 17% in January and 23% in May 1987. The economy was virtually fully reindexed except for wages which, as a result of the month-long lag in wage increases and substantial inflation in excess of the 20% adjustments, declined in real terms.

1.05 In June 1987, the authorities adopted a new anti-inflation program --the Bresser plan. Although this plan avoided some of the major pitfalls encountered by the Cruzado Plan, the targets for inflation, the size of the fiscal deficit and the composition of its financing were not fully consistent, and the 1987 operational deficit rose to 5.5% of GDP (3.5% in 1986). As soon as price controls were relaxed in early September, the inflation rate increased from an average of 5% per month during the third quarter of 1987 to an average of 12% per month during the last three months of the year. Moreover, increases in public sector wages granted in late 1987, which were not consistent with the income policies set forth in the Plan, increased aggregate demand, fueled inflationary expectations and led to anticipatory price increases by firms. The rate of inflation reached 14.1% in December and 16.5% in January, remaining in the 16-19% range in February-April of 1988.

1.06 The failure of the Cruzado and Bresser Plans demonstrated that "heterodox" attempts at stabilization, e.g., programs centered on income policies that include a wage and price freeze coupled with some form of deindexation, cannot succeed unless they are supported by strong monetary and fiscal policies that are consistent with a lower inflation rate. Although the design of the price and income policies played a major role in the breakdown of the Cruzado Plan, the main reason for the failure of the two stabilization attempts was the inadequate fiscal effort. In the absence of substantial foreign savings, deficit financing through excessive

monetary expansion and domestic borrowing results in a combination of high inflation and domestic crowding out of the private sector that tends to undermine stabilization efforts.

Recent Economic Developments

1.07 In 1988, after two failed heterodox stabilization attempts, the Brazilian government undertook a gradualistic approach to fight inflation. The objective was to stabilize and then bring down the inflation rate. The strategy was to cut the fiscal deficit, thus enhancing the credibility of the approach and preparing the ground for an additional fiscal effort planned for 1989. The authorities' first set of measures were targeted at reducing the fiscal deficit and consisted mainly of expenditure cuts that included a two month wage freeze and ceilings on the expansion of credit to the public sector. These measures, which became the centerpiece of the Government's program presented later to the IMF, succeeded in reducing the fiscal deficit that early in the year was projected to exceed 7% of GDP. Preliminary data suggests that the 1988 fiscal deficit should be close to 4% of GDP. However, the gradualistic approach failed to stabilize inflation. Between the first and second quarters of 1988 the average monthly inflation rate (IPC) increased from 16.8% to 18.8%. The upward trend continued in the second half of the year and inflation reached 23% and 27.2% in the third and fourth quarters, respectively. The inflation for the year was a staggering 934%. The combination of widespread indexation, inflationary expectations and a loose monetary policy undermined the gradualistic approach.

1.08 Stagflationary tendencies characterized economic performance in 1988 - the annual rate of inflation reached almost 1000%, and GDP growth was close to zero, largely as a result of a decline in industrial output. On the other hand, the performance of the external sector was very encouraging. In 1988, the trade and current accounts registered a surplus of US$ 19 billion and US$ 4.6 billion, respectively (in both cases the largest in Brazilian history). In nominal terms exports increased by 29% and, in part on the account of declines in the oil and wheat categories, imports declined by 2.6%. The stagnation in economic activity, faster growth in international economy and favorable price movements in some commodities contributed to the outcome of the external accounts.

1.09 By October it had become clear that the gradualistic approach was not having the desired results on the inflation front. Faced with an initial shift from financial assets into real estate, gold, and dollars the Government joined ongoing talks between labor and business groups to establish an improved framework for wage and price increases. On November 3, representatives of the Government, labor and business groups signed a Social Pact setting ceilings on price increases for private and public goods and services. Wages would continue to be adjusted according to the URP monthly adjustment formula. Initial agreement was for a 60 day period ending in December. The strategy underlying the Social Pact was to stabilize and then gradually reduce inflation by setting decreasing monthly guidelines for wage and price increases. It represented a continuation of the gradualistic approach, but a shift from backward to forward indexing.

1.10 The Social Pact quickly faced strong difficulties. Although November's inflation rate of 26.9% was close to the target established in the Pact, December's inflation reached 28.9%, well above the Pact's objectives (25%). For January, inflationary expectations embedded in financial contracts suggested that financial markets expected a further increase in the monthly rate. Although the difficulties associated with obtaining Congressional approval of the Government's 1989 fiscal package eroded the public's confidence in the authorities' approach, the indexation system remained the main obstacle to gradualism. If wage adjustments in January and February had been allowed to follow the URP formula and thus were based on the average inflation for the September to November period (26%), it would have been unlikely that a decline in inflation could have been achieved. Thus, the fight against inflation had reached an impasse: either the indexing system for wages based on the URP formula was modified or the gradualistic approach incorporating forward looking indexation would have to be abandoned. Given the problems that changes in indexation rules would entail, after an internal debate the Government decided to abolish indexation and to undertake another heterodox shock--the Summer Plan.

The Summer Plan "Plano Verao"

1.11 On January 15, President Sarney unveiled the third major anti-inflation effort of his administration--the "Summer Plan." The new program combined heterodox measures, including a price freeze and the end of monthly wage adjustments based on past inflation with orthodox fiscal and monetary measures. Immediately prior to the freeze, several prices and public sector tariffs were raised and a 16.4% devaluation of the domestic currency was undertaken. A new currency was created--the New Cruzado--which is equivalent to one thousand cruzados. It has been announced that the exchange rate will remain frozen as long as the price freeze is maintained. In the fiscal area the Plan suggests cuts in expenditures to reduce the deficit. At the federal level, initially, expenditures will be limited on a monthly basis to the level of revenues collected. Priority outlays are salaries, debt service and social programs. Ceilings are imposed on credit to the private sector, complementing a similar measure already in place for the public sector. Indexation of financial instruments was substantially modified. Passbook savings accounts will remain the only indexed financial asset, the OTN was was abolished as of the beginning of February and only contracts for a period longer than 90 days may remain indexed.

1.12 The Plan represents a decent effort at stabilization. In comparision to the Cruzado Plan, improvements were made in the program's design in the areas of wage policy and pre-adjustment of relative prices. The design of the Summer Plan has benefited from the lessons learned as a result of the failure of the two previous stabilization attempts. The plan recognizes the importance of an adjustment of the fiscal deficit and of a tight monetary policy. A priori, after incorporating the effects of the December fiscal package, the initial conditions on fiscal policy should be better than in previous Plans, but the authorities have not completed the design of the fiscal package. If the fiscal underpinnings of the plan turn out to be weak and no corrective actions are taken, fiscal policy will, once again, undermine the stabilization attempt. Because the absence of a well defined fiscal stance prevents an evaluation of the consistency of the plan, the credibility of this effort is not yet established.

1.13 Recognizing the importance of a tight monetary policy for the Plan's success, in the weeks following the announcement of the measures the Central Bank has supported very high real interest rates. Given their impact on the fiscal deficit, how long the policy can be maintained remains to be seen. Overall, the Plan's outcome will depend on its implementation. There are some important downside risks. Slippages in the implementation of the announced wage policies represent a major downside risk. The possibility that such slippages can occur in other areas, particularly fiscal and monetary policies cannot be discarded. Two additional areas of concern are the absence of a clear fiscal policy stance and the absence of concrete proposals on how to ease the economy out of the price freeze without rekindling inflation. In each of these risky areas the Government is still developing and refining its program.

1.14 The Summer Plan represents an important stabilization effort that profited from the lessons learned following the failure of past stabilization attempts. Nevertheless, given the difficulties in implementing difficult economic measures in an election year its present prospects remain quite uncertain. Domestically, the main risk is of slippages in the implementation of the Plan. The present Government has a strong commitment to stabilization. However, it faces strong obstacles in pursuing its policies and faces a credibility issue arising from the failure of the last two heterodox stabilization programs. On the external side, the main risks are that an increase in interest rates or delays in obtaining the needed external financing may substantially increase the fiscal deficit without simultaneously providing the necessary external financing.

External Debt Developments

1.15 Debt rescheduling has substantially assisted Brazil since 1983. Agreements reached with commercial banks and official creditors resulted in a rollover of maturities and, in the case of bank lending, lower interest rates. The debt situation changed on February 20, 1987, when faced with balance of payments problems including large losses in reserves, the Government temporarily suspended interest payments on its external commercial bank debt, while reaffirming its intention to negotiate a multi-year rescheduling of this debt. At the end of 1987, Brazil suspended principal payments on Paris Club debt contracted before March 1983, but remained current on interest payments.

1.16 During the last months of 1987, significant progress was achieved towards a normalization of the relations between Brazil and commercial bank creditors. On June 22, 1988, Brazil reached an agreement with the Advisory Committee of creditor banks on a financing package designed to provide the country with both new money and refinancing of existing external debt. The financing package signed September 22 covers the period 1987-88 and the first half of 1989 and consists of three main components. First, new money facilities in the total amount of US$5.2 billion to be disbursed in three tranches of about US$4.0 billion, US$0.6 billion, and US$0.6 billion, respectively. Secondly, facilities to refinance both public sector and private sector external debt in the total amount of about US$62 billion. Thirdly, facilities intended to assure the availability of existing interbank and trade credit lines at their previous commitment levels of

about US$15 billion. The first tranche of this agreement (US$4.0 billion) was disbursed in November 1988.

1.17 On July 29, 1988, the Paris Club agreed to reschedule 100 percent of principal and 70 percent of interest falling due from August 1, 1988 to March 31, 1990, for 10 years including 5 years grace. The agreement also provides for the rescheduling of principal due between January 1 and July 31, 1988. Bilateral discussions between Brazil and the appropriate institutions of the creditor countries, to be completed no later than March 31, 1989, will set the details for the debt rescheduling or the refinancing, including the rates of interest to be charged.

1.18 On June 29, the Brazilian Government sent a letter of intent to the IMF requesting a stand-by agreement equivalent to SDR$1096 million for a period of 19 months. The stand-by was approved after a "critical mass" of commercial bank commitments was achieved in late August. Since September 30, 1988, additional access to Fund resources under the stand-by agreement have been subject to the results of a revision of the 1988 Program and the establishment of performance criteria for 1989. With the exception of the limit on borrowing requirements of the non-financial public sector (nominal deficit), Brazil met the other September targets of the Fund program. For December, in addition to the nominal target for the fiscal deficit the operational target was exceeded as well. The difference between the nominal and operational deficits is that the former includes monetary correction and therefore is dependent on the rate of inflation. An IMF decision regarding the waiver is expected as soon as an evaluation of the Summer Plan is completed.

Collaboration with the IMF

1.19 The Bank and the IMF have been and will continue working closely together in exchanging views on Brazil's Macroeconomic situation. This collaboration is particularly important during the first semester of 1989, when the adjustment policies of the "Plano Verao" take place. The Fund's evaluation and recommendation of Brazil's short- and medium-term macroeconomic policy actions and their results are important inputs to the Bank's own evaluation of the adequacy of the macro framework. Thus, the Bank will carefully consider the Fund's judgement in assessing whether macroeconomic conditions are satisfactory to warrant Board presentation and second tranche release.

PART II - THE ENERGY AND POWER SECTORS, THE ENVIRONMENT AND ENERGY CONSERVATION

A. INTRODUCTION

2.01 The Bank's strategy in the energy sector in Brazil has supported the Government in moving closer towards a situation in which energy pricing and investment policy will foster the most economically efficient development and use of energy resources, taking into account comprehensive environmental considerations and the macroeconomic, regional and social implications. Specific elements in this general strategy are: the basing of the energy investment program upon a realistic demand forecast and the least-cost method of supplying the demand; establishment of a closer relationship between energy prices and economic costs, especially at the regional and retail levels; strengthening of energy sector institutions, particularly in terms of improved coordination among different agencies and the effective execution of an integrated national energy policy; wider use of market-based incentives; and increased participation of the private sector. An indispensable constraint on energy policy is that energy development in Brazil should take place in a manner consistent with sound environmental and natural resources management.

2.02 In implementing this strategy, it is necessary to confront and try to resolve a number of key policy issues, principally in the areas of pricing, investment, the institutional structure, demand management and conservation, and environment. Clearly, this is a long-term task which cannot be tackled through any single Bank operation. The proposed loan would make significant progress by addressing an important subset of the above issues, viz. environmental matters and energy conservation. The remaining energy sector issues are being dealt with by the Bank in other ongoing and future lending operations and through its program of energy sector work. On the Brazilian side, a major initiative has been launched to design a new energy sector strategy, through the Integrated Energy Strategy Study (IESS), which is being carried out by the Government through the National Energy Commission (CNE) under terms of reference agreed with the Bank.

B. ENERGY SECTOR

Energy Resources

2.03 Brazil is endowed with substantial energy resources, both renewable (hydraulic power and biomass) and nonrenewable (hydrocarbons, coal and uranium). According to the National Energy Balance, as prepared by the Ministry of Mines and Energy (MME), the proven energy resources for 1986 were: petroleum, 325 million toe; natural gas, 87 million toe; shale oil, 10 million toe; coal, 1,945 million toe; hydroelectric power, 270 million toe per year; and uranium, 1,340 million toe.

Energy Supply, Demand and Investments

2.04 Primary energy production almost trebled from 1970 to 1986, rising from 49 to 143 million toe. During the 1970s, the increase of energy production was provided mainly by hydropower and biomass -- in the latter

case, principally wood and sugar cane. Between 1980 and 1986, crude oil production rose from 9 million toe to 29 million toe, while natural gas output grew from 2 million toe to 5 million toe. Domestically produced oil, which now exceeds 600,000 barrels/day (equivalent to about 30 million toe per year), accounts for some 50% of domestic consumption, compared to less than 20% in 1975. Hydrocarbons amount to 22% of total Brazilian energy production while hydropower represents 37%; biomass, 38%; and coal, only 3%.

2.05 Primary energy consumption grew 2.5 times from 1970 to 1986. While energy demand rose faster than local energy production in the 1970s, the situation reversed after 1980, when domestic energy production grew by 7.5% annually, 1.7 times faster than energy demand. Such growth resulted in a major decrease of imported energy (i.e., petroleum) from 34% of total energy consumption in 1980 to 19% in 1985. It should be noted that, with respect to the faster rate of energy consumption, the price of several energy products rose more slowly in 1980-85 than in the 1970s or even declined in real terms, and energy consumption may have been boosted as a result. This is particularly the case for gasoline, alcohol, LPG, electricity and charcoal, the prices of which declined in real terms.

2.06 During the period 1984-86, Brazil's energy sector absorbed almost half of all Federal and Federally-funded investment in the country. The bulk of this investment was undertaken by two of Brazil's parastatals: the national electricity holding company Centrais Eletricas Brasileiras S.A. (ELETROBRAS), which was responsible for about 22% and the national oil company Petroleos Brasileiros, S.A. (PETROBRAS), for about 18%. As far as the electric power sector is concerned, total annual investment in recent years has been on the order of about US$5.0 billion annually (in mid-1987 prices). The energy sector is likely to continue to account for a significant part of Brazil's public investment.

Energy Pricing and Investment

2.07 As a general principle, energy prices need to reflect more closely their scarcity value or opportunity costs. For non-tradeable forms of energy this value is the long-run marginal cost of supply, including geographical differences, in order to encourage efficient inter-fuel substitution -- which will reduce the overall costs of energy consumed in the country -- and energy conservation. Evidently, this principle may have to be tempered by the need: (i) for affordability to meet the basic needs of low-income households in urban and rural areas, especially in poorer regions such as the northeast; and (ii) to meet sector financial and cost-recovery objectives. Furthermore, investment programs and operating costs in each energy subsector need to be governed by least-cost principles. Efficient pricing and investment policies would not only improve resource allocation within the energy sector: they would have a beneficial impact on the macroeconomy, in terms of public investment; external debt and debt service; the public sector deficit; the balance of trade; and inflation.

2.08 In the electric power sector, Brazil has made considerable progress in formulating a marginal-cost based tariff structure (see para. 2.24). Brazil has also taken several steps to adjust petroleum product prices, even during periods of high inflation, so that at present the average domestic price of a composite barrel of products is about 91%

higher than the border parity equivalent. However, naphtha and LPG are heavily subsidized and diesel is seriously underpriced relative to gasoline. Both electricity tariffs and petroleum product prices are subject to a system of uniform national pricing, which involves cross-subsidization of areas having high transport and distribution costs, by areas where such costs are low.

2.09 Natural gas pricing has been geared mainly to encouraging its use in petrochemicals, fertilizer production and substitution for fuel oil. In the long run, revisions will be required and are being made (for example under the recently approved Sao Paulo Natural Gas Distribution Project) in gas pricing, to ensure that efficient utilization takes place on the basis of the economic opportunity value of gas, with due recognition of regional and consumer-related cost differentials.

2.10 The high level of petroleum prices in the 1970's and early 1980's led to a national energy strategy that emphasized increased energy self-sufficiency and the development of domestic energy sources sometimes at the expense of least-cost investment principles. The issue is relevant in alcohol, biomass, nuclear and coal production as well as the development of domestic petroleum resources. For the petroleum sector, the impact on public investment, public indebtedness and public sector finances can be mitigated by defining a more appropriate role for the international oil companies and for equity shareholders in State gas companies. Public investment can also be reduced by rationalizing oil exploration, but the eventual decline in the reserve/production ratio would lead to a fall in domestic oil production and a rise in imports. Electricity investment issues are discussed in para. 2.22 and 2.23.

Institutional Structure

2.11 Although the energy sector is under the jurisdiction of the MME, created in 1960, energy planning, decision-making and policy implementation in Brazil have been characterized by a lack of coordination and clearly-defined goals. On the one hand, there are large and powerful public-sector enterprises, notably ELETROBRAS and PETROBRAS; and on the other hand, numerous privately-owned companies or individual entrepreneurs which are active in other subsectors, such as coal, alcohol and fuelwood. The application of different pricing policies by ELETROBRAS and PETROBRAS and the co-existence of key energy resources which are generally free from central control and others which are subject to highly-centralized decisions has resulted in some distortion in pricing and investment policies and inconsistency of policy among different forms of energy. Furthermore, there is the potential for using increased market-based incentives in energy, especially to encourage cost-reducing measures.

2.12 As far as the electricity sector is concerned, the institutional structure has served the nation well in the past. However, the basic legislation dates back more than 30 years and profound changes have occurred. The power sector is currently analyzing several options to implement basic institutional reforms. With respect to hydrocarbons, PETROBRAS has responded well to its mandate to lead Brazil towards greater self-sufficiency. In doing so, it has achieved a powerful monopolistic position, which sometimes poses the threat of a conflict of interest. In the area of investment, the Government has lacked the technical skills to

scrutinize PETROBRAS' program adequately, e.g., with regard to the amount of resources devoted by PETROBRAS to the development of off-shore oil. A partial view of Brazil's energy needs may have induced PETROBRAS to take inadequate account of natural gas in energy development, with the result that large amounts have been flared in the past.

Energy Conservation

2.13 Since 1980, energy consumption has increased more rapidly than GDP and urgent attention needs to be given to the rational use of energy, especially in industry. Various indices of energy intensity for the economy show an upward trend relative to the unit value of output. For example, the aggregate final consumption of energy and of commercial energy, in t.o.e. per 1970 dollar of GDP, increased respectively from 0.288 and 0.235 in 1980 to 0.304 and 0.260 in 1986. In particular, electricity consumption per unit of output in industry has risen sharply since 1980, as has the consumption of both petroleum products and electricity per unit of agricultural output. While the experience naturally varies between different types of industry, specific electricity consumption has risen in a wide cross-section of Brazilian industries since 1980.

2.14 In general, both price and non-price policy tools may be used to improve energy efficiency. Experience from a variety of countries shows that the level and structure of energy prices can be a critical element in any effective energy demand management and conservation strategy. Notably, energy prices can induce the desired entrepreneurial behavior, for example with regard to the choice of type of fuel, technological process and investments in energy saving measures (including, but not restricted to, retrofitting). Technical methods, legislation, education and promotion are also useful policy tools to induce energy conservation.

2.15 The Brazilian authorities have pursued a variety of methods and mechanisms to promote energy conservation. In 1981, the Ministry of Industry and Commerce launched an ambitious program promoting the rationalization of energy use in industry. A special conservation fund (CONSERVE) was established in the Banco Nacional do Desenvolvimento (BNDES) to provide free energy audits as well as conservation loans at subsidized interest rates, to industry. CONSERVE was principally a program to substitute petroleum products with electricity rather than a broad program of energy conservation. Considerable progress has been made but there is still scope to improve the implementation of the CONSERVE program.

2.16 Apart from CONSERVE, energy conservation measures in Brazil have included pricing, advertising campaigns, improvement of industrial processes and power system loss reduction. Although energy prices in general and electricity prices in particular have undergone a long-term decline in real terms, there has been a substantial recovery in 1987 and 1988. The subsidized industrial electricity tariffs for the promotion of oil substitution ("Eletrotermia" loads) were discontinued as of December 31, 1986 and implementation of long-run marginal cost pricing is proceeding well (see para. 2.24). Recently, the Government launched a National Program of Electric Energy Conservation (PROCEL). PROCEL is targeted to stimulate electricity conservation (see paras. 2.30 and 3.21 for details). The IESS will also reconsider Brazil's entire energy conservation policy. The IESS has already provided a valuable focus for the Bank's continuing

dialogue with the Brazilian authorities on the full range of energy issues and policy, and thus, during negotiations, the Bank should seek agreement of the Government that satisfactory execution of the IESS would be a condition for effectiveness and for release of the second tranche of the proposed loan.

Environmental Aspects in the Energy Sector

2.17 Major improvements have been achieved under the Power Sector Loan (2720-BR) in the capability of the energy sector to address properly the environmental and social consequences of its investment program. At the same time further progress is achievable, but this will require additional longer-term efforts. The electric power sector in particular faces important environmental and resettlement issues, including potential problems created by the construction of hydroelectric generation schemes. These plants often have an important impact on surrounding human communities -- including (in some cases) Indian populations, and on the equilibrium of ecological systems, river basin management and broader regional developments. Other issues facing the Government are: (a) the depletion of forests, due to indiscriminate land clearing and increasing charcoal production for the iron and steel industry; (b) air and water pollution caused by the consumption of high-sulphur industrial fuels in the conurbation of Sao Paulo and by alcohol producers; (c) the dispossession of share croppers in the Northeast, due to the development of large sugar plantations; (d) water pollution from the improper disposal of sugar-alcohol stillage wastes; (e) insufficient compliance with existing regulations regarding oil drilling and control of work camps to protect existing Amazon Indians; (f) potential environmental problems which could result from open-cast coal mining in the South; (g) air pollution related to the operation of coal-fired power plants; and (h) environmental and safety aspects related to nuclear power plants. The environmental issues relating to the power sector are the most critical for Brazil, as detailed in the next section.

C. POWER SECTOR

Organization

2.18 The Brazilian power sector, one of the largest and most complex in the world, is in general reasonably well organized. The institutional development of the sector over the last 50 years has been characterized by progressive nationalization and growing centralization, resulting in the consolidation of a few large and hundreds of small utilities into a relatively compact structure of state and federally-owned utilities. The power sector is under the jurisdiction of the MME. In 1962, ELETROBRAS was established under the MME as a mixed-economy corporation. It functions as a holding company (of four major subsidiaries: FURNAS, CHESF, ELETRONORTE and ELETROSUL and two distribution companies LIGHT and ESCELSA) and as a sector development bank. ELETROBRAS holds the 50% interest of the Government in Itaipu Binacional (the binational agency set up by the Governments of Brazil and Paraguay to build and operate jointly the 12,600 MW Itaipu hydroelectric facility on the Parana River) and owns minority stock interests in the state-owned utilities. ELETROBRAS also analyzes

expansion plans for major generating and transmission facilities and coordinates and supervises the interconnected public power system.

2.19 The Departamento Nacional de Aguas e Energia Eletrica (DNAEE), within MME is the regulatory agency. It grants licenses for generating plants; assigns concessions; approves expansion plans; and sets tariff levels under the principle of service-at-cost plus an adequate return on capital and tariff structures on the basis of LRMC. In some areas, the approval of other Federal authorities is also required: e.g., that of the President for major licenses and concessions, and of the Ministry of Finance (MOF) for tariff increases. However, there are anomalies and overlapping of functions in the sector organization which are being reconsidered in connection with the Power Sector Institutional Structure and Policies Study, REVISE ("Revisao Institucional do Setor Eletrico") (para. 2.20).

Institutional Reform

2.20 Under Loan 2720-BR, the Government is carrying out REVISE to review the institutional structure and certain policies of the electric power sector. A draft report was furnished to the Bank for comments. The study addresses institutional relations, tariffs, and finance (all of which need revision); and is expected to lead to changes and improvements reflecting present realities in Brazil. Questions being addressed in the areas of tariffs and finance are: the practicality of implementing tariffs on a uniform national basis; and the redistribution of revenues among sector companies, in order to better balance their respective rates of remuneration.

Growth of Demand

2.21 In 1987, national average consumption of electricity was about 1,327 kWh per capita. The industrial sector used 54% of the electricity consumed and the residential sector 21%. During the period 1975-87, electricity consumption rose at an average annual rate of 9.2%, which is very high when compared with rates in other similar countries. Though the annual rate of increase in the last seven years (from 1980), about 7.0% p.a., has been lower than that of the previous decade, it is still comparatively high. The revised projections of electricity consumption show that demand is expected to grow at only 6.2% from 1988 to 1990 and at about 4.9% p.a. thereafter. The forecast of lower rates of growth reflects Brazil's current economic constraints and electricity savings derived from the implementation of the electricity demand management and conservation programs, which have already started (Part III C), and will be further strengthened through the proposed loan and other forthcoming operations.

System Expansion Planning

2.22 ELETROBRAS has the primary responsibility for the coordination of expansion planning in the power sector; planning techniques and methodologies are satisfactory. Distribution planning is the responsibility of each individual utility company. The participation of ELETROBRAS in the global assessment of the adequacy of the level of investments of the individual utilities ensures a consistent approach. ELETROBRAS is subject to the supervision of DNAEE in the preparation of its

plans, and the plans themselves are subject to the formal approval of MME. Since 1981, SEST within MOF has exercised the responsibility for approving the levels of investment of public utilities to ensure consistency with the level of public sector investment spending.

2.23 ELETROBRAS has sound analytical and planning capability to formulate a least-cost investment program for the sector. The Bank has monitored this program to ensure that there is: (i) a reasonable balance in the allocation of investment spending for generation plants and for transmission and distribution networks; and (ii) an appropriate mix of generation among fuel sources: hydro, coal, natural gas, and, most recently, nuclear. In late August 1988, the Government transferred to the power sector, the responsibility for financing and building two nuclear power plants, Angra II and Angra III. Construction of Angra II is at an advanced stage (70% completed) while construction of Angra III is just beginning. ELETROBRAS has provided a satisfactory economic justification for inclusion of Angra II in the least-cost investment program. However, there are doubts about the economic viability of Angra III, especially in relation to its proposed commissioning date. The issue of power system reliability also has become increasingly important due to the sharp cutbacks in investment, as has the rehabilitation of electric power transmission and distribution facilities, especially in the smaller systems, where technical losses are higher. This problem is discussed at greater length in Part III, Section C.

Electricity Tariffs

2.24 A comprehensive study of electricity tariffs was completed by DNAEE (in association with ELETROBRAS) in 1985. The results of this study have been partially implemented already and continue to be put into effect on a nationwide basis within the framework of currently enacted legislation and will result in a more efficient use of installed capacity. The new policy features the introduction of tariff structures to reflect differences in long-run marginal costs. The new electricity tariff policy incorporates peak and off-peak prices, seasonal schedules, and power and energy demand rates. The application of the new tariff schedule to high-demand electricity consumers was initially optional, but has been mandatory since January 1986. Implementation of the new tariff policy is expected to be completed by December 1989 (para. 3.21) and will result in a more efficient allocation of resources and better energy conservation. As of December 1988, Brazilian electricity tariffs were about 90% of marginal costs. Tariffs for each class of consumer and rates of remuneration for the utilities are uniform on a nationwide basis; and sector revenues are transferred among sector companies through a nation-wide mechanism known as RENCOR (Reserva Nacional de Compensacao de Remuneracao).

Sector Finances

2.25 Adequate levels of tariffs, revenues, and internal fund generation are an important source of financing for internal expansion of the electric power sector, which plays an important role in the development of Brazil. Before 1978, the sector enjoyed a long period of robust financial performance because the Government implemented a realistic tariff policy and provided adequate equity contributions. After 1978, sector financial performance declined and borrowing as a source of investment financing

increased. In the early 1980's, the Government introduced programs to increase tariffs, but these programs did not reverse the deteriorating financial trend. In 1986, to improve sector finances, in connection with Loan 2720-BR, the Government agreed to carry out a comprehensive Power Sector Rehabilitation Plan (PSRP). The PSRP was expected to complement the objectives of a macroeconomic stabilization plan introduced in March 1986, the Cruzado Plan. Among other measures, the Cruzado Plan featured economy-wide price controls and a "freeze" on tariff increases.

2.26 The Government maintained certain policies of the Cruzado Plan longer than expected, with the result that there were delays in the implementation of measures contemplated in the PSRP aiming at improved sector finances. In late 1986, the Cruzado Plan was relaxed and then abandoned amid resurgent inflation. In June 1987, the Government introduced a second macroeconomic stabilization plan, the Bresser Plan, which also featured price controls including a short-term "freeze" on electricity tariffs. By the end of 1987, the Government succeeded in raising the real level of tariffs and these increases were continued through 1988. In summary, the efforts of the Government to implement the PSRP resulted in slowly improving sector finances during 1987 and 1988, as measured by the real level of tariffs and rates of return on remunerable assets. By December 1988, having been increased by about 50% in real terms since December 1986, the level of average tariffs reached about 90% of the long-run marginal cost of supply. Basically, the implementation of the macroeconomic stabilization plans in 1986 and 1987 resulted in a one-year lag in the rate of improvement of sector financial performance as compared with the rate initially expected at appraisal of Loan 2720-BR.

2.27 In January 1989, the Government introduced a new macroeconomic stabilization plan, the Plano Verao, which featured fresh price controls and a tariff "freeze". At the time of introduction, this tariff "freeze" was expected to last for about four months. In late April, the Government announced complementary measures to the Plano Verao. In the case of electricity tariffs, these measures would provide for adjustments in the light of movements in the Consumer Price Index. The PSRP is being reformulated to reflect the impact of the Plano Verao and its complementary measures. The PSRP would aim at achieving sound financial performance in order to sustain the ambitious investment program of the sector, consistent with development targets. The Bank would pursue compliance with respect to such sound financial performance.

Environmental Background in the Power Sector

2.28 Since the mid-1970s, the Brazilian power authorities have made significant progress towards implementing environmental and social safeguards in the power sector. Notably, they have taken initiatives to mitigate the harmful side effects of large hydroelectric projects on riverine ecosystems and human populations. By 1985, ELETROBRAS and various regional utilities had created environmental units, carried out studies, and in 1986 ELETROBRAS prepared a "Manual for Studies of Environmental Effects of Electric Systems" (the Manual), which has since served as the basis for environmental studies in the various stages of planning and implementation of electric systems. The studies proposed in this Manual also provided the basis for preparing Environmental Impact Assessments (RIMAs), which have been, since 1982, a fundamental legal requirement for

licensing the construction and operation of electric systems (power generation plants and transmission lines), by relevant federal and state level environmental agencies. While this manual became an effective first step for sector wide progress in environmental management, ELETROBRAS and the regional utilities soon recognized the need to follow it up in more depth, including social questions.

2.29 In this context ELETROBRAS has, since 1986, prepared the Environmental Master Plan (EMP) for the Power Sector in connection with Loan 2720-BR. The EMP (available in the Project Files) consists of sections on: (i) national environmental policy, legislation, regulations, and guidelines; (ii) specific guidelines to improve environmental planning and operation on the part of the power sector, including criteria to assess environmental costs and benefits related to the construction of power projects and the operation of the system; (iii) preparation of environmental and social action plans on a project-by-project basis; and (iv) measures to strengthen the institutional capabilities of the sector for implementing the EMP. Together with the Manual and the general federal guidelines for the preparation of RIMAs, the EMP provides guidelines for the treatment of environmental, resettlement, and tribal matters, and specific project-by-project social and environmental action programs. It is considered a dynamic instrument to assure and further improve the environmental and social performance of the power sector. The EMP is periodically updated and re-issued. Results of the implementation of the EMP can be measured primarily in terms of (a) the environmental, resettlement and Indian assistance programs, which have been carried out since 1986 by ELETROBRAS and the Electric Power Sector Companies in compliance with its guidelines, (b) improvements in the investment selection process, and (c) institution building (see Part III for detailed listing of progress achieve to date).

Electric Energy Conservation

2.30 In December 1985, through "Portaria Interministerial" No. 1877/85, the MME launched a program to establish policy measures, integrate activities and secure financing necessary to implement the PROCEL (para. 2.25). The main objective of the program is to rationalize the use of electricity through increased power system efficiency; reduced electricity waste and optimized resource allocation. Because of the inadequate support available to implement the policy reforms and measures included in the PROCEL, as well as the financial constraints imposed on the power sector as a result of the current macroeconomic difficulties of Brazil (as outlined in Part I) which substantially restricted the availability of funds for electricity conservation purposes, the PROCEL has been implemented at a much slower pace than originally scheduled. At the same time, significant progress has been made on demand management in the complementary area of efficient pricing: by December 1988 electricity tariffs already were, on average, about 90% of long run marginal costs and further tariff restructuring is underway (see para. 2.24 for details). Meanwhile the Government also has been pursuing a comprehensive Distribution Network Rehabilitation and Loss Reduction Program (DRELOR) with the Bank's support (see para. 3.16 for details).

2.31 Despite these constraints within the power sector, in particular the limited availability of human and financial resources to carry-out

PROCEL, significant progress has been achieved through the implementation of basic conservation measures. Since the inception of PROCEL under the joint initiative of MME, ELETROBRAS, the sector utilities and industrial undertakings, over 100 specific projects (which were conceived and developed based on the results obtained from 2,400 energy audits performed within industrial consumers and from 10,600 energy surveys within residential and commercial consumers) are now being implemented. The results so far obtained are encouraging as it is estimated that during 1988 electricity savings derived from the implementation of the PROCEL amounted to about 840 GWh, equivalent to US$250 million. It is also estimated that 48% of the above savings were due to use of more efficient lamps for public lighting; 36%, to improved air conditioning systems; and 16%, to upgraded refrigeration equipment. Important complementary actions to achieve these goals included the education and advertising campaigns undertaken by the sector though the distribution of over 2,000,000 energy saving manuals among consumers and intensive public advertising campaigns through TV, radio and newspapers.

Power Sector Issues

2.32 To summarize, the power sector confronts a set of important policy issues, the most important of which are: environmental reform, energy conservation, efficient pricing and demand management, sector finances, optimal investment planning, and institutional restructuring. This loan would help the sector to address a particularly crucial subset of these issues -- namely, environmental reform and energy conservation -- through the implementation of the programs of the EMP, PROCEL, and the distribution network rehabilitation and loss reduction (DRELOR). This loan will also be the umbrella operation that will set the guidelines on environmental reform and energy conservation for future Bank operations in the power sector. Previous Bank loans are currently helping to address the other important policy issues relating to pricing, institutional reform, sector finances, and investments. For example with respect to pricing, under Loan 2565-BR, the Government has undertaken to complete the introduction of a marginal-cost based tariff system by December 31, 1989, and made good progress already, towards achieving this goal. The proposed loan also would reinforce this undertaking (paras. 2.24 and 3.21). Concerning institutional reform, as required under Loan 2720-BR, the Government has provided the Bank with the preliminary findings of their study on this subject, REVISE (para. 2.20). Also under Loan 2720-BR, the Government committed itself to improved sector financial performance and investment programming in connection with the implementation of a PSRP. The level of financial performance improved in 1987 and 1988, over the level of performance in 1986 -- but this improvement was at a rate slower than anticipated (para. 2.26). Due to the Plano Verao, the PSRP is being reformulated to reflect levels of sound financial performance that are consistent with the new economic environment of the country (para. 2.27). The continuity of the Bank's dialogue with the Government on the full range of policy issues and measures related to the power sector will be maintained and developed in connection with proposed future lending operations such as the Electricity Transmission and Conservation, Electricity Distribution and Conservation, and National Environment Loans.

D. ENVIRONMENTAL POLICIES AND PROGRAMS IN THE ENERGY AND POWER SECTORS

The Evolution of Environmental Legislation

2.33 National environmental concerns were addressed in many early laws, such as the Water Code (Decree 24.643) of 1934, or the Historic Patrimony Decree-Law of 1937 creating the first National Parks, the Fishing Code of 1938, and later, among others, through the National Health Code (Decree 49.974) of 1961, the Protection of Archeological and Historical Heritage (Law 3.924) of 1961, the creation of the Superintendency for Fisheries (SUDEPE) in 1962, the new Forest Code (Law 4.771) of 1965, the Fisheries Development Superintendency of 1962, the Hunting Code of 1943, substituted for by the Faunal Protection Law of 1967, creation of the Forestry Institute (IBDF) in 1967, and the Indian Statute of 1973. The Special Secretariat of the Environment (SEMA, created in 1973) secured promulgation of the National Environmental Law (Law 6.938, which is regulated by Decree 88.351 of 1983) in 1981, and the institution of a National Environmental System (SISNAMA), which is headed by the National Environmental Council (CONAMA) (ELETROBRAS and DNAEE are represented on CONAMA). In its Resolution 001 of 1986 CONAMA stipulated that mandatory RIMAs must be carried out for all major development projects (in the case of the power sector as part of feasibility studies) and approved by environmental authorities prior to construction (legislation pertinent to the SISNAMA is available in the Project File).

2.34 Since 1985, SISNAMA has been increasingly decentralized, and state-level environmental and forestry agencies have been created in most of Brazil's states. In 1987, CONAMA resolved to delegate licensing to state level environmental agencies. State level agencies have the option of seeking advice in licensing matters from the federal level environmental agency. So far, both state level and federal environmental agencies tend to lack some of the expertise necessary to fully analyze the RIMAs of the power sector.

2.35 Brazil's new constitution of October 1988 includes two chapters on the environment and on Brazilian Indians, which significantly strengthened the Government's objectives in those aspects. Also in October 1988, the government launched a special program " Nossa Natureza", creating six working groups and halting fiscal incentives for livestock projects in the Amazon. On April 6, 1989, President Sarney formally enacted the Nossa Natureza Program, issuing and submitting to Congress a large package of decrees and draft laws, which seek to (a) contain the predatory use of natural resources, (b) rehabilitate ecosystems affected by deforestation, (c) strengthen environmental protection, (d) promote environmental conservation and protection through educational and communication campaigns, (e) control the occupation and exploitation of Amazonia, on the basis of improved planning, and particularly zoning; and (f) to protect Indian, riverine and other populations who derive a livelihood from extractive (e.g. rubber tapping) uses of the forest (a summary of legislation passed and/or proposed under the Nossa Natureza program is contained in Annex VII). In January 1989, the program's recommendations resulted in the creation of a single and strengthened environmental agency, the Brazilian Institute for Environment and Renewable Natural Resources (IBMA), which incorporated SEMA, IBDF, SUDEPE and the Superintendency for Rubber (SUDHEVEA). IBMA is responsible for formulating, coordinating,

executing and enforcing the National Environmental Policy (see Project File), as well as for managing renewable natural resources.

Environmental Policy Development in the Power Sector

2.36 Concern with the environmental impact of major hydroelectric projects began in the early 1970s. CEMIG was the first utility in Brazil to include an environmental reconnaissance as part of the feasibility study for the Sao Simao project completed in 1978, assisted by Loan 829-BR. Environmental reconnaissances were carried out in connection with some additional hydroelectric projects: Itaipu and Itumbiara in 1972, Sobradinho in 1973, Salto Santiago 1974, and Foz do Areia in 1975.

2.37 In the early 1970s awareness of environmental issues in power projects also increased internationally. For example, the Bank created an environmental unit in 1971 and in 1972 there was the world's first environmental conference (Stockholm, 1972). Further, doubts were expressed about the environmental impact of the Aswan High dam (1972). Since then, the Brazilian power sector has progressively introduced the environmental assessments in its planning for hydroelectric projects. Environmental analyses have been commissioned earlier in the project cycle, and their findings integrated into project design.

ELETROBRAS' Role and Early Amazonian Dams

2.38 ELETROBRAS created a modest in-house environmental unit in the early 1970s. Under Loan 2720-BR, it was restructured and strengthened, and finally upgraded to a full department, with three divisions, the Environmental Department (DEMA). CESP was the first electric power sector company to address systematically the environmental impact of its dams, doing so even before 1970, with other leading regional utilities progressively following suit.

2.39 There are several dams completed so far in the Amazon region, and the Bank was not associated with the design or financing of any of them. The first dam in Amazonia was CELPA's 68 MW Coaracy Nunes, inaugurated in 1975, which flooded only 23 sq. kms. (mainly of savanna with little forest). The main environmental problem, identified years later, was the precipitation of metal salts, which clogged the turbine's cooling coils. In 1977, Amazonia's second dam, the 40 MW Curua-Una also owned by CELPA, was completed, flooding 86 sq kms of forest. In both cases there had been little environmental planning. Environmental problems, such as intense production of poisonous hydrogen sulfide gas, and water weeds clogging the intakes and spillways, arose at Curua-Una soon after reservoir filling. ELETRONORTE's first project and the third in Amazonia -- Tucurui -- was designed in 1973, and an environmental study was conducted shortly after construction had started. The adverse environmental impacts of this project, above all the loss of 2,430 sq kms of tropical rain forest and the relocation of the Parakanan Indian tribe, sparked controversy. On the positive side, Tucurui, with a present capacity of 1.980 MW (and a final installed capacity of 7.260 MW), has generated considerable amounts of energy. This contrasts with Balbina, ELETRONORTE's second dam and the fourth in Amazonia, which has an installed capacity of only 250 MW, but caused the loss of over 2,430 sq kms of tropical forest, and has had severe consequences for the Waimiri-Atroari Indian tribe. Although this dam was

almost entirely completed by 1986, mitigatory environmental measures for this dam were carried out, on an emergency basis, in the context of Loan 2720-BR. Early dams in the Amazon and elsewhere (well before the advent of the EMP) have been criticized not only with regard to their direct environmental impacts, but also to their (usually less well recognized) indirect impacts caused by large construction camps, unplanned settlements, access roads and transmission lines.

Environmental and Social Issues in the Power Sector

2.40 In 1986, the sector had 57 operating hydroelectric plants of more than 30 MW capacity, with an installed total capacity of 38,478 MW, and a total reservoir area of 20,107 Km2. Brazil's "Plan 2010", which was published in December 1987, analyses the need and options for a significant expansion of electric power generation capacity to support national economic growth and development over the next two decades. It is based on the estimate, that Brazil's population will grow from 135 million in 1986 to 208 million in 2010, and that the demand for energy might increase at an average annual rate of about 5% during the same time period (i.e., from 43 GW in 1986 to 160 GW in 2010). Another assumption of the "Plan 2010" is, that the share of hydroelectric power will remain at its present level of about 90%. These projections will be adjusted in the context of the sector's planning strategy, which always takes into account long term (20-30 years), medium term (10-15 years) and short term (5 year) investment needs.

2.41 To expand its electric power generation capacity to the essential, minimum levels Brazil will have to rely on projects in both the Southern and Amazon regions. In both regions, however, hydroelectric development raises serious concerns: in the South, the identified options tend to be problematic primarily for social reasons, because they would typically involve highly developed and densely settled areas and, therefore, would require large scale resettlement programs. In the Amazon, construction of hydroelectric projects could have significant adverse environmental consequences, and would directly or indirectly affect Indian tribes. In remote areas of the Amazon, which have remained largely untouched so far, the respective projects, transmission lines, access roads to the constructions sites and workers' camps could also trigger broader frontier development processes.

2.42 The proposed hydro-generation expansion program represents the largest single such program in the world. About 425 potential sites for hydroelectric projects have been identified. Of these, 73 are located in Legal Amazonia. Seventy percent (70%) of all hydroelectric plants foreseen under the expansion plan are located in the South and Southeast. For Amazonia, 15 projects were included under the medium term "Plano 2001" investment plan. However, in analyzing these plans it is important to understand that out of these (i) two projects have already been completed (Balbina and Samuel); (ii) six projects are not located within, but are south of the tropical rainforest environments; (iii) for five projects, studies have been delayed indefinitely (Apiakas, Caiabis, Aparai, Avila and Paredao); (iv) three projects, have been delayed at least 24 months (Manso, Cachoeira Porteira and Ji-Parana), and (v) two projects have been cancelled (Santa Isabel, Babaquara). In effect, the only project which seems to be on schedule is Kararao on the Xingu River, which appears to

have exceptional advantages, generating 6,300 MW of power by 2001 (and eventually 11,025 MW, with equipment installed later than 2001), while requiring a proportionately very small reservoir of 1.225 km2. Originally, all plants foreseen until 2001 were expected to dislocate 400 to 500 thousand people. However, due to the most recent revisions, which eliminated the Santa Isabel, Pedra Branca, Belem and Ilha Grande projects (largely because of their resettlement aspects), this number has been reduced by almost 200,000. The resettlement requirements of the remaining projects include about 2,800 Indians, who would be directly affected.

2.43 With the objective of minimizing adverse environmental and social impacts in the context of future generation projects, the power sector should: (a) undertake a large number of environmental and social studies and impact evaluations at the inventory and feasibility planning stages; (b) identify the least damaging environmental and social options; (c) exclude environmentally and socially high-cost projects; and (d) assure that the highest environmental and social standards are adhered to in those projects which are licensed for construction within the context of the least-cost power investment program. Under the " Plan 2010" most of the fundamental investment choices and decisions regarding hydroelectric development are in the process of being made, or are expected to be made over the next few years. Hence, this is a singularly important time for environmental and social planning in the Brazilian power sector, and for the implementation of sector guidelines and action programs under the EMP.

2.44 Continued progress in the achievements of sound environmental and social goals in the power sector will require: (i) improved implementation of the guidelines of the EMP with regard to ongoing as well as planned projects (including adequate funding arrangements) on the part of individual power utilities; (ii) monitoring and evaluation of such implementation by ELETROBRAS; (iii) in connection with (ii), development of a separate accounting system for the environmental and social budgets of the operating utilities; (iv) hiring or contracting adequate numbers of properly qualified staff, or contracting of specialist services, by ELETROBRAS, the Electric Power Sector Companies and governmental agencies outside the power sector which must make specific contributions to the implementation of the EMP under the applicable general legislation; (v) ensuring adequate institutional arrangements related to licensing procedures; (vi) updating of the EMP to include under its guidelines the recommendations of thematic studies with regard to riverine populations (resettlement, local participation and land acquisition), regional planning, Indian populations, coal fired plants, flora and fauna, and water quality; (vii) legal assistance to Brazilian tribal groups; (viii) improvements in the effectiveness of a consultative body, the Environmental Advisory Committee, (CCMA) (para. 3.05) and a coordinating group, the Coordination Committee for Environmental Activities in the Power Sector, (COMASE) (para. 3.05); and (ix) strengthening the Government's capability to deal with specific environmental and safety aspects arising from the nuclear power program. In addition the EMP will have to be revised to take account of the environmental and safety aspects of the nuclear power program; and CCMA will be invited by the Consultative Committee on Radiological Protection and Nuclear Safety, to participate in the preparation of recommendations concerning the environmental radiological impact of nuclear power plants.

E. THE BANK'S ROLE

The Bank's Policy on Environment

2.45 During the nearly two decades which have elapsed since the creation of the Bank's first environmental unit, concerns for the environment have evolved in the Bank as they have in Brazil. The overall thrust of the Bank's environmental policies is to strengthen governmental efforts to develop and implement rational environmental and natural resource management policies, rather than to do detailed analyses and monitoring of particular aspects. Within the broad spectrum of environmental concerns, the Bank has addressed some aspects more rapidly than others. For example, water-borne disease, reservoir sedimentation, induced seismicity, and in reservoirs and river water quality, were addressed early on, while related social issues, such as involuntary resettlement and Brazilian Indians, began to receive attention at a subsequent stage. The Bank codified its best prevailing practice into formal policies, such as those relating to involuntary resettlement (1980), tribal peoples (1982), environment in general (1984), wildlands (biodiversity) (1986), cultural property (1986), and dams and reservoirs (1989). These policies are being increasingly implemented both in Bank-assisted projects and others.

2.46 Over the years, the Bank's growing concern to avoid the negative social and environmental impacts of projects, has evolved into an approach involving direct support and financing for environmental, and especially natural resource management programs, either as components of larger economic development projects, or freestanding. In addition, the Bank sought to support institution building for the environmental area (see paras. 2.49 and 2.50).

The Bank's Policy on Energy Conservation

2.47 The Bank has placed increased emphasis over the past decade, since the second oil price shock, on addressing the task of improving energy efficiency in the developing countries. The Joint UNDP/World Bank Energy Assessment Program, launched in 1980, was particularly successful in increasing awareness of the scope for energy savings, notably in industry and transport and in the electric power sector. Additional work in this area took place within the framework of the Joint UNDP/World Bank Energy Sector Management Assistance Program (ESMAP), started in 1983, which has implemented a number of technical assistance activities in the energy conservation field. At the same time, the Bank's lending to improve energy efficiency has increased markedly: a number of structural adjustment loans have addressed the need for energy conservation; loans have been made for modifying existing processes and for converting to cheaper fuels in energy-intensive plants; and technical assistance has been provided for energy audits and institutional strengthening for energy conservation.

2.48 Many of the Bank's lending operations in industry and energy have addressed energy-pricing policies, helping countries towards more rational pricing for the various forms of energy (para. 2.24). Energy pricing is also frequently discussed as part of the dialogue on structural adjustment lending. Bank operations have improved power transmission and distribution

systems; and power system loss reduction and rehabilitation have become a distinct and valuable component of ESMAP. The Bank has supported studies on how to improve energy efficiency in transport and a number of urban traffic management projects have been designed to alleviate congestion and thereby reduce automotive fuel consumption. Efforts to make the consumption of fuelwood and other biomass fuels more efficient have included the promotion of better woodstoves in agriculture and rural development projects.

Institution Building

2.49 The policies noted above strongly assisted both the borrower and the Bank to improve the environmental quality of projects and energy conservation efforts. Although the policies have been implemented over time, the weakness lay in the lack of specialists to implement, and the inability of the Bank to scrutinize projects within sector loans to the same degree as individual project loans. Therefore, the Bank sought to promote institution building for environmental work and energy conservation in the borrowing agencies. For environmental activities, this began modestly with one specialist (plus training) included in project costs. Now it is becoming routine for agencies sponsoring a project with major environmental aspects to create at least a modest unit, usually in-house or on-site. Such units normally contain a range of expertise in physical, biological, financial, economic, engineering and social fields.

2.50 On the environmental side, the Bank is codifying these new procedures into policy, namely Environmental Procedures in Dams and Reservoirs (O.D.4B, scheduled for 1989 summer). Under the Loan 2720-BR, the Bank assisted ELETROBRAS to create DEMA (para. 2.38) and CCMA (para. 2.44). In addition, the Bank assisted ELETROBRAS to strengthen those non-power sector agencies whose input is needed for the power sector's environmental needs, such as the federal agencies responsible for forests, conservation units, Indians and environment.

2.51 In the areas of electricity conservation and substitution, ELETROBRAS, through the Division of Energy Conservation and Substitution, which operates under the Department of Coordination, has also undertaken considerable efforts to expand and enhance its activities by substantially upgrading its capabilities to undertake relevant policy measures and action plans. Its human resources have been strengthened by incorporating additional specialized professionals who are continuously trained through foreign institutions, local research centers and specialized seminars/courses. The above efforts will be supported through this loan, and future Bank lending to the Brazilian power sector.

PART III. THE ENVIRONMENTAL MASTER PLAN (EMP) AND THE ELECTRIC ENERGY CONSERVATION PROGRAM

A. INTRODUCTION

3.01 Part II outlined the energy and power sectors and their environmental and energy conservation dimensions in general terms. It also summarized key aspects of the Borrower's National Environmental System (SISNAMA) and its policy towards electric energy conservation. Section B of Part III focuses on the EMP (para. 2.29), (a) describing the function of the EMP as the sector's main tool for promoting environmental and social improvements sector-wide; (b) summarizing the institutional responsibilities for the implementation of the EMP; (c) summarizing the progress achieved by the EMP to date; and (d) describing the specific means by which the Borrower proposes to refine and implement the EMP under this loan. Section C examines the PROCEL (para. 2.16) and DRELOR (Para 2.30).

B. THE ENVIRONMENTAL MASTER PLAN (EMP)

Function of the EMP

3.02 The fundamental concern in the preparation of the EMP was to overcome a situation in which, in 1986, the environmental units of most concessionaires and ELETROBRAS were inadequately equipped and funded, and in which the environmental and social programs for most projects were significantly delayed and received comparatively little attention. In addition, the sector had to deal with, and seek to mitigate the legacy of a number of environmentally and socially ill planned and implemented projects. The issuance of the EMP was preceded by that of the ELETROBRAS "Manual for Studies of Environmental Effects of Electric Systems" in June 1986, which improved environmental planning at a general level, by setting, for the first time, common standards for environmental analysis in the sector as a whole. Following the completion of the Manual, ELETROBRAS prepared the complementary, more comprehensive and detailed EMP for sector-wide environmental management, which was to parallel the long term power sector expansion "Plan 2010". The first version of the EMP was prepared in the second half of 1986, with the dual objective of (a) putting in place the means to implement the Manual, and (b) expanding and complementing the guidance provided by the Manual through social guidelines for projects involving resettlement and Indians (see para. 2.29).

3.03 Loan 2720-BR supported the preparation and implementation of the EMP. Following its publication in December 1986, the EMP, in combination with the Manual and general federal guidelines for the preparation of RIMAs, has provided guidelines for the treatment of environmental, resettlement, and tribal matters, for different stages of project planning and implementation. The EMP has also called for and led to the implementation of institutional strengthening, monitoring, and evaluation programs in connection with the implementation of guidelines, and it led to specific action programs (including funding) for environmental and social purposes at the level of the Electric Power Sector Companies. In an introductory background section, the EMP analyzes the implications of

national environmental policies and legislation for the power sector. The EMP is considered an evolving instrument to assure and further improve the environmental and social performance of the power sector. Following extensive discussions with concessionaires, COMASE, CCMA, government agencies and others, it is periodically re-issued to update and upgrade its guidelines, project-by-project environmental and social action programs, and relevant questions of institutional strengthening and legislative background. The first, November 1986 version of the EMP has been revised once so far, in December 1987.

3.04 In October 1988, Brazil's nuclear power program, which had previously been under the responsibility of NUCLEBRAS, was included in the Electric Power Sector (see para. 2.23). Because of the recent integration of the nuclear power generation program in the power sector, its environmental and safety aspects have not yet been addressed in the EMP. ELETROBRAS plans to deal with conventional and nuclear safety-related environmental issues, and related institutional responsibilities, which remain largely outside the ELETROBRAS system, in the next (1989) version of the EMP.

Institutional Responsibilities for the Implementation of the EMP

3.05 Responsibilities for the implementation of the EMP are divided among: (a) institutions of the power sector, namely the MME, DNAEE (para 2.19), ELETROBRAS, the Electric Power Sector Companies (including ELETROBRAS' subsidiaries and state level electric power companies), COMASE and CCMA; and (b) federal and state level environmental, forestry, fisheries and Indian agencies:

(a) Responsibilities within the power sector:

- DNAEE exercises the licensing function. In its examination of technical and environmental project aspects, DNAEE is assisted by ELETROBRAS, which analyzes the proposals made by the Electric Power Sector companies and submits statements and recommendations to DNAEE. The licenses for projects must be ultimately approved by the President of the Republic, upon the recommendation of the MME.

- ELETROBRAS has a coordinating function for the sector. Through DEMA, it is responsible for (i) the monitoring and evaluation of the implementation of and funding for the EMP by the Electric Power Sector Companies (in this regard, its influence is strongest in the case of its direct concessionaires, and lesser in the case of state-level power companies); (ii) the further improvement of guidelines, on the basis of comprehensive studies; (iii) convening the sector-wide environmental coordinating committee (COMASE); (iv) convening and acting as a secretariat for the sector's independent "blue-ribbon committee", CCMA; (v) the periodic up-dating of the EMP, (vi) sector-wide environmental training programs, and (vii) representing, jointly with MME. the environmental concerns of the power sector in the National Environmental Council (CONAMA). The CEMA has functioned as ELETROBRAS' Environmental Advisory Committee since December 1986. It has nine professional members -- planners, academics, researchers, non-governmental officers -- with no affiliation to the power sector. It meets at least four times a year,

often on one of the project sites, reviews the implementation of the EMP, and of the sector's plans and programs, and advises ELETROBRAS' Board of Directors; it can call for special studies as the need arises, and can coop specialists when needed. The report of each CCMA meeting contains recommendations to ELETROBRAS, which are required to respond to them before CCMA's next meeting.

- The Electric Power Sector Companies have the principal responsibility for the expansion of generation capacity under the "Plano 2010". In this context, they are responsible for carrying out environmental and social action programs. These involve (i) at the inventory stage, environmental and social data collection, which allows, early on, for a preliminary assessment of related environmental and social costs and mitigation possibilities; (ii) at the feasibility study stage, detailed environmental impact studies (including the preparation of the legally required RIMAs) in accordance with the Manual and the EMP, among others considering the impacts of proposed projects on flora and fauna, riverbasin management, water quality, water-related diseases, and in addition detailed social studies considering potential resettlement needs, direct or indirect ways in which the proposed project might affect Indian communities, and broader implications for regional development; these impact studies must also discuss ways in which negative impacts might be mitigated; (iii) consultations (and, as needed, contractual agreements) with populations who would be affected by proposed projects; (iv) "convenios" (including funding for) federal and state environmental and Indian agencies involved in the studies, licensing or implementation of projects; (v) decisions, jointly with ELETROBRAS, concerning choices between alternative investment options; (vi) participation, jointly with ELETROBRAS, in mandatory public hearings to discuss RIMAs with local representatives; (vii) during the construction stage, the carrying out of any mitigatory environmental measures (agreed upon in the context of RIMA licensing), and of resettlement, Indian assistance, archaeological salvage or any obligatory financial indemnification measures, as well as safeguards related to the construction site, access routes and transmission lines; (viii) observation of environmental and social safeguards during plant operation, (ix) participation in COMASE; and, (x) consultations with CCMA upon request. While the Electric Power Sector Companies maintain environmental and social staffs at headquarters as well as on site, most of their work is contracted out to the major consultant companies of the sector.

- Coordination Mechanisms within the Electric Power Sector. In addition to the "Grupo Coordenador de Planejamento de Sistemas Eletricos" (Coordination Group for the Planning of Electric Systems (GCPS)), which was created in 1982 with 34 Power Sector Companies, under the coordination of ELETROBRAS, a specific coordination mechanism, COMASE, has been created by the Minister of Mines and Energy, under the EMP, in 1988. COMASE includes federal, state, municipal and private power companies, ELETROBRAS and DNAEE. It has a structure similar to that of the GPCS, which it advises, and is coordinated by ELETROBRAS as a forum for the discussion of environmental matters, to agree on coordinated action, and to assign responsibilities.

(b) Responsibilities of the Federal and State level Environmental Agencies:

These agencies have normative and licensing functions, and they are in many cases also involved in directly implementing the EMP in line with their respective legal attributions:

- IBMA is responsible for (a) overseeing the implementation of national environmental legislation, including adherence to norms and standards for RIMAs, as they are set by CONAMA, (b) acting as a secretariat for CONAMA and enforcing its resolutions, (c) providing guidance, training and, upon request, direct assistance to state-level environmental agencies in licensing and monitoring, (d) commenting on any changes/updatings of environmental guidelines for the power sector, (e) executing conservation and forestry components related to power projects, (f) executing fisheries components related to power projects.

- FUNAI is responsible, at the federal and regional levels, for studies and action plans for all Indian areas which might be affected or are being affected by power sector projects. In addition to FUNAI, Indians can rely on the Ministerio Publico and assistance by ELETROBRAS, if they wish to draw on independent legal counsel in the context of power sector projects. In the past, FUNAI has been exclusively responsible for all Indian matters under Law 6001 (The Indian Statute). This law is likely to be changed once existing legislation is made consistent with the Indian Chapter of the new 1988 Constitution.

- State level environmental agencies are responsible for the licensing and monitoring of projects, that is, they must review and comment on RIMAs. Following the approval of RIMAs, they must monitor compliance with agreed upon environmental safeguards throughout project implementation; this compliance is a precondition for the subsequent licensing of the operations of projects. In many cases, the state level agencies lack specialist staff, who would be necessary either for a satisfactory compliance with their licensing attributions, or with their contractual agreements with the power sector for purposes of implementing project components relevant to their area of competence under the law. State level environmental, forestry and fisheries agencies may also be called upon for purposes of implementing components relevant to their area of expertise.

3.06 Institutional responsibilities for the implementation of environmental safeguards for nuclear power generation projects are as follows:

- FURNAS is the Electric Power Sector Company responsible for the operation of the Angra I plant;

- directly under the Presidency, the National Commission for Nuclear Energy (CNEN) is the normative regulatory body for Brazil's nuclear sector. In the context of the August 31, 1988 reorganization of the nuclear sector, a Superior Council for Nuclear Policy was established, which will have the mandate to advise the President of the Republic in formulating the national nuclear policy. It is composed of three Ministers and of Government officials, and allows for the participation of

representatives of the scientific community. Advisory Committees were also created, to advise the Council in the areas of radiological protection and nuclear safety; nuclear development; radioactive wastes; nuclear industry and trade; and nuclear applications. CNEN has the authority to license nuclear power plants with regard to the nuclear aspects of environmental safety, based on RIMAs which must be prepared by the relevant sector utility. Before issuing environmental licenses, CNEN consults with federal and state level environmental agencies, and other state and local authorities. CNEN formulates plans and arrangements regarding catastrophic emergency and evacuation, while the armed forces would be called in to execute such plans. CNEN has maintained close relations with IAEA and the Karlsruhe Nuclear Research Center (Kerforschungszentrum Karlsruhe/KfK). Cooperation between CNEN and KfK has led to the development of the pre-operational environmental monitoring program for the Angra nuclear power plant site, and monitoring of environmental radioactivity since the beginning of the operation of the nuclear power plant in March 1982, **and,**

- state level environmental agencies (in the case of the Angra plants, the Rio de Janeiro State Environmental Agency, FEEMA) are responsible for the monitoring of conventional (non-radiological) environmental impacts of nuclear power generation.

Progress in the Implementation of the EMP to Date

3.07 As a result of the EMP, since 1986, social and environmental safeguards have been increased, most importantly through the carrying out of specific project level action plans, improvements in the investment screening and selection process, and through institutional strengthening. At the same time, the outcome of many of these efforts will depend on their continuity and sustained support over the typically long time horizons involved in both project analysis and planning and in project implementation (for example of environmental and Indian protection programs, or of resettlement processes).

3.08 Since 1986, ELETROBRAS and the Electric Power Sector Companies have complied with the EMP through:

(a) the carrying out and financing of action plans addressing environmental, Indian, resettlement and archaeological matters:

- in this context, the Electric Power Sector Companies have, among others, prepared detailed environmental and social inventory and feasibility studies, and RIMAs;

- they have also initiated processes of regular consultation with affected populations and their representatives (e.g. in Machadinho, Ita and Itaparica) and held or participated in public hearings and seminars regarding a number of proposed projects (e.g. in Manso, Belem and Altamira);

- for projects at more advanced stages of planning, action programs were begun to assure local participation in resettlement planning, to demarcate Indian areas in the vicinity of proposed projects, to initiate biotic inventories, and to

carry out conservation and archaeological salvage operations, and for some of the projects at the inventory and feasibility stages, the environmental and social analyses led to important design adjustments, with a view to minimizing negative impacts (the Ji-Parana project on the Machado/Ji-Parana River is a case in point).

- for a number of advanced or already operational projects, for which overall design adjustments were not possible, mitigatory interventions were implemented (the Balbina project is a case in point). The demarcation of Indian reserves affected by all projects which were under construction has been completed, and special Indian assisting programs have been implemented. A first resettlement operation is being carried out under the Itaparica project, in line with the improved guidelines under the EMP.

(b) In some cases, new parameters in the evaluation and analysis of proposed projects led to shifts in the overall investment program:

- priority is now given to projects with more manageable environmental and social features. Several environmentally or socially problematic hydropower development options, which were originally considered under the "Plano 2010" (published in December 1987) have been dropped or postponed indefinitely. Among them are, as a result of the respective environmental and social assessments, Babaquara (which would have flooded 6000 km2), Sta. Isabel (which would have flooded 3.746 km2 and displaced 43.000 population), Belem (which would have displaced a population of 36.000), Pedra Branca (which would have flooded 1.352 km2 and displaced 92.000 population), Ilha Grande (which would have flooded 3.270 km2 and displaced 17.000 population), and Capanema (which would have flooded 18 km2 of the Iguacu National Park). Several others, which are also characterized by environmental and social complexities, are also being postponed for the time being. At the same time, projects which were originally planned for a later stage, and which have comparatively more acceptable environmental and social features, were advanced (Belo Monte/Kararao on the Xingu River is a case in point).

(c) ELETROBRAS and the Electric Power Sector Companies have strengthened their implementation capabilities for the environmental program through:

- an exceptional Governmental permit, for the hiring of 180 environmental specialist staff for the Electric Power Sector in 1987 (today, the sector employs a staff of about 700 in the environmental area);

- creation and initial staffing of a Department for the Environment (DEMA) at ELETROBRAS;

- the creation and/or upgrading of substantial in-house environmental and social units, at the level of the leading Electric Power Sector Companies, and of the major consulting corporations for the Brazilian Power Sector;

- the satisfactory operation and functioning of the CCMA (para. 2.44);

- the functioning, since April 1988, of the COMASE (para. 2.44);

- the development of a monitoring and evaluation system for the execution of the EMP (including the implementation of the Manual) in ELETROBRAS and its subsidiaries (this system has been designed, tested and is in the initial implementation stage);

- the convening, by ELETROBRAS of an inter-agency work group, to prepare environmental (including social) guidelines and procedures for the licensing of electric power sector projects, for the purpose of contributing to the improvement of general federal guidelines for RIMAs;

- the initiation, by ELETROBRAS and COMASE, of the design of the Environmental and Social Accounting System in the budgetary process of the Electric Power Sector;

- the functioning, since 1987, of an environmental training program for high level staff and managers of the power sector.

(d) The implementation of the EMP has been further strengthened on the basis of specific Environmental Commitment Letters which ELETROBRAS received in October/November 1988 from the Electric Power Sector Companies (from ELETROBRAS' subsidiaries ELETRONORTE, CHESF, FURNAS, and ELETROSUL, as well as from CEEE, CESP, COPEL, CEMIG, CEMAT, CER, CERON, and CELPA):

- These letters express the formal agreement of these companies to comply with all guidelines laid out in the latest version of the EMP (December 1987) with regard to all their projects and studies. These letters also specify more detailed commitments for the most advanced group of projects, to assure that the timing and progress of activities related to environmental, resettlement and Indian matters will be commensurate with overall project construction schedules (Annex IV). They also confirm their respective intentions to collaborate in the implementation of the ELETROBRAS monitoring system for the EMP, and in the design and preliminary implementation of a related separate financial planning and accounting system for environmental programs (including the preparation of specific environmental budgets for the most advanced group of projects, where reservoirs would be created by or before 1993). They also commit them (a) with regard to staffing, to the employment of services of adequate specialist teams, and the informing of Eletrobras of their numbers and qualifications, (b) with regard to environmental conservation, to the establishment of conservation units, the preparation of inventories, and reports

on the status quo and action plans for existing conservation units, and (c) to timely archaeological salvage. Finally, ELETRONORTE and CESP have also agreed to carry out environmental and social evaluation studies for Tucurui and Rosana.

(e) The funding, by ELETROBRAS and the Electric Power Sector Companies of environmental specialists for federal and state level institutions involved in the carrying out of the EMP:

- funds have been provided to FUNAI, SEMA, IBDF and SUDEPE, in the context of a large number of special cooperation agreements with the power sector;

- funds have also been provided for the hiring of expert services for state level environmental agencies engaged in the licensing and monitoring of projects.

(f) The guidelines of the 1986 EMP have been progressively improved:

- In December 1987, ELETROBRAS submitted a first, updated version of the EMP. This version has been reviewed by CCMA, as well as FUNAI, SEMA and IBDF, who have furnished their comments to ELETROBRAS, for incorporation in the 1989 updated version of the EMP. In addition, ELETROBRAS commissioned in 1987, and has by now largely completed five special thematic studies on (a) Riverine Populations; (b) Coal-fired Plants; (c) Indian Populations; (d) Flora and Fauna; and (e) Regional Integration, and has prepared a schedule under which the results of these studies will be reviewed within the sector and translated into guidelines under the EMP in 1989.

(g) Governmental and CONAMA initiatives:

- New parameters for environmental licensing of power projects were established in 1987 by a governmental work group;

- in 1988 the National Environmental Council (CONAMA) approved resolutions for mandatory public hearings for all power projects at the RIMA stage;

- Government legislation now mandates that at least 1% of the total cost of any power project shall be allocated to environmental conservation purposes.

(h) Progress relevant to the implementation of the EMP has also occurred at the level of the National Environmental System (SISNAMA):

- Brazil's new constitution of October 1988 includes two chapters on the environment and on Brazilian Indians, which significantly strengthened the Government's objectives in those aspects.

- also in October 1988, the government launched a special program " Nossa Natureza", which focused unprecedented attention on the environmental problems of the Amazon (see Annex VII) and,

- in January 1989, a decree was passed creating a stronger national environmental agency, the "Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renovaveis" (IBMA) (see Annex VII).

3.09 The implementation of the Manual and the EMP involves a large number of actors. Provided that all of them are adequately equipped to perform their functions, the system can produce high quality technical work, enforced among others through a system of multiple checks and balances within the power sector, within SISNAMA at the federal and state levels, and by means of organized public participation. Major efforts have been made with regard to institutional strengthening within the power sector; however, while current performance represents a significant improvement over pre-1986 levels, a further strengthening of monitoring functions is needed. Licensing, monitoring and technical cooperation functions at the level of federal and state level agencies, do not yet match the requirements of the EMP. It is therefore a purpose of the proposed loan, (a) to assure higher and more uniform levels of quality control, within ELETROBRAS, and (b) to strengthen capabilities at the level of federal and state environmental authorities.

Implementation of the EMP under the Proposed Loan

3.10 The government's policy letter (Annex III) informs the Bank that the government seeks to achieve its strategy of integrating environmental concerns into the power sector primarily by means of implementing the EMP, with the objective of fostering environmentally and socially sound investment choices in the context of its expansion program under the "Plano 2010", and of ensuring satisfactory performance under its more advanced and its operational projects.

3.11 As the preceding section on progress in the implementation of the EMP to date points out, a large number of appropriate environmental and social action plans and structures have been initiated since 1986. However, given the typically long time horizons in the planning and execution of hydro-power projects, and the large number of long term investment decisions which are pending in the context of the "Plano 2010", strong support for the implementation of the EMP is critical at this time. This loan would support the implementation of the EMP throughout the sector, in order to achieve its objectives and support the specific measures outlined below (paras. 4.13 to 4.15 and summarized in Annexes IV and V), for which the Bank will seek agreement, at negotiations, from the Borrower and ELETROBRAS.

3.12 The loan will support Government programs for priority environmental and social actions which include, among others:

(a) actions to resolve environmental problems and to upgrade projects already under construction (i.e., planned prior to the EMP). In this context, the following projects need immediate attention and funding, in order to assure completion of the resettlement and environmental programs: Itaparica, Balbina and Samuel; the initiation and completion in 1989 of resettlement and environmental programs under the Tres Irmaos and Taquarucu projects (Sao Paulo State). Plans, resettlement discussion,

archaeological salvage, land regularization etc. are required for the Caiabis, Segredo, Aparai and Xingo Projects. The originally scheduled completion dates for these projects (1993) have been deferred.

(b) environmental and social studies to catch up fully with the more advanced engineering studies for projects which would start construction between 1989 and 1991, much of the original planning for these projects also preceded the EMP. The projects in this category are Manso, Corumba I, Ita, Nova Ponte and the (now delayed) Avila, Paredao and Apiakas projects;

(c) environmental and social studies for projects which will begin construction between 1992 and 1997. This larger group of projects is at a planning stage which still allows for a consideration of alternative options, and for a full consideration of all EMP guidelines in project design. The most important project in this category is Kararao/Belo Monte.

(d) environmental and social studies for projects scheduled to begin construction after 1997; for this group, flexibility for the consideration of alternatives is greatest, but must be used and developed now, before investment program decisions are made final.

3.13 The objective of the loan is to support the implementation of the EMP both within the power sector and at the level of all relevant government agencies. The specific objectives of the implementation of the EMP will be: (a) the satisfactory implementation of the project specific environmental action plans, as they are specified in the Environmental Commitment Letters which ELETROBRAS has received from ELETRONORTE, CHESF, FURNAS, ELETROSUL, CEEE, CESP, COPEL, CEMIG, CEMAT, CER, CERON, and CELPA, (Annex IV); (b) full accounting for environmental and social factors in investment screening and selection under the Plano 2010, which will depend on improvement in the quality of inventory and results of initial feasibility studies; (c) that all necessary means be made available to give continuity to ongoing urgent resettlement, Indian, environmental and archaeological programs, especially in the cases of the Itaparica, Tres Irmaos, Taquarucu and Samuel projects, where resettlement is underway in 1989, and for all projects where reservoirs have recently been formed or are about to be formed between 1990 and 1993; (d) improvements in the preparation of RIMAs through higher quality technical analysis, and more detailed designs of mitigatory options and programs; (e) increased scrutiny in the review of RIMAs within the sector, in the context of public hearings and by relevant government agencies; (f) implementation of mitigatory or preventative measures, especially in isolated areas, already at the inventory study stage, to minimize any undesirable impacts on local, and especially on Indian communities; and (g) better integration of planning for power projects with general regional, and especially river-basin planning and management.

3.14 To better achieve these objectives, at negotiations, the Bank should seek the agreement of the Government and ELETROBRAS, as required with covenants in support of the following measures (paras. 4.13 to 4.15):

(a) provision of sufficient funding to carry out the ongoing environmental and social action plans, within the power sector as well as at the level of all relevant government

agencies for activities under the EMP which fall into their respective domains. This involves (i) the allocation of funds in 1989, and (ii) the completion of the design and implementation in ELETROBRAS and its subsidiaries of a separate budgetary system for environmental and social programs starting in FY 1990.

(b) provision of sufficient staffing, and/or availability of specialist services, at the level of ELETROBRAS and the Electric Power Sector Companies (in accordance with staffing provisions for DEMA, and the Environmental Commitment letters (para. 3.08(d));

(c) the full implementation of ELETROBRAS' monitoring system;

(d) support to the ELETROBRAS sector-wide environmental training program;

(e) implementation of an institutional strengthening program (ISP), specifically tailored to the task requirements under the EMP (see Project File) and the general RIMA legislation, for federal and state level environmental, forestry, fisheries and Indian agencies to enhance, as needed, their abilities to (a) review and comment upon RIMAs, (b) to monitor the implementation of safeguards, (c) to collaborate with the power sector under existing special agreements (convenios);

(f) with regard to Indians directly or indirectly affected by power projects and transmission lines, (i) assistance, as needed, by ELETROBRAS for Indians, to take full advantage of their entitlement to independent legal counsel under Brazil's Ministerio Publico, and (ii) satisfactory implementation of all existing agreements between ELETROBRAS, the Electric Power Sector Companies, FUNAI and Indian communities, especially with regard to land demarcations, protection and health services.

(g) additions to and improvements of the guidelines of the EMP, in the new 1989 updated version, which will include: (a) the results of the latest studies on, and improved guidelines for, riverine populations, coal fired plants, Indian populations, flora and fauna, and regional integration; (b) a section reflecting legislative changes following the enactment of the Borrower's 1988 Constitution; (c) an enhanced version of the Annex VI detailing the commitments of individual Electric Power Sector Companies; (d) adjustments resulting from the earlier comments and recommendations of CCMA, COMASE, SEMA, IBDF and FUNAI; (e) terms of reference for two follow-on complementary studies for the improvements of guidelines for (1) water quality, and (2) land tenure issues in resettlement, and (f) a section on environmental aspects of

the nuclear power sector. This version will be furnished for comments to COMASE, CCMA, IBMA and FUNAI, and to the Bank.

(h) A tightening of licensing standards and procedures under the mandatory RIMA system: To be approved, RIMAs must, in addition to assessing environmental impact, contain appropriate plans for mitigating environmental impacts, and these plans must be monitored by the appropriate environmental agencies at several stages of the construction stage. A license to operate depends on the satisfactory implementation of environmental safeguards agreed upon at the time of the licensing of the RIMA. Since 1985, SISNAMA has been increasingly decentralized, and state-level environmental and forestry agencies have been created in most of Brazil's states. In 1987, CONAMA resolved to delegate licensing to state level environmental agencies. State level agencies have the option of seeking advice in licensing matters from the federal level environmental agency.

Under the loan, the RIMA system will be strengthened (i) through the Institutional Strengthening Program referred to in (e) above, (ii) strict adherence in the preparation of RIMAs to pertinent national legislation, the Electric Power Sector's Environmental Manual, and EMP guidelines, and (iii) recommendations by special power sector task force for the further improvement of RIMA guidelines for the power sector;

(i) strengthening of outside, independent oversight of the implementation of the EMP by the CCMA, among others by increasing its meeting frequency, skills mix and access to information, and a detailed agenda for the coming year;

(j) strengthening of sector-wide integration of activities under the EMP, by fully operationalizing COMASE; this involves the final detailing of COMASE's internal procedures and work programs, and their implementation, and,

(k) strengthening the capability of the Government to address environmental and safety issues related to the nuclear power program, through (i) the carrying out, by IAEA, of an updated Operational Safety Review (OSAR) for Angra I, (ii) a review, also under the direction of IAEA, of regulatory practices and safety standards related to nuclear power generation (including a consideration of civil safety); (iii) adequate funding for CNEN, IBMA and FEEMA, for monitoring and licensing of environmental aspects of the nuclear power generation program; and (iv) initiation of special studies on nuclear waste disposal, decommissioning of Angra I and II, and for the RIMA of Angra II.

C. THE ELECTRIC ENERGY CONSERVATION PROGRAM

Introduction

3.15 In the past, both the Government and the power sector did not provide adequate support to implement the policy measures and action programs necessary to carry-out a comprehensive electric energy conservation plans. Because of the encouraging results and benefits obtained since 1987 through the implementation of basic/low-cost conservation policies and measures in limited areas of electricity consumption, such as the ones mentioned in paras. 2.30 and 2.31, the Government and the sector are now beginning to give increased priority and providing greater support to the establishment of policy reforms to conserve electricity and to the implementation of the corresponding action plans. The steps now being taken by the Government and the sector are extremely important because the above policy measures will help relieve the financial problems which currently affect the power sector, as these electric energy conservation measures are expected to defer for some time the necessity of installing new additional generation and transmission facilities as explained in para 3.16 below.

3.16 Currently PROCEL is being carried-out at a less than optimal pace because of the financial constraints faced by the sector. Nevertheless, the results of the policy actions already taken are extremely encouraging. Both energy conservation policies and activities have been already defined in detail. Electricity conservation is to be pursued through policy reforms and measures including: economically efficient pricing, improvement of equipment/ construction standards, load management; enhancement of industrial processes; power system loss reduction and educational/ advertisement campaigns. Some of the activities related to the program have been implemented only partially, however, because of limited availability of funds. To avoid further delays in processing some of these activities, implementation of the PROCEL program needs to be improved urgently through additional financial support.

3.17 The Bank is currently financing distribution expansion, rehabilitation of networks and loss reduction programs (DRELOR - para. 2.30) for various small state-owned utilities[1] located in the less-developed areas of Brazil. The main objectives of these loans were to establish sound commercial practices, specifically on electricity metering and billing, and to improve the operational efficiency of their installations and to provide both technical and financial support for these activities. The bulk of the works included in the above projects were related to the objective of reducing substantially the system power losses through the construction of new distribution lines (to unload existing lines); reconductoring existing networks (to reduce thermal losses of existing overloaded distribution lines), install new distribution transformer banks (to unload the existing ones) and install/replace

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1/ The companies benefitting from Loans 2138/2364-BR include: Companhia Eletrica de Alagoas, Companhia Eletrica do Para, Companhia de Eletricidade de Pernambuco, Centrais Eletricas do Maranhao, Centrais Eletricas do Piaui, Centrais Eletricas de Rondonia, Companhia de Eletricidade do Ceara, Companhia de Servicos Eletricos do Rio Grande de Norte, and Empresa de Energia Eletrica de Mato Grosso do Sul.

electricity meters (to enhance accuracy of electricity metering and to reduce pilferage/unaccounted electricity). Most of the sub-projects included in above loans are expected to be completed with delays of two to three years with respect to the original completion dates scheduled at appraisal.

3.18 The implementation of PROCEL and DRELOR, which aim at establishing policies and measures ranging from short-term, low-cost, quick paybacks on domestic and commercial uses to medium-term outlays - consisting mainly of implementing retroffiting schemes and installing new equipment on industrial uses, will result in investment savings during the period 1989-92 of about US$1.0 billion/year (or equivalent to deferring the installation of 800 MW of additional generating capacity in each of the above years). Some electricity conservation policies such as efficient electricity pricing and load management are expected to modify the system load curve patterns by displacing peaking capacity requirements (estimated at about 500 MW), while some measures such as system loss reduction schemes, improved use of equipment (motors, lighting, etc.), and more efficient industrial processes are expected to reduce electricity consumption (about 8,000 GWh/year).

3.19 It is in the above context that the proposed loan will enable the Bank to continue with its strategy of supporting the efforts of the power sector and the Government to enhance the efficiency of its operations and provide the grounds to adequately optimize the allocation of their resources. In particular, the Bank has financed several power projects which have: (a) improved the power systems' efficiency and promoted energy conservation through project components aimed at reducing power system losses; and (b) improved power load management by establishing upgraded as well as new Load Dispatch Centers in order to enhance the quality of power supply by improving voltage levels, system power factors and continuity of service. The proposed Energy Conservation component included in the loan is based on the establishment of comprehensive conservation policies and on specific projects (works, studies) to be implemented under PROCEL and DRELOR as currently carried-out by various state-owned utilities.

The PROCEL

3.20 The power sector and the industrial undertakings (both state owned and private) have taken important steps to implement electric energy conservation policies, guidelines and programs. It is difficult to determine the exact amount of funds already allocated by the Brazilian power sector and consumers to energy conservation as some of the conservation programs are the indirect result of larger investments on transmission/distribution networks or policies being adopted regarding energy uses. The proposed PROCEL program will be pursued through a variety of methods and mechanisms as detailed below.

3.21 The PROCEL program seeks to undertake the following policy measures and activities:

(a) Economically Efficient Pricing: Pricing policy reform will continue to be applied in order to complete the implementation of long-run marginal cost (LRMC) structures through the application of a premium to hourly and seasonal tariffs for on-peak and dry-season consumption as compared to lower tariffs for off-peak and wet-season consumption (para. 2.24).

(b) Load Management: This sub-program aims to develop policies, analytical methodologies and technologies which will stimulate the efficient supply and use of electric power.

(c) Educational and Advertising Campaigns: Most of the large utilities in the sector (over thirty) have been implementing since 1986 intensive public advertising campaigns through radio, TV, seminars and newspapers addressing power demand management and conservation issues. This sub-program supports and enhances the continuation of such campaigns.

(d) Research and Development: This sub-program includes the establishment of new policy measures and the support through the provision of human and financial resources to increase the activities on the areas of technical assistance to the industry, manufacturers of electrical equipment and overall electricity consumers as well as to promote and strengthen the institutions in charge of research and development of advanced technologies.

(e) Improvement of Industrial Processes: Establishment of new policy measures and implementation of programs to be undertaken by industry (both in the public and private sectors) to reduce electricity consumption. To assist the energy sector in this particular area, the proposed PROCEL program includes resources to finance components of specific conservation program mainly among large industrial enterprises during 1989-91.

(f) Improvement of equipment performance, construction methods and standards. This sub-program aims to establish new policy measures and to support and develop the adoption of more efficient technologies in: (i) the manufacturing of electrical equipment such as motors, refrigeration/heating systems, control, lighting; and (ii) the conceptual design of architectural and urban developments as well as the use of construction/insulation materials. It also will review and amend as necessary all standards, codes, legislation and regulations related to improved electricity conservation measures.

3.22 During negotiations the Bank should seek, as required, the agreement of the Government and ELETROBRAS to carry out the above policy measures and activities in a manner satisfactory to the Bank (para. 4.15 (xi) to (xvi)), especially in connection with the provision of funds for the execution of PROCEL, the completion of the implementation of the level and structure of tariffs to reflect the long-run marginal cost.

The DRELOR

3.23 The implementation of DRELOR during the early stages was not fully satisfactory because the financial and managerial constraints affecting these utilities, in particular the inability to provide the necessary counterpart funds. In late 1987, ELETROBRAS appointed a full-time coordinator and assigned additional staff from other ELETROBRAS departments, reactivating project execution and improving supervision and procurement monitoring. At the request of the Bank, ELETROBRAS recently submitted satisfactory programs reformulating the scope, implementation and disbursement schedules and financing plans of the sub-projects of the various state-owned utilities. Furthermore, the utilities benefitting from the above loans are committed to undertake important policy measures and have taken substantial measures to strengthen their corresponding executing units through the appointment of competent unit managers and by increasing the amount of professional staff assigned to the implementation of their corresponding sub-projects.

3.24 Because of the importance of fully implementing the policy measures and of carrying out the DRELOR and in order that they are timely commissioned, during negotiations, the Bank should seek, as required, the agreement of the Government and ELETROBRAS that: (i) as a condition for effectiveness the Borrower has approved an adequate financing plan, satisfactory to the Bank, for the DRELOR beneficiaries, which includes adequate financial resources for the full executing of DRELOR; and (ii) as a condition for the release of the second tranche of the proposed loan, to make available funds for the DRELOR beneficiaries, for an equivalent amount of US$70 million in a manner satisfactory to the Bank.

PART IV - THE PROPOSED LOAN

Loan History

4.01 The proposed loan is based on comprehensive work in the power sector and an intense dialogue with the Government on environmental policy and energy conservation since the early 1980's, especially in the last 3 years. The Bank's early involvement in these areas included projects for Energy Conservation/Distribution Network Rehabilitation/Loss Reduction - DRELOR (Loans 2138/2364/2565-BR) and continued, in 1986, under the Power Sector Loan (2720-BR) with the issuance of the EMP. Since then, the dialogue has proceeded with voluntary compliance by the Government on systematic enhancement of the EMP, follow up and implementation of EMP guidelines and recommendations, as well as with strengthening of energy conservation and loss reduction programs (e.g. PROCEL and DRELOR). Several missions from 1987 onwards have established a sound basis for the proposed loan.

Objectives

4.02 The principal objective is to continue improving the power sector policy and institutional capability to address properly the environmental and sociological aspects of its investment program; and to support the ongoing electricity conservation and distribution network rehabilitation/ loss reduction programs. This loan will be the umbrella operation that will establish the guidelines on environmental reforms and energy conservation in the power sector. It will thus, permit the Bank to continue to assist the Government in the implementation of sound environmental and energy conservation policies.

Loan Description

4.03 A quick disbursing loan of US$325 million equivalent is proposed to support the significant past progress as well as ongoing and anticipated future efforts by the Government in the implementation of sound environmental policies and energy conservation and demand management programs. The borrower would be the Federative Republic of Brazil; the implementing agencies would be ELETROBRAS and other Electric Power Companies.

4.04 The policy improvements under the proposed loan are an important precondition for rational investment decisionmaking in a sector where annual investments average around $5 billion. The environmental reforms to be undertaken are unique and unprecedented for any developing country in terms of comprehensiveness as well as depth. The policy reforms and measures undertaken through this loan will significantly improve the efficiency of future investments in the power sector, and it would also come at a critical juncture when the Brazilian Government is prepared to assume the additional short-term costs of environmental protection and energy conservation despite the country's difficult economic and financial situation. The proposed loan, particularly its quick disbursing characteristics, will serve as a crucial bridge to maintain the momentum of past efforts undertaken by the Brazilian power sector in both the

environmental and energy conservation areas through loans such as 2138/2364/2565 and 2720-BR. It will provide support to the Government in connection with costs already incurred in the development of environmental and energy conservation programs. It will also enable the Government to continue to implement on-going measures and maintain the necessary momentum of activity that will be picked up through planned future operations, including the proposed Electric Transmission and Conservation Loan, the Electric Distribution and Conservation Loan, and the National Environmental Loan.

4.05 The quick disbursing nature of the proposed loan will make it possible for the Government to undertake a number of difficult and urgent policy adjustments and costly administrative and implementation measures on the environmental side, including: crucial studies that will influence imminent decisions on the next generation of large power projects in the "Plano 2010"; action plans to implement environmental and resettlement related mitigatory measures arising from several large hydroelectric dams that were built in the recent past; generally expand institutional capability to regulate, monitor and implement the EMP; support and facilitate the work of the newly created federal environmental agency, IBMA, in its role of monitoring and licensing power projects; and strengthen Government capability to deal with environmental and safety issues relating to the nuclear power program.

4.06 On the conservation side, the loan will support and consolidate the fundamental policy shift in the power sector, a shift which recognizes the importance of demand management and conservation as a cost effective alternative to building new power supply facilities. A quick-disbursing operation for energy conservation would give strong impetus to the ongoing program of policy reforms and conservation measures that need to be undertaken urgently in order to relieve the burden of investments on the already limited financial resources of the power sector. Steady growth of electricity demand and financial shortfalls in the sector could result in power shortages in the next few years, that would be very costly to the economy. Gains in energy savings that can mitigate these effects could be realized in time, only if the policies and actions proposed under this loan are financed and implemented early. More specifically, this loan will help to offset the immediate costs of the various policy reforms and specific measures under the distribution rehabilitation and PROCEL programs.

4.07 From a macroeconomic point of view, the quick-disbursing nature of the proposed loan would contribute to cushioning the balance-of-payments impact of some recent external and internal developments. On the external side, Brazil's 1989 interest payments on its foreign debt are projected to increase significantly, relative to 1988. Over the last twelve months the LIBO rate has increased by more than two percentage points, reaching a level that, if maintained throughout 1989, would add about US$2 billion to Brazil's foreign interest payments. Because about 75% of Brazil's medium-and-long-term debt is at variable interest rates, the country's balance of payments is very vulnerable to interest rate shocks. Thus, any additional pressure on interest rates would further worsen the balance-of-payments picture. It is estimated that a one percentage point increase in the LIBO rate would add about US$0.9 billion to the country's interest payments. The quick-disbursing nature of this loan will help to reduce the impact on

the country's balance of payments of the expected rise in interest rates during 1989.

4.08 In 1989, domestic economic policy is expected to be conducted within the framework of the Summer Plan. Some of the measures established in the Plan are likely to have external implications. In an attempt to break inflationary expectations, the authorities have temporarily fixed the nominal exchange rate. A small devaluation of 3.2% was undertaken on April 16, 1989, that was insufficient to restore the real exchange rate to 1988 level. Although only a short-term measure, a fixed nominal exchange rate coupled with a low but positive monthly rate of inflation has resulted in some appreciation of the real exchange rate that, if maintained, could adversely affect exports. Moreover, the authorities are engaged in a process of gradually easing import controls. For some goods, additional imports are being used to supplement domestic supply and to support the price freeze in the early phases of the stabilization process. The potential net effect of these two factors would be a reduction of the expected trade surplus for 1989.

4.09 Under the most likely policy adjustment scenario, the 1989 trade surplus could reach at least US$14.5 billion and interest payments would amount to US$10.6 billion. In this case a small current account surplus of about US$0.9 billion could be attained. Assuming an increase in foreign reserves of about US$1.2 billion and projecting, on the basis of past trends, other net external outflows of about US$1 billion, Brazil's net external borrowing needs could amount to US$1-2 billion (see Annex II). The combination of two factors, however, may enlarge Brazil's 1989 balance of payments financing needs. One is the increase in interest rates relative to earlier forecasts that may add about US$1.8 billion to the external interest bill. The other is the reduction of the trade surplus that results from, on the export side, the pegging of the exchange rate that, in an attempt to break inflationary expectations, may lead to an overvaluation of the domestic currency, and, on the import side, the combination of the previous effect and the increase in imports needed in the short term to raise the supply of some goods. The above factors could roughly reduce the trade surplus by about US$2.0 billion. The combination of higher interest rates and lower trade surplus would add about US$3.5 to US$4.0 billion to the 1989 current account deficit. Therefore, in this scenario the current account would reach a deficit of US$2.6 to US$3.0 billion. Even if Brazil does not raise its foreign reserves to cushion the balance of payments impact of these effects, net external financing could increase by about US$2.5 billion.

4.10 Additional foreign resources could contribute to easing the impact of the Summer Plan on domestic financial markets. On the internal front, the main policy instrument in the early phase of the Summer Plan has been a policy of high real interest rates. But because most of the Government's internal debt bears floating interest rates, this policy has resulted in an increase in domestic interest payments and hence in the expected fiscal deficit for 1989. Additional external resources would thus reduce the pressure on domestic financial markets imposed by the Government's financing needs corresponding to the high interest rate policy. If the 1989 public sector deficit remains at about 4% of GDP, the enlarged borrowing needs of about US$3.5 to US$4.0 billion would amount to about 1% of GDP, contributing to the financing of one-fourth of the fiscal deficit.

The quick-disbursing nature of this loan will contribute to facilitating this adjustment process, and hence to increasing the scope for sustaining the Summer Plan, and in particular, its inflation objectives.

Cofinancing

4.11 In order to enhance its capability for dealing with environmental issues pertinent to the power sector, the Government of Brazil has requested a quick-disbursing, untied cofinancing facility in the amount of $325 million equivalent from the Export Import Bank of Japan (JEX). Since this request was made only recently, the terms, conditions and timing of the proposed JEX cofinancing remain undetermined, as yet. However, it is understood that the preliminary JEX reaction has been positive, but their firm position would be known once they have been able to review the relevant project documentation in greater detail.

Policy Letter

4.12 The basis for the loan is provided by a Policy Letter (Annex III) in which the Government declares its commitment to adopt and implement the policies and programs described in Part III above.

Tranches

4.13 The proposed loan would be disbursed in two equal tranches of US$162.5 million. The first tranche would be available upon loan effectiveness. The loan will become effective when all legal requirements are met and all conditions for loan effectiveness, as summarized in para. 4.14, have been fulfilled. The release of the second tranche, projected to be disbursed about six months after loan effectiveness, would be contingent upon (i) continued satisfactory macroeconomic performance, and (ii) the Government having taken several key actions and certain events having occurred as summarized in para. 4.15.

Conditions for Effectiveness

4.14 The conditions for effectiveness call for submission to the Bank of satisfactory evidence that:

(i) The Government, ELETROBRAS and the Electric Power Sector Companies are implementing the EMP in a manner satisfactory to the Bank;

(ii) ELETROBRAS has initiated the hiring process for the remaining staff for DEMA, and has obtained the required governmental authorization for the hiring of an additional 17 professional and 8 support staff positions;

(iii) The Borrower has made, or cause to be made adequate funding arrangements, satisfactory to the Bank, for the environmental action programs to be carried out by the Electric Power Sector Companies in 1989 pursuant to the Environmental Commitment Letters received by ELETROBRAS from ELETRONORTE, CHESF, FURNAS, ELETROSUL, CEEE, CESP, COPEL, CEMIG, CEMAT, CER, CERON, and CELPA;

(iv) ELETROBRAS has approved drafts, satisfactory to the Bank, detailing CCMA and COMASE's internal procedures and, work programs and their schedules of meetings until June 30, 1990;

(v) The Borrower has approved an adequate financing plan, satisfactory to the Bank for the conclusion of the Itaparica Resettlement Project;

(vi) The Borrower has made adequate funding arrangements for the strengthening of IBMA's environmental licensing and monitoring capabilities, in accordance with the tasks and timetables set forth in the ISP;

(vii) The updating process of the EMP is progressing in terms satisfactory to the Bank;

(viii) The Borrower has made, or cause to be made adequate funding arrangements, satisfactory to the Bank, for the strengthening of environmental monitoring functions of the FEEMA, in connection with the Angra Plants, as set forth in the ISP;

(ix) The Borrower has approved an adequate financing plan, satisfactory to the Bank, for the DRELOR Beneficiaries;

(x) CNE has made progress, satisfactory to the Bank, in the execution of the IESS.

Conditions for Second Tranche Release

4.15 The release of the second tranche of US$162.5 million is projected to take place about 6 months after the first tranche release and would be contingent upon submission to the Bank of satisfactory evidence that:

(i) The Borrower, ELETROBRAS and the Electric Power Sector Companies, are implementing the EMP in a manner satisfactory the Bank, and as set forth in the Environmental Commitment Letters particularly in regard to achievements satisfactory to the Bank on ongoing resettlement programs, Indian protection components in electric power projects and agreements with IBMA;

(ii) The relevant Electric Power Sector Companies have prepared on a timely manner RIMAs for the following proposed electric generation and transmission projects (....) in strict adherence to pertinent national legislation, the Electric Power Sector's Environmental Manual, and EMP guidelines;

(iii) ELETROBRAS has updated the Environmental Master Plan, and furnished it for comments to the Bank, COMASE, CCMA, IBMA and FUNAI;

(iv) ELETROBRAS has completed the strengthening and coordination of its environmental program, through hiring the remaining additional staff, implementation of the monitoring and

evaluation system of the EMP and completing the budgetary system for environmental and social programs;

(v) Adequate higher-level staffing and funding arrangements have been made by the Borrower for IBMA and FUNAI, in accordance with the ISP including task requirements under agreements entered into by IBMA and FUNAI with Electric Power Sector Companies and their analysis of RIMAs and the Electric Power Sector;

(vi) Satisfactory progress has been made by the Borrower towards strengthening its capabilities to deal with environmental and safety aspects of the nuclear power generation program, including an updated operational safety review;

(vii) CCMA and COMASE are carrying out their work programs and activities (set forth for loan effectiveness) in a manner satisfactory to the Bank;

(viii) CNE has continued to make progress since loan effectiveness, satisfactory to the Bank, in the execution of the IESS;

(ix) The Borrower has made available, on terms satisfactory to the Bank, funds equivalent to at least $70,000,000 to the DRELOR Beneficiaries as set forth for loan effectiveness;

(x) The Borrower and the relevant Electric Power Sector Companies have achieved progress, satisfactory to the Bank, in the execution of DRELOR;

(xi) The Borrower has made available, on terms satisfactory to the Bank, funds equivalent to at least $60,000,000 to the relevant Electric Power Sector Companies for the carrying out of PROCEL in a manner satisfactory to the Bank during 1989.

(xii) The Bank is satisfied that the level and structure of prices for the sale of electricity charged by the Electric Power Sector Companies substantially reflect the long-run marginal costs of supply of electricity, calculated in accordance with a methodology satisfactory to the Bank;

(xiii) The Electric Power Sector Companies have made progress, satisfactory to the Bank, in the execution of educational and advertising campaigns on energy conservation;

(xiv) The Borrower has issued a progress report, satisfactory to the Bank, on its efforts to develop load management policies, analytical methodologies and technologies to promote the efficient supply and use of electric power;

(xv) The Borrower has made progress, satisfactory to the Bank, in the execution of programs of technical assistance to industrial consumers, manufacturers of electrical equipment and technical institutions, all satisfactory to the Bank, to

promote and strengthen the institutions in charge of research and development of advanced conservation technologies; and

(xvi) The Borrower has made progress (including amendments to relevant legislation and regulations), satisfactory to the Bank, in the establishment of new or revised electric equipment performance, construction methods and standards for buildings, electric machinery and appliances requiring the use of more efficient technologies of energy use and conservation.

Disbursement

4.16 Disbursements would be made against acceptable general imports (items such alcoholic beverages, tobacco, jewelry, uranium, nuclear reactors, military equipment and materials, etc., are excluded) from eligible countries and territories, imported to Brazil. Proceeds of the loan would be disbursed based on satisfactory evidence of: (i) physical entry of the imports into the country; (ii) actual payment in foreign exchange for such imports; and (iii) evidence that the prices of the imported goods are reasonable and in line with international price quotations and past experience. The Central Bank will ensure that these requirements are met for all imports to be financed with loan resources.

4.17 Disbursements would be made on the basis of statements of expenditures, each of not less than US$1.0 million, to be submitted to the Bank by the Central Bank. The details of the expenditures would be provided from the Central Bank's on-line data base system which links all important transactions carried out in Brazil by commercial banks. The Central Bank would cause commercial banks to retain documentary evidence of such expenditures, to make it available for inspection, and to undertake audits in accordance with standard Bank requirements. The loan closing date would be December 31, 1990. Given the nature of the proposed loan, IBRD standard project disbursement profiles are not applicable.

Procurement

4.18 The general goods to be financed by the Bank loan (except the ones mentioned in para. 4.12 and detailed in Schedule I of the Loan Agreement which will not be financed by this Loan) would be imported by public entities and private-sector importers, under procurement procedures acceptable to the Bank. Contracts for the procurement of imports exceeding US$5.0 million would be awarded on the basis of international competitive bidding in accordance with procedures consistent with Bank procurement guidelines. Contracts under US$5.0 million would be procured through normal procedures used by the importing entities. The Bank has reviewed the procurement procedures used by public and private sector Brazilian companies for a substantial number of commodities -- including commodities imported, directly or indirectly, for the power sector such as copper, steel, metallurgical coal, insulating oil, and other insulting materials -- and found them to be satisfactory.

Reporting Requirements

4.19 During negotiations the Bank should seek agreement of the Government and ELETROBRAS to furnish the Bank with standard reporting requirements of Bank, loans specifically to provide semestral progress reports on the implementation of the EMP to the Bank, and to review progress jointly with Bank supervision missions. Specific project level, social and environmental action plans are based on the revised investment plan ("Plano 2010") of September 1988. They would need to be revised in accordance with any further revisions which this investment plan might undergo. Should a project be delayed, its environmental action plan will be delayed accordingly. Similarly, projects may be dropped and/or added to the list.

Benefits

4.20 Quantifiable Benefits:

In the short term the program supported by this loan already has imposed and will continue to impose substantial costs on the Brazilian economy in the form of environmental mitigatory and administrative measures. The program will also provide financial benefits in the short term particularly with respect to conservation. The main quantifiable benefits attributable to this loan during the period 1989-92 arise from the implementation of the electric energy conservation policy measure and action plans included in the PROCEL and the DRELOR. Such implementation is expected to reduce sector financial requirements by about US$1.0 billion during each of the years under consideration. This is equivalent to approximately 0.3% of the 1988 GDP and 8% of the 1988 operational fiscal deficit. The benefits are twofold in nature. Firstly, there are benefits associated with the implementation of policy measures such as efficient electricity pricing and load management, both of which are expected to modify the system load curve patterns by displacing the system peaking capacity requirements. The reduction of required peak generating capacity is estimated at about 500 MW, equivalent to savings in deferred investments of about US$2.4 billion during the period 1989-92. Secondly, there are benefits associated with the implementation of conservation programs such as system loss reduction, use of improved technologies/equipment and efficient industrial processes, and educational and advertising campaigns which are expected to reduce overall electricity consumption. The reduction of overall electricity consumption is estimated at about 8000 GWh/year, equivalent to about US$1.6 million during the period 1989-92.

4.21 Non-Quantifiable Benefits:

The main non-quantifiable benefits stem from environmental policy reforms and actions supported by the proposed loan. It is expected that such measures and actions will result in better use of natural resources, avoidance or reduction of environmental costs associated with power projects, and rationalization of the long-term power sector investment program averaging about $5 billion per year. More specifically, the loan would yield benefits arising from the following:

(a) Anticipation of and provision for realistic investment levels and necessary financing. Such provision would avoid future costs in the

event that environmentally unsound elements of the Plano 2010 were carried out or there were other investment decisions which deviated from standards set by the EMP.

(b) Mitigating existing, and minimizing future negative social and environmental effects resulting from the formation of major reservoirs.

(c) Satisfactory completion of the Itaparica resettlement project. Such an event would be in the highest interest of the Borrower and the Bank.

(d) Enhancement of the RIMA process and the capacity of Federal and state-level environmental institutions to contribute to the implementation of the EMP.

(e) Maintenance of the momentum of implementation of the EMP and of its monitoring; and sector-wide institutional strengthening.

Risks

4.22 The main risks to the successful implementation of the Environmental Master Plan (EMP) and of the Electric Energy Conservation Program arise from the ability of: (i) the power sector to comply and implement in timely manner the different studies, works and other actions included in both programs; and (ii) the Government to provide the adequate financial resources required for the execution of the above undertakings. Closer monitoring by the Bank of the implementation of the EMP and the Electric Energy Conservation Program and of the allocation of resources for this purpose would help substantially reduce such risks.

PART V. BANK GROUP OPERATIONS IN BRAZIL

A. PAST EXPERIENCE ON POLICY LENDING

5.01 The Bank has made four sectoral policy loans to Brazil in recent years, totalling US$1.65bn: two Agricultural Sector Loans, an Export Development Loan, and the First Electric Power Sector Loan. A Financial Sector Adjustment Loan is in an advanced state of preparation, and work on several other adjustment projects is currently under way. No structural adjustment lending has been made or is envisaged at present.

Agricultural Sector

5.02 The Agricultural Credit and Export Development Loan (Ln. 2348-BR), for US$303m approved in August 1983, supported rural investment and pre-export financing facilities, and helped support the introduction of real positive interest rates (3%) for most rural credit operations after years of heavy subsidies. This process of reduction in rural credit subsidies, and the enhanced market-orientation of the agricultural credit system, were further supported through the Credit and Marketing Reform Project (Ln. 2727-BR), for US$500m approved in June 1986 (the first tranche of US$300m was released in September 1986; the second tranche was released in November 1988). The project in addition included the liberalization of trade and domestic pricing policies for key agricultural commodities, and the improvement of agricultural-price risk management, through the development of futures markets and a bankers acceptance market.

5.03 With the support of the above loans, the Government of Brazil has taken important and difficult decisions reforming agricultural credit, reducing wheat subsidies, and more generally improving agricultural pricing and liberalizing trade policies for grains. These have already begun to have an impact on the agricultural sector and on the reduction of fiscal deficits. Conditions under the first and second loans have been met, setting a good precedent for Government performance under adjustment operations in the sector.

5.04 As far as lessons for future lending are concerned, experience with these loans has emphasized: (a) the importance of involving private sector representatives, and Government officials from all relevant agencies, in a process of developing reform programs, in order to gain widespread support; (b) the need to have a very clear understanding and definition of second-tranche conditionality as part of initial negotiations; and (c) the difficulties of implementing policies of market liberalization in a changing political environment.

Export Development

5.05 The Export Development Project (Ln. 2347-BR), for US$351.3m and effective October 1983 (closed June 1987), was designed to assist the government of Brazil in establishing a de facto free trade regime for exporters, primarily through the reinforcement of the duty drawback system and simplification of its import procedures. The loan also included provisions to support the government in moving towards a more open and efficient trade policy through the financing of a number of policy studies on trade and industry.

5.06 The project yielded four useful results: a reduction in the time required for the approval of drawback-related import licenses; a measure of decentralization of drawback operations; and the positive influence that two project-financed technical studies had on the subsequent freight reform and the recent tariff reform.

5.07 Nevertheless, the project failed to address any of the major policy issues or institutional deficiencies that affect the Brazilian trade system, and which form the focus of the Bank's current dialogue in this area with the Brazilian authorities. For one thing, the project was too narrow to be an effective policy-reform instrument, illustrating the inadequacy of parcelling sectoral adjustment programs into highly interrelated but separately-treated components (here, exports vis-à-vis trade policy generally). On the other hand, the objectives of the project were not translated into clear conditionality: for example no measure of performance was specified in relation to key targets, such as the length of time needed to process drawback operations; similarly the levels of drawback imports agreed by the Bank and the Government were non-binding and had no bearing on loan disbursements.

Power Sector

5.08 The third area where the Bank has advanced policy lending to Brazil is the electric-power sector. The Executive Directors of the Bank approved the (first) Electric Power Sector Loan (2720-BR; US$500 million) in June 1986. It was disbursed in two equal tranches ($250 million) in September and December 1986. The objectives of Loan 2720-BR were to help the Government rehabilitate the sector through optimized (least-cost) investment expenditure and improved financial performance. These objectives were incorporated in a PSRP covering the period 1986-1989. The Loan also aimed to promote institutional reform and the development of sector guidelines for environmental policies. The REVISE study was the vehicle for institutional reform (para.); the EMP served the same function with respect to environmental policy.

5.09 Achievements with respect to the above objectives have materialized at a slower pace than expected due to the difficulties facing the country since 1986: inflation, foreign exchange shortages, and a complex domestic political situation, including the writing of a new Constitution. These problems required the Government to shift its priorities and to defer the timing of actions expected at appraisal. However, notwithstanding delay, there has been improvement in the financial performance of the power sector (para.), the Government is completing the REVISE, and ELETROBRAS and the sector are implementing the EMP. In the context of the country's difficult economic and political problems, these achievements assume a more positive aspect and indicate the steadiness of the Government's commitments.

Conclusions

5.10 In sum, the experience with Bank adjustment loans to Brazil is on balance encouraging, albeit mixed. Some of the main lessons that arise from past exercises concern the need to:

(a) Address whole areas of policy, rather than parcelling these into closely interrelated but "more manageable" components, to the extent that success on any one of these components depends on developments throughout the rest;

(b) Identify measures of performance that, while being central to the success of the reforms being contemplated, are also objectively monitorable and, if possible, quantifiable;

(c) Inscribe the loan, and the policy reforms it is designed to support, within a broader and longer-term program, which both enhances the overall coherence of the package of reforms and provides a longer term incentive to good performance under the initial loan;

(d) Recognize the difficulties of implementing market liberalization in an environment of severe macroeconomic imbalance, and thus make provisions (perhaps including explicitly flexible, contingent conditionality) to accommodate possible external shocks or alternative scenarios.

PART VI. RECOMMENDATION

6.01 I am satisfied that the proposed loan would comply with the Articles of Agreement of the Bank and recommend that the Executive Directors approve the proposed loan.

Barber Conable
President

Attachments

Washington, D.C.

_____, 1989

BRAZIL

ENVIRONMENTAL REFORM AND ENERGY CONSERVATION LOAN

BRAZIL - KEY ECONOMIC INDICATORS (To be revised)

	1/ Actual			Prelim.	Est.	Projected				
	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
GDP Growth Rate (%)	5.7	8.4	8.0	2.9	0.0	1.0	1.0	3.0	5.0	6.0
GDP /capita Growth Rate (%)	3.4	6.1	5.8	0.8	-2.1	-1.1	-1.0	0.9	2.8	3.8
Consumption/capita Growth Rate (%)	-1.5	4.6	7.4	0.9	-0.9	-0.2	0.6	-2.5	1.9	4.0
Debt Service (in US$ millions) 2/	19,995	22,319	24,243	25,274	16,437	17,329	18,340	17,019	16,782	15,648
Debt Service/XGS 8/	0.66	0.76	0.96	0.88	0.45	0.50	0.58	0.46	0.41	0.35
Debt Service/GDP 8/	0.095	0.098	0.087	0.079	0.048	0.047	0.048	0.042	0.038	0.032
Gross Investment/GDP	0.155	0.167	0.185	0.197	0.170	0.180	0.180	0.200	0.210	0.210
Domestic Savings/GDP	0.221	0.231	0.236	0.236	0.227	0.220	0.207	0.233	0.240	0.239
National Savings/GDP	0.166	0.179	0.193	0.199	0.187	0.187	0.176	0.203	0.213	0.213
Marginal National Savings Rate	0.647	0.917	0.231	1.078	3.937	0.119	-0.750	1.114	0.393	0.224
Public Investment/GDP 9/	0.060	0.062	0.062	0.069	0.060	0.060	0.060	0.060	0.060	0.060
Public Savings/GDP 9/	0.033	0.019	0.026	0.014	0.020	0.020	0.030	0.050	0.050	0.050
Private Investment/GDP	0.095	0.105	0.123	0.128	0.110	0.120	0.120	0.140	0.150	0.150
Private Savings/GDP	0.122	0.147	0.143	0.178	0.167	0.167	0.146	0.153	0.163	0.163
Ratio of Public/Private Investment	0.632	0.590	0.504	0.539	0.545	0.500	0.500	0.429	0.400	0.400
Government Revenues/GDP 10/	0.297	0.328	0.293	n.a.	n.a.	...	...	...	...	...
Government Expenditures/GDP 10/	0.349	0.431	0.389	n.a.	n.a.	...	...	...	...	...
Deficit (-) or Surplus (+)/GDP 11/	-0.027	-0.043	-0.035	-0.055	-0.040	-0.040	-0.030	-0.010	-0.010	-0.010
Export Volume Growth Rate (%) 4/	22.1	-2.0	-23.6	14.5	17.6	-9.8	0.0	4.7	6.6	6.7
Export Value Growth Rate (%) 3/ 4/	22.6	-4.2	-12.6	17.7	27.8	-6.6	-8.5	16.9	9.9	10.0
Exports/GDP 3/ 4/	0.135	0.120	0.085	0.095	0.111	0.100	0.090	0.100	0.102	0.102
Import Volume Growth Rate (%) 5/	-3.0	-1.1	15.0	-3.8	-0.7	9.4	6.9	9.3	12.0	9.7
Import Value Growth Rate (%) 3/ 5/	-9.9	-3.8	4.5	7.1	-0.9	15.8	9.3	13.7	16.3	13.7
Imports/GDP 3/ 5/	0.079	0.069	0.061	0.055	0.055	0.059	0.063	0.067	0.071	0.074
Current Account (in US$ millions)	45	(241)	(5,304)	(1,428)	4,616	884	(3,354)	(1,733)	(2,442)	(2,474)
Current Account/GDP 3/ 6/	0.000	-0.001	-0.017	-0.004	0.013	0.002	-0.009	-0.004	-0.006	-0.005

1/ Historical figures based on IBGE national accounts data, May 1988.
2/ Includes IMF.
3/ Growth rates and ratios calculated using current US$ values.
4/ Exports of goods and non-factor services.
5/ Imports of goods and non-factor services.
6/ Projected values assume maintenance of the 1986 real exchange rate.
7/ Includes estimated debt conversions of US$ 3.0 billion in 1988, US$ 1.75 b in 1989, US$ 1.25 b in 1990, US$ 1.0 b in 1991, and US$ 1.0 b in 1992.
8/ Debt service reflects 1988 Paris Club rescheduling agreement.
9/ Public sector also includes public enterprises which are included in the private sector in the national accounts data.
10/ Refers to the national accounts definition of the General Government.
11/ Operational Deficit

BRAZIL

ENVIRONMENTAL REFORM AND ENERGY CONSERVATION LOAN

BALANCE OF PAYMENTS
(US$ millions at Current Prices)

	1984	1985	1986	1987p	1988e	1989	1990	1991	1992	1993
A. Exports of GNFS	28529	27333	23763	28085	35880	33499	30653	35836	39369	43297
1. Merchandise (FOB)	27005	25639	22349	26220	33780	31486	28609	33614	36910	40572
2. Non-factor services	1524	1694	1414	1865	2100	2013	2043	2222	2459	2725
B. Imports of GNFS	16688	15834	17127	17748	17589	20366	22260	25313	29445	33485
1. Merchandise (FOB)	13916	13153	14044	15053	14691	16995	18603	21163	24618	27987
2. Non-factor services	2772	2681	3083	2695	2899	3370	3656	4150	4827	5497
C. Resource balance	11841	11499	6636	10337	18291	13134	8393	10522	9925	9813
D. Net factor income	-11967	-11889	-12027	-11861	-13775	-12349	-11847	-12355	-12467	-12387
1. Factor receipts	1680	2051	1368	645	550	900	1150	1150	1200	1200
2. Factor payments	13647	13940	13395	12506	14325	13249	12997	13505	13667	13587
(of which LT interest)	7102	7262	7516	5849	9218	9536	9258	9571	9466	9266
E. Net current transfers (prv)	171	150	87	70	100	100	100	100	100	100
1. Transfer receipts	192	174	148	..	..	..	..	..	..	..
a. of wh. workers remit.	..	..	..	..	..	..	..	..	..	..
2. Transfer payments	21	24	61	..	..	..	..	..	..	..
F. Curr.Acct.Bal exc.off.trans	45	-240	-5304	-1455	4616	884	-3354	-1732	-2442	-2474
G. Long-term capital inflow	6942	2710	1561	4273	2971	2440	6458	4208	5118	5199
1. Net direct investment	1548	1263	186	1098	2330	981	1104	1422	1661	1872
2. Net official transfers	10	7	-2	0	0	0	0	0	0	0
3. Net LT loans	6725	329	106	-2128	640	1458	5354	2787	3457	3328
a. disbursements	9582	2807	3170	1554	6242	7281	12672	9324	9881	8846
b. repayments (actual)	2857	2478	3064	3683	5602	5823	7318	6537	6424	5518
4. Other LT inflows (net)	-1341	1111	1271	5303	0	0	0	0	0	0
H. Total Other items (Net)	-1840	-2689	414	-974	-6168	-1225	-1225	-1225	-1325	-1325
1. Net short-term capital	-3077	-2786	428	-601	-750	0	0	0	0	0
2. Capital flows n.e.i.	834	502	537	77	0	-1225	-1225	-1225	-1325	-1325
3. Errors and omissions	403	-405	-551	-450	-5418	0	0	0	0	0
I. Changes in net reserves	-5147	220	3330	-1844	-1419	-2099	-1879	-1251	-1351	-1400
1. Use of IMF credit	1788	-65	-613	-1146	-419	-899	-779	0	0	0
2. Other reserve changes (- indicates increase)	-6935	285	3943	-698	-1000	-1200	-1100	-1251	-1351	-1400

p = preliminary data

e = estimated data

BRAZIL

ENVIRONMENTAL REFORM AND ENERGY CONSERVATION LOAN

BALANCE OF PAYMENTS

	1984	1985	1986	1987p	1988e	1989	1990	1991	1992	1993
Shares of GDP (Current US$):										
1. Resource Balance	5.6	5.0	2.4	3.2	5.3	3.5	2.2	2.6	2.2	2.0
2. Total Interest Payments	5.5	5.0	3.8	3.0	3.0	2.9	2.7	2.6	2.3	2.1
3. Current Account Balance	0.0	-0.1	-1.7	-0.4	1.5	0.3	-0.9	-0.4	-0.6	-0.5
4. LT Capital Inflow	3.3	1.2	0.6	1.3	0.9	0.7	1.7	1.0	1.2	1.1
5. Net Credit from IMF	0.8	0.0	-0.2	-0.4	-0.1	-0.2	-0.2	0.0	0.0	0.0
Memorandum item:										
GDP (millions of current US$) 1/	211345	228724	280190	319000	345300	370800	380200	406500	442900	487200
Foreign Exchange Reserves:										
1. Intl. Reserves (IFS 1ld)	11508.0	10605.0	5803.0	6299.0	..	..	..	..	..	..
2. Gold (National valuation)	488.0	1004.0	958.0	1159.0	..	..	..	..	..	..
3. Gross Res. Incl. Gold	11996.0	11609.0	6761.0	7458.0	..	..	..	..	..	..
4. Gr.Res. in Months Imports	10.3	10.6	5.8	5.9	..	..	..	..	..	..
Exchage Rates (LCU/US$):										
1. Nom. Off. X-Rate (IFS)	1.8	6.2	13.7	39.2	..	..	..	..	..	..
2. Real Eff. X-Rate(1980=100)	104.3	100.1	94.5	95.0	..	..	..	..	..	..
3. X-Rate for GNP Conversion	..	..	..	39.0	..	..	..	..	..	..

1/ After 1986 assumes maintenance of the 1986 real exchange rate.

p = preliminary data

e = estimated data

Annex III

Policy Letter
(draft)

Brazilia, April --, 1989

Mr. Barber B. Conable
President
International Bank for Reconstruction and Development
1818 H Street N.W.
Washington D.C. 20433

Dear Mr. Conable:

Ref: Letter of Environmental Reform and Energy Conservation

I. Environmental Reform

As you are aware Brazil has embarked on a comprehensive program to strengthen national environmental management and the protection of its Indian population. The recently enacted new Constitution has unprecedented provisions on these matters. The Federal Government has also recently approved an ambitious program called "Nossa Natureza" which proposes to dedicate substantial resources to environmental programs and to reorganize and coordinate efforts of the large number of existing Federal agencies and other entities concerned with these matters. In this context, the Government created the "Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renovais" (IBMA) in February this year to strengthen and expand environmental activities. A copy of the "Nossa Natureza" program is attached to this letter.

Within these efforts, an area which deserves particular attention is the electric power sector, both because of the substantial needs for additional electric power to support Brazil's economic and social development, and because of the significant environmental and social impact of the energy development options that are available to meet these requirements.

As you know, the electric power sector has developed rapidly over the last four decades -- with major support from the World Bank in 37 loans since 1949. The Government's strategy of centralizing most electrical generation into a federal holding company and/or one entity per state, and of interconnecting all relevant states, has been successfully attained. Our recent dependence on unreliable oil imports has been reduced by increasing our domestic production. Modernization of most of these entities has been completed, so that in engineering terms -- that is, the construction and operation of plant and equipment -- and systems planning. Brazil's power sector has achieved much. However, in terms of evaluation of its performance and future programs, the sector faces delicate social and environmental issues, not historically central to the concerns of power planners. These issues needed to be addressed, especially now that the Government, to meet growing power demand at the least cost, is about to expand hydroelectric generation in the densely settled south and in the vulnerable and less familiar Amazon region.

Our present challenge is to reconcile those heightened social and environmental concerns with the imperative to double our generating capacity in 15 years. Now that we have significantly advanced on the engineering and economic side, we seek to balance this with equivalent analytical work and progress on the social and environmental side. Specifically, the Government strategy is to enhance and strengthen the power sector entities to be able to plan and implement our ambitious electric power expansion program while at the same time systematically and conscientiously integrating all necessary social and environmental implications in the widest sense, for the sustained benefit of Brazilian society as whole.

Up to now, a number of concrete measures have already been taken by Federal agencies and other entities working on the electric power sector. In 1986, ELETROBRAS issued a detailed manual setting forth how environmental considerations are to be integrated through the power sector, in consonance with Federal policies and a comprehensive Environmental Master Plan (EMP) for the electric power sector. The execution of both was supported by the World Bank's First Power Sector Loan. In its updated version of December 1987, the EMP is the sector's fundamental tool for addressing the social and environmental issues. We want the EMP to be comprehensive and dynamic and to span the whole power sector and all relevant government agencies. That is why the EMP has been crafted in such close collaboration between all parties, and why it is updated periodically, as our knowledge base expands. Our medium term objective is to further improve the EMP, and to make its systematic implementation by all power utilities a matter of routine.

The EMP includes: (i) making consistent the policies and procedures of the power sector with the National Environmental Policy, its legislation, regulations, and guidelines, (ii) specific guidelines to improve the power sector's environmental planning and operation, including criteria to assess the environmental costs and benefits of the power sector's projects and operations, (iii) preparation of environmental and social actions plans on a project-by-project basis, and (iv) measures to strengthen the institutional capabilities of the sector for implementing the EMP.

These initial steps of a complex, long and comprehensive program to which the Brazilian Government and the Electric Power Sector Companies are committed, will require a continued and substantial support for which financial help through a US$ _____ million equivalent loan is requested.

The next steps of this program to achieve our medium-term objectives include:

(a) biannual updating of the EMP and enhancement of its guidelines to reflect both emerging needs and priorities and technical and political developments, which could have a bearing in its content;

(b) provision of funding and staffing sufficient to carry out the prompt implementation of the environmental action plans, as specified in Environmental Commitment Letters prepared by ELETROBRAS and Electric Power Sector Companies;

(c) implementation of a monitoring and evaluation system to encourage compliance with the EMP on the part of Electric Power Companies';

(d) increasing the effectiveness functioning of the "Comite Consultivo de Meio Ambiente" (CCMA): This includes maintaining CCMA'a continuity and high-level disciplinary mix; financing any special studies or short term consultants needed by CCMA; and supplying CCMA with responses to their previous recommendations well in advance of the next meeting;

(e) completion of the organization of COMASE and setting up its internal procedures and work programs;

(f) support for the sector's training, scholarship, courses and conference program, as laid out in ... (document name to be obtained from ELETROBRAS);

(g) tightening of licensing standards and procedures under the mandatory RIMA system;

(h) completion of the demarcation, registration, legal assistance, health service and protection process of Indian reserves in connection with all individual power projects at the appropriate stage in the project cycle;

(i) improvement of capacity of IBMA and state level environmental agencies administer effectively the RIMA system;

(j) strengthen the operational procedures for land acquisition for resettlement and other environmental purposes; and

(k) strengthening the capabilities of the government agencies to deal with environmental and safety aspects of the nuclear generation program.

II Electric Energy Conservation Program

In addition to, and closely related to the implementation of the foregoing EMP, the Government has launched a comprehensive program to establish sound policy measures to conserve electric energy in order to rationalize its production and use through the implementation of policy guidelines and action. This program aims to increase power system operational efficiency, reduce electricity waste and optimize financial resource allocation. The measures included in the Electric Energy Conservation Program would promote better use of available power resources without any further detriment to the environment. To attain the above medium-term objectives the following actions will be implemented:

(a) Economically Efficient Pricing: Implementation of pricing policy reform will continue to be applied in order to complete the implementation of long-run marginal cost (LRMC) structures by end 1989.

(b) Load Management: Development of policies, analytical methodologies and technologies which will stimulate the efficient supply and use of electric power.

(c) Educational and Advertising Campaigns: Implementation of intensive public advertising campaigns through radio, TV, seminars and newspapers addressing power demand management and conservation issues.

(d) Research and Development: Establishment of new policy measures and support through the provision of human and financial resources to increase the activities on the areas of technical assistance to the industry, manufacturers of electrical equipment and overall electricity consumers. Promotion and strengthening of the institutions in charge of research and development of advanced technologies.

(e) Improvement of Industrial Processes: Establishment of new policy measures and implementation of programs to be undertaken by industry to reduce electricity consumption, including resources to finance components of specific conservation program mainly among large industrial enterprises during 1989-91.

(f) Improvement of equipment performance, construction methods and standards. Establishment of new policy measures to support and develop the adoption of more efficient technologies in: (i) the manufacturing of electrical equipment, refrigeration/heating systems, control, lighting; and (ii) the conceptual design of architectural and urban developments as well as the use of construction/insulation materials. Review and amend as necessary standards, codes, legislation and regulations related to improved electricity conservation measures.

(g) Reduction of Power System Losses: These sub-programs aims to reduce power system losses through: (i) construction of new distribution lines; (ii) reconductoring existing networks; (iii) installation of new distribution transformers banks; and (iv) installation and replacement of electricity meters, within various small state-owned utilities located in the less-developed areas.

To complete the above conservation programs additional resources equivalent to US$ ___ million are required. It is estimated that the implementation of the above conservation program will result by 1991 in savings equivalent to about 10.000 GWh/year (or about US$300 million per year).

Annex IV

BRAZIL

ENVIRONMENTAL REFORM AND ENERGY CONSERVATION LOAN

SUPPLEMENTARY LOAN DATA SHEET

Section I: Timetable of Key Events

(A)	Time Taken to Prepare Project:	December 1987 - March 1989
(B)	Project Prepared by:	Government of Brazil (SEPLAN) and SEAIN, ELETROBRAS and Bank staff
(C)	First Bank Mission:	December 1987
(D)	Appraisal Mission:	July 1988
(E)	Post Appraisal Missions:	January and March 1989
(F)	Negotiations:	April 1989
(G)	Planned Date of Effectiveness:	June 1989
(H)	List of Relevant PCRs and PPARs:	N.A.

Section II: Special Bank Implementation Actions

None

Section III: Actions already taken

A. In the context of the First Power Sector Loan (2720-BR), the first version of the EMP was issued in December 1986. Agreement was reached between the Borrower and the Bank that implementation of the EMP includes specific actions by the Borrower, ELETROBRAS and the Electric Power Sector Companies that are discussed in Part III. Since then, the Government and ELETROBRAS have taken important actions in connection with the environmental, social and energy planning and conservation measures in the power sector. The following main actions have been completed:

(1) Institutional strengthening and coordination of the environmental program of ELETROBRAS, through:

- an exceptional Government permit for the hiring of 180 environmental staff for the Electric Power Sector in 1988;

- creation and initial staffing of a Department for the Environment (DEMA);

- the creation of permanent and substantial in-house environmental and social units, at the level of the leading Electric Power Sector Companies, and of the leading consulting corporations for the Brazilian Power Sector;

- The satisfactory operation and functioning of the "Comite Consultivo de Meio Ambiente" (CCMA) of ELETROBRAS;

- The creation and functioning of the "Comite Coordinador des Atividades de Meio Ambiente do Setor Eletrico" (COMASE);

- the development of a monitoring and evaluation system for the execution of the EMP and of the Power Sector's Environmental Manual (1985) in ELETROBRAS and its subsidiaries; this system has been designed, tested and is in the initial implementation stage;

- the convening, by ELETROBRAS of an inter-agency work group, to prepare environmental (including social) guidelines and procedures for the licensing of electric power sector projects, additional to general federal guidelines for RIMAs;

- the initiation by ELETROBRAS and COMASE, of the design of the Environmental and Social Accounting System in the budgetary process of the Electric Power Sector.

(2) Environmental Action Plans of the Electric Power Sector Companies:

The Electric Power Sector Companies have complied with the EMP through:

- the carrying out of specific action plans for environmental, Indian resettlement and archeological salvage. In this context, the Electric Power Sector Companies have, among others, completed the demarcation of Indian reserves affected by all projects which were under construction but did not have their demarcation completed at the time of the First Power Sector Loans, and carried out a typical resettlement operation under the Itaparica project;

- the postponement of several environmentally or socially problematic hydropower development options, which were originally considered under the "Plano 2010";

- preparation of detailed environmental and social inventory and feasibility studies, and RIMAs;

- public hearings and seminars regarding a number of proposed projects;
- In November 1988, ELETROBRAS had received and submitted to the Bank, Environmental Commitment Letters from the Electric Sector Companies (ELETROBRAS' subsidiaries ELETRONORTE, CHESFT, FURNAS, and ELETROSUL, as well as from CEEE, CESP, COPEL, CEMIG, CEMAT, CER, CERON, and CELPA) expressing their formal agreement to comply with all guidelines laid out in the EMP with regard to all their projects (content of the Environmental Commitment Letters is outlined in Annex VI).

(3) Strengthening of Federal level Institutions Involved in the Carrying out of the EMP:

- ELETROBRAS and the Electric Power Sector Companies have since 1986 maintained agreements and financed programs with FUNAI, SEMA, IBDF and SUDEPE, which are essential to the carrying out of the EMP.

- The Government has, in January 1989 and in the context of its broader "Nossa Natureza" (Our Nature) environmental protection program, created the "Instituto Brasileiro de Meio Ambiente e Recursos Naturais Renovais" (IBMA), which consolidated and strengthened previously existing environmentally-related agencies, especially the Environmental Secretariat (SEMA), the Forestry Institute (IBDF), and the Fisheries Superin-tendency (SUDEPE), and the Rubber Authority (SUDHEVEA) into a single entity.

(4) Improvement of Guidelines under the EMP:

- In December 1987, ELETROBRAS submitted to the Bank an improved, updated version of the EMP. The CCMA, as well as FUNAI, SEMA and IBDF have reviewed this version of the EMP and have furnished their comments to ELETROBRAS, for incorporation in the 1989 updated version of the EMP.

- ELETROBRAS has commissioned and completed, for sector internal discussion, first drafts of five special thematic studies agreed upon during project preparation on (a) Riverine Populations; (b) Coal-fired Plants; (c) Indian Population; (d) Flora and Fauna; and (e) Regional Integration), and has prepared a schedule under which the results of these studies will be reviewed in the sector and translated into guidelines under the EMP in 1989.

(5) Energy Conservation:

- ELETROBRAS has prepared the detailed electricity conservation program, PROCEL, which is being partially implemented;

- ELETROBRAS and the beneficiaries of Loan 2138/2364-BR are partially implementing the distribution/loss reduction subprojects.

Section IV: Agreements to be Reached

A. Conditions of effectiveness. During negotiations, the Bank would seek the agreement of the Borrower, to submit satisfactory evidence that:

(i) The Government, ELETROBRAS and the Electric Power Sector Companies are implementing the Environmental Master Plan in a manner satisfactory to the Bank;

(ii) ELETROBRAS initiated the hiring process for the remaining staff for DEMA, and has obtained the required governmental authorization for the hiring of an additional 17 professional and 8 support staff positions;

(iii) The Borrower has made, or cause to be made adequate funding arrangements, satisfactory to the Bank, for the environmental action programs to be carried out by the Electric Power Sector Companies in 1989 persuant to the Environmental Commitment Letters received by ELETROBRAS from ELETRONORTE, CHESF, FURNAS, ELETROSUL, CEEE, CESP, COPEL, CEMIG, CEMAT, CER, CERON, and CELPA;

(iv) ELETROBRAS has approved drafts, satisfactory to the Bank, detailing CCMA and COMASE's internal procedures and, work programs and their schedules of meetings until June 30, 1990;

(v) The Borrower has approved an adequate financing plan, satisfactory to the Bank for the conclusion of the Itaparica Resettlement Project;

(vi) The Borrower has made adequate funding arrangements for for the strengthening of IBMA's environmental licensing and monitoring capabilities, in accordance with the tasks and timetables set forth in the ISP;

(vii) The updating process of the EMP is progressing in terms satisfactory to the Bank;

(viii) The Borrower has made, or cause to be made adequate funding arrangements, satisfactory to the Bank, for the strengthening of environmental monitoring functions of the FEEMA, in connection with the Angra Plants, as set forth in the ISP;

(ix) The Borrower has approved an adequate financing plan, satisfactory to the Bank, for the DRELOR Beneficiaries; and

(x) CNE has made progress, satisfactory to the Bank, in the execution of the IESS.

B. Conditions for Release of the Second Tranche. During negotiations, the Bank should seek the agreement of the Borrower, to submit satisfactory evidence, as a condition for release of the Second Tranche, that:

(i) The Borrower, ELETROBRAS and the Electric Power Sector Companies, are implementing the EMP in a manner satisfactory the Bank, and as set forth in the Environmental Commitment Letters and especially that they have:

(a) achieved satisfactory progress in the implementation of ongoing resettlement measures under the Itaparica, Tres Irmaos, Taquarucu and Samuel projects;

(b) implemented, in a manner satisfactory to the Bank, the existing agreements between ELETROBRAS, the Electric Power Sector Companies, FUNAI and Indian communities on the procedures, schedules and programs (including budgetary needs) of Indian components for electric power projects (especially legal assistance and demarcations);

(c) implemented in a manner satisfactory to the Bank all existing agreements between ELETROBRAS and the Electric Power Sector Companies and IBMA and/or State level environmental and forestry authorities.

(ii) The relevant Electric Power Sector Companies have prepared on a timely manner RIMAs for the following proposed electric generation and transmission projects ( ) in strict adherence to pertinent national legislation, the Electric Power Sector's Environmental Manual, and EMP guidelines.

(iii) ELETROBRAS has updated the Environmental Master Plan, and furnished it for comments to the Bank, COMASE, CCMA, IBMA and FUNAI; such updated version of the EMP shall include:

(a) the results of the latest studies on, and improved guidelines for, riverine populations, coal fired plants, Indian populations, flora and fauna, and regional integration;

(b) an amplified legal section, reflecting legislative changes following the enactment of the Borrower 1988 Constitution;

(c) an enhanced version of its Annex I, detailing the commitments of individual Electric Power Sector Companies;

(d) adjustments resulting from the earlier comments and recommendations of CCMA, COMASE, SEMA, IBDF and FUNAI; and

(e) terms of reference for two follow-on complementary studies for the improvements of existing guidelines for (1) water quality, and (2) land tenure issues in resettlement;

(iv) ELETROBRAS has completed the strengthening and coordination of its environmental program through:

- completion of the hiring of the remaining additional higher-level staff (to complete additional 17 permanent professional positions with relevant technical qualifications and experience), and middle-level staff (to complete the additional 8 positions) for DEMA over the staff working in or assigned to DEMA as of April 1, 1989;

- full functioning of the ELETROBRAS monitoring and evaluation system for the execution of the EMP at the level of the Power Sector Companies;

- completion of the design and implementation in ELETROBRAS and its subsidiaries of a separate budgetary system for environmental and social programs starting in FY 1990;

(v) Adequate higher-level staffing and funding arrangements have been made by the Borrower for IBMA and FUNAI, in accordance with the ISP including task requirements under agreements entered into by IBMA and FUNAI with Electric Power Sector Companies and their analysis of RIMAs and the Electric Power Sector.

(vi) Satisfactory progress has been made by the Borrower towards strengthening its capabilities to deal with environmental and safety aspects of the nuclear power generation program, including furnishing to the Bank:

- the updated Operational Safety Review (OSAR) for Angra I carried out by IAEA;

- copies of the review of regulatory practices and safety standards related to Brazil's nuclear power generation carried out by IAEA;

- satisfactory evidence that adequate funding, in terms satisfactory to the Bank, is available for CNEN, IBMA and FEEMA, for monitoring and licensing of environmental aspects of Brazil's nuclear power generation program; and

- satisfactory evidence that the studies on nuclear waste disposal, decommissioning of Angra I and II, and the RIMA of Angra II are being carried out according to their respective schedules, furnished by the Borrower to the Bank on _____.

(vii) CCMA and COMASE are carrying out their work programs and activities (set forth for loan effectiveness) in a manner satisfactory to the Bank.

(viii) CNE has continued to make progress since loan effectiveness, satisfactory to the Bank, in the execution of the IESS.

(ix) The Borrower has made available, on terms satisfactory to the Bank, funds equivalent to at least $70,000,000 to the DRELOR Beneficiaries as set forth for loan effectiveness;

(x) The Borrower and the relevant Electric Power Sector Companies have achieved progress, satisfactory to the Bank, in the execution of DRELOR;

(xi) The Borrower has made available, on terms satisfactory to the Bank, funds equivalent to at least $60,000,000 to the relevant Electric Power Sector Companies for the carrying out of PROCEL in a manner satisfactory to the Bank during 1989.

(xii) The Bank is satisfied that the level and structure of prices for the sale of electricity charged by the Electric Power Sector Companies substantially reflect the long-run marginal costs of supply of electricity, calculated in accordance with a methodology satisfactory to the Bank;

(xiii) The Electric Power Sector Companies have made progress, satisfactory to the Bank, in the execution of educational and advertising campaigns on energy conservation;

(xiv) The Borrower has issued a progress report, satisfactory to the Bank, on its efforts to develop loan management policies, analytical methodologies and technologies to promote the efficient supply and use of electric power;

(xv) The Borrower has made progress, satisfactory to the Bank, in the execution of programs of technical assistance to industrial consumers, manufacturers of electrical equipment and technical institutions, all satisfactory to the Bank, to promote and strengthen the institutions in charge of research and development of advanced conservation technologies; and

(xvi) The Borrower has made progress (including amendments to relevant legislation and regulations), satisfactory to the Bank, in the establishment of new or revised electric equipment performance, construction methods and standards for buildings, electric machinery and appliances requiring the use of more efficient technologies of energy use and conservation.

BRAZIL

ENVIRONMENTAL POLICY AND ENERGY CONSERVATION LOAN

Policy Matrix

Reform Areas Policy Objectives	Actions Already Taken	Actions to be Taken by Loan Effectiveness	Actions to be Taken by Second Tranche Release
I. Institutional Strengthening			
(a) ELETROBRAS and Electric Power Sector Companies	- An exceptional Government authorization for the hiring of 180 environmental staff for the Electric Power Sector in 1988; - Creation and initial staffing of a Department for the Environment (DEMA) in ELETROBRAS; - The creation of permanent and substantial in-house environmental units, in leading Electric Power Sector Companies; - The satisfactory operation and functioning of the "Comite Consultivo de Meio Ambiente" (CCMA) of ELETROBRAS; - The development (design and initial implementation) of a monitoring and evaluation system for the execution of the EMP and of the Power Sector's Environmental Manual in ELETROBRAS and its subsidiaries; - The convening by ELETROBRAS of an inter-agency work group, to prepare environmental (including social) guidelines and procedures for the licensing of electric power sector projects, additional to general federal guidelines for RIMAs; - The initiation, by ELETROBRAS and COMASE, of the design of the Environmental and Social Accounting System in the budgetary process of the Electric Power Sector.	ELETROBRAS to initiate the hiring process for the remaining staff for DEMA, and obtain the required governmental authorization for the hiring of an additional 17 professional and 8 support staff positions; ELETROBRAS to approve drafts, satisfactory to the Bank, detailing CCMA and COMASE's internal procedures and work programs and their schedules of meetings until June 30, 1990.	ELETROBRAS to complete the strengthening and coordination of its environmental program through: (a) completion of the hiring of the remaining additional higher-level staff (to complete additional 17 permanent professional positions with relevant technical qualifications and experience), and middle-level staff (to complete the additional 8 positions) for DEMA over the staff working in or assigned to DEMA as of April 1, 1989; (b) full functioning of the ELETROBRAS monitoring and evaluation system for the execution of the EMP at the level of the Power Sector Companies; (c) completion of the design and implementation in ELETROBRAS and its subsidiaries of a separate budgetary system for environmental and social programs starting in FY 1990. CCMA and COMASE to carry out their work programs and activities (set forth for condition of loan effectiveness) in a manner satisfactory to the Bank.

ENVIRONMENTAL POLICY AND ENERGY CONSERVATION LOAN

Policy Matrix

Reform Areas Policy Objectives	Actions Already Taken	Actions to be Taken by Loan Effectiveness	Actions to be Taken by Second Tranche Release
(b) Federal and State Agencies	- ELETROBRAS and the Electric Power Sector Companies have (since 1986) maintained agreements and financed programs with FUNAI, SEMA, IBDF and SUDEPE, which are essential to the carrying out of the EMP. - The Government has (in January 1989) in the context of its broader "Our Nature" environmental protection program, created the "Instituto Brasileiro de Meio Ambiente e Recursos Naturais Renovais" (IBMA), which consolidated and strengthened previously existing environmentally-related agencies, especially the Environmental Secretariat (SEMA), the Forestry Institute (IBDF), and the Fisheries Superintendency (SUDEPE), and the Rubber Authority (SUDHEVEA) into a single entity. - The creation and functioning of the "Comite Coordinador das Atividades de Meio Ambiente do Setor Eletrico" (COMASE).	The Borrower to make adequate funding arrangements for the strengthening of IBMA's environmental licensing and monitoring capabilities, in accordance with the tasks and timetables set forth in the Institutional Strengthening Program (ISP).	Adequate higher-level staffing and funding arrangements to be made by the Borrower for IBMA and FUNAI, in accordance with the Institutional Strengthening Program (ISP) including task requirements under agreements entered into by IBMA and FUNAI with Electric Power Sector Companies and their analysis of RIMAs and the Electric Power Sector.

ENVIRONMENTAL POLICY AND ENERGY CONSERVATION LOAN

Policy Matrix

Reform Areas Policy Objectives	Actions Already Taken	Actions to be Taken by Loan Effectiveness	Actions to be Taken by Second Tranche Release
II. Implementation of Environmental Action Plans of the Electric Power Sector Companies	Since mid-1986 the Electric Power Sector companies have complied with and implemented the EMP through: - the carrying out of specific action plans for environmental, Indian resettlement and archeological salvage. Demarcation of Indian reserves was completed for projects under construction, (without demarcation) at the First Power Sector Loan. - the carrying out of a typical resettlement operation under the Itaparica project; - the postponing of several environmentally problematic hydroelectric projects which were considered under the "Plano 2010". - preparation of environmental inventory, feasibility studies, and RIMAs; - public hearings and seminars regarding a number of proposed projects; In November 1988, ELETROBRAS had received and submitted to the Bank Environmental Commitment Letters (Annex VI) from the Electric Power Sector Companies ELETRONORTE, CHESF, FURNAS, and ELETROSUL, as well as from CEEE, CESP, COPEL, CEMIG, CEMAT, CER, CERON, and CELPA) expressing their agreement to fully comply with the EMP with regard to all their projects.	The Government, ELETROBRAS and the electric Power Sector Companies to implement the Environmental Master Plan in a manner satisfactory to the Bank; The Borrower to make, or cause to be made adequate funding arrangements, satisfactory to the Bank, for the environmental action programs to be carried out by the Electric Power Sector Companies in 1989 pursuant to the Environmental Commitment Letters received by ELETROBRAS, from ELETRONORTE, CHESF, FURNAS, ELETROSUL, CEEE, CESP, COPEL, CEMIG, CEMAT, CER, CERON, and CELPA; The Borrower to approve an adequate financing plan, satisfactory to the Bank for the conclusion of the Itaparica Resettlement Project;	The Borrower, ELETROBRAS and the Electric Power Sector Companies, to implement the EMP in a manner satisfactory to the Bank, and as set forth in the Environmental Commitment Letters and especially that they have: (a) achieved satisfactory progress in the implementation of ongoing resettlement measures under the Itaparica, Tres Irmaos, Taquarucu and Samuel projects; (b) implemented, in a manner satisfactory to the Bank, the existing agreements between ELETROBRAS, the Electric Power Sector Companies, FUNAI and Indian communities on the procedures, schedules and programs (including budgetary needs) of Indian components for electric power projects (especially legal assistance, and demarcations); (c) implemented in a manner satisfactory to the Bank all existing agreements between ELETROBRAS and the Electric Power Sector Companies and IBMA and/or State level environmental and forestry authorities. The relevant Electric Power Sector Companies have prepared on a timely manner RIMAs for the following proposed electric generation and transmission project (....) in strict adherence to pertinent national legislation, the Electric Power Sector's Environmental Manual, and EMP guidelines.

ENVIRONMENTAL POLICY AND ENERGY CONSERVATION LOAN

Policy Matrix

Reform Areas Policy Objectives	Actions Already Taken	Actions to be Taken by Loan Effectiveness	Actions to be Taken by Second Tranche Release
III. Improvement and Implementation of Guidelines under the EMP	- In December 1987, ELETROBRAS submitted to the Bank an improved, updated version of the EMP. The CCMA, as well as FUNAI, SEMA and IBDF have reviewed this version of the EMP and have furnished their comments to ELETROBRAS, for incorporation in the 1989 updated version of the EMP. - ELETROBRAS has commissioned and completed, for sector internal discussions, first drafts of five special thematic studies agreed upon during project preparation on (a) Riverine Populations; (b) Coal-fired Plants; (c) Indian Population; (d) Flora and Fauna; and (E) Regional Integration), and has prepared a schedule under which the results of these studies will be reviewed in the sector and translated into guidelines under the EMP in 1989.	The updating of the EMP to be progressing in terms satisfactory to the Bank.	ELETROBRAS to update the Environmental Master Plan and furnish it for comments to the Bank, COMASE, CCMA, IBMA and FUNAI; such updated version of the EMP shall include: (a) the results of the latest studies on, and improved guidelines for, riverine populations, coal fired plants, Indian populations, flora and fauna, and regional integration; (b) an amplied legal section, reflecting legislative changes following the enactment of the Borrower 1988 Constitution; (c) an enhanced version of its Annex I, detailing the commitments of individual Electric Power Sector Companies; (d) adjustments resulting from the earlier comments and recommendations of CCMA, COMASE, SEMA, IBDF and FUNAI; and (e) terms of reference for two follow-on complementary studies for the improvements of existing guidelines for (1) water quality and (2) land tenure issues in resettlement.

ENVIRONMENTAL POLICY AND ENERGY CONSERVATION LOAN

Policy Matrix

Reform Areas Policy Objectives	Actions Already Taken	Actions to be Taken by Loan Effectiveness	Actions to be Taken by Second Tranche Release
IV. Environmental and Safety Aspects of the Nuclear Power Generation Program		The Borrower to make, or cause to be made aadequate funding arrangements, satisfactory to the Bank, for the strengthening of environmental monitoring functions of the FEEMA, in connection with the Angra Plants, as set forth in the ISP;	The Borrower to make satisfactory progress towards strengthening its capabilities to deal with environmental and safety aspects of the nuclear power generation program, including furnishing to the Bank: (a) the updated Operational Safety Review (OSAR) for Angra I carried out by IAEA; (b) copies of the review of regulatory practices and safety standards related to Brazil's nuclear power generation carried out by IAEA; (c) evidence that adequate funding, in terms satisfactory to the Bank, is available for CNEN, IBMA and FEEMA, for monitoring and licensing of environmental aspects of Brazil's nuclear power generation program; and (d) evidence that the studies on nuclear waste disposal, decommissioning of Angra I and II, and the RIMA of Angra II are being carried out according to their respective schedules, furnished by the Borrower to the Bank on _____.

ENVIRONMENTAL POLICY AND ENERGY CONSERVATION LOAN

Policy Matrix

Reform Areas Policy Objectives	Actions Already Taken	Actions to be Taken by Loan Effectiveness	Actions to be Taken by Second Tranche Release
V. Energy Conservation			
(a) Studies	CNE has initiated the Integrated Energy Strategy Study.	CNE to make progress, satisfactory to the Bank, in the esecution of the IEES.	CNE to continue to make progress since loan effectiveness, satisfactory to the Bank, in the execution of the IESS.
(b) Distribution Network Rehabilitation/Loss Reduction Programs (DRELOR)	- ELETROBRAS and the DRELOR Beneficiaries are partially implementing the distribtuion/ loss reduction subprojects.	The Borrower to approve an adequate primary plan, satisfactory to the Bank, for the DDRELOR Beneficiaries.	The Borrower to make available, on terms satisfactory to the Bank, funds equivalent to at least $70,000,000 to the DRELOR Beneficiaries as set forth for loan effectiveness. The Borrower and the relevant Electric Power Sector Companies to make progress, satisfactory to the Bank, in the execution of DRELOR.
(c) Electricity Energy Conservation	- ELETROBRAS has prepared the detailed electricity conservation program, PROCEL which is being partially implemented.		The Borrower to make available, on terms satisfactory to the Bank, funds equivalent to at least $60,000,000 to the relevant Electric Power Sector Companies for the carrying out of PROCEL in a manner satisfactory to the Bank during 1989. The Bank to be satisfied that the level and structure of prices for the sale of electricity charged by the Electric Power Sector Companies substantially reflect the long-run marginal costs of supply of electricity, calculated in accordance with a methodology satisfactory to the Bank. The Electric Sector Companies to make progress, satisfactory to the Bank, in the execution of educational and advertising campaigns on energy conservation.

ENVIRONMENTAL POLICY AND ENERGY CONSERVATION LOAN

Policy Matrix

Reform Areas Policy Objectives	Actions Already Taken	Actions to be Taken by Loan Effectiveness	Actions to be Taken by Second Tranche Release
(continuation)			
(c) Electricity Energy Conservation	- ELETROBRAS has prepared the detailed electricity conservation program, PROCEL, which is being partially implemented.		The Borrower to issue a progress report, satisfactory to the Bank, on its efforts to develop load management policies, analytical methodologies and technologies to promote the efficient supply and use of electric power. The Borrower to make progress, satisfactory to the Bank, in the execution of programs of technical assistance to industrial consumers, manufacturers of electrical equipment and technical institutions, all satisfactory to the Bank, to promote and strengthen the institutions in charge of research and development of advanced conservation technologies. The Borrower to make progress (including amendments to relevant legislation and regulations, satisfactory to the Bank, in the establishment of new or revised electric equipment performance, construction methods and standards for buildings, electric machinery and appliances requiring the use of more efficient technologies of energy use and conservation.

ANNEX VI

BRAZIL

ENVIRONMENTAL REFORM AND ENERGY CONSERVATION LOAN

Environmental Commitment Letters

In November 1988, ELETROBRAS had received and furnished to the Bank, Environmental Commitment Letters from the Electric Power Sector Companies (ELETROBRAS' subsidiaries ELETRONORTE, CHESF, FURNAS, and ELETROSUL, as well as from CEE, CESP, COPEL, CEMIG, CEMAT, CER, CERON, and CELPA) expressing their formal agreement to comply with all guidelines laid out in the EMP with regard to all their projects. These letters also specify more detailed commitments for the most advanced group of projects, and indicate their respective intentions to collaborate in the following:

a. the implementation of the ELETROBRAS EMP monitoring system;

b. the design and preliminary implementation of a separate financial planning and accounting system for environmental programs;

c. the preparation of specific environmental budgets for the most advanced group of projects (falling into categories (i) - (iii) below) for the 1989 budget year;

d. the employment of services of adequate specialist teams, and the informing of ELETROBRAS of their numbers and qualifications;

e. with regard to the establishment of conservation units:

- an inventory and report on the status quo and action plans for existing conservation units; and

- for projects which are to begin operation by 1991, adherence to adequate timetables.;

f. with regard to archeological salvage, for projects which are to begin operation by 1991, adherence to adequate timetables;

g. the carrying out by ELETRONORTE and CESP of environmental and social evaluation studies for Tucurui and Rosana; AND

h. adherence to the following programs set out for the most advanced projects (as specified in Categories (i) - (iii) below).

Category (i):
Projects where the reservoir would be filled before December 31, 1989

- with regard to resettlement: Resettlement plans and financing shall be available, consistent with the Plano 2010 to carry out the actions therein contained, and land acquisition and

implementation of programs shall actually be underway in accordance with such plans;

- with regard to Indian issues: All measures shall have been taken which are within the legal competence and possibilities of the Electric Power Sector Companies, leading up to the confirmation of title (regularizacao) of Indian lands by the relevant federal and state authorities.

Category (ii):
Projects where the reservoir would be filled in 1990 and 1991:

- With regard to resettlement: Consultations with local populations and preliminary plans for resettlement, land acquisition and financing shall be adequate and in accordance with overall timetables and progress of the respective projects;

- with regard to Indian issues: The necessary anthropological studies and proposals shall be underway and implemented in accordance with adequate timetables.

Category (iii):
Projects where the reservoir would be filled in 1992 or 1993:

- With regard to resettlement: The design of resettlement schemes and preliminary steps towards land acquisition and/or expropriation shall be underway in accordance with overall timetables and progress of the respective projects. In cases where no socio-economic and resettlement studies have yet been initiated, terms of reference for such studies shall be prepared, and the studies shall be initiated and/or contracted.

- With regard to Indian issues: The design of schemes to protect the interests of Indian population affected by the respective projects would be underway, in accordance with overall timetables and progress of the respective projects.

Annex VII
In preparation

BRAZIL

ENVIRONMENTAL REFORM AND ENERGY CONSERVATION LOAN

The Program "Nossa Natureza"

Annex VIII
In preparation

BRAZIL

ENVIRONMENTAL REFORM AND ENERGY CONSERVATION LOAN

The Nuclear Power Program

THE STATUS OF BANK GROUP OPERATIONS IN BRAZIL

A. SUMMARY STATEMENT OF LOANS
(As of September 30, 1988)

Loan #	Year	Borrower	Purpose	Amount less Cancellation (US$ Millions)	Undisbursed	
One Hundred and five loans fully disbursed				6,238.0		
1721	1979	COPEL	Power	86.7	-	
1721-5	1979	COPEL	Power	22.3	0.2	
1877	1980	State of Minas Gerais	Rural Development	33.0	2.8	
1924	1981	Brazil	Rural Development	54.0	4.4	
1939	1981	ELETROBRAS	Power	54.0	13.2	
1970	1981	CEF	Water Supply	180.0	-	1/
1989	1981	Brazil	Alcohol Development	232.8	-	1/
2015	1981	Brazil	Agriculture	17.0	-	1/
2016	1981	Brazil	Agriculture	60.0	-	1/
2060	1982	Brazil	Agriculture	67.0	12.2	
2061	1982	Brazil	Health	13.0	1.0	
2062	1982	Brazil	Highways	206.0	0.7	
2116	1982	Brazil	Agriculture	26.4	6.1	
2138	1982	ELETROBRAS	Power	182.7	95.6	
2163	1982	Brazil	Agriculture	26.4	6.8	
2170	1982	Brazil	Urban Development	123.9	45.0	
2177	1982	Brazil	Rural Development	42.7	12.7	
2224	1983	Brazil	Feeder Roads	154.0	21.4	
2249	1983	CEF	Water Supply	302.3	1.0	
2268	1983	Brazil	Agro-Industries	400.0	94.4	
2269	1983	Brazil	Rural Development	67.8	50.5	
2343	1984	Brazil	Urban Development	52.7	11.0	
2347	1984	Brazil	Export Development	351.4	0.1	
2348	1984	Brazil	Agriculture	303.0	0.5	
2353	1984	Brazil	Agriculture	65.2	49.6	
1729-1	1984	Brazil	Agriculture	7.7	1.5	
2060-1	1984	Brazil	Agriculture	22.8	22.7	
2364	1984	ELETROBRAS	Power	250.0	166.0	
2365	1984	ELETROBRAS	Power	222.8	4.1	
2366	1984	Brazil	Education	20.0	10.4	
2412	1984	Brazil	Education	40.0	19.6	
2446	1984	Brazil	Federal Highways	210.0	26.1	
2447	1984	State of Sao Paulo	Health	55.5	19.4	
2448	1984	Brazil	Health Studies	2.0	1.1	
2488	1985	Brazil	Development Banking	300.0	76.3	
2489	1985	Brazil	Education	72.0	44.2	
2523	1985	Brazil	Rural Development	61.3	44.6	
2524	1985	Brazil	Rural Development	61.4	45.2	
2532	1985	Brazil	Rural WS&S Pilot	16.3	13.9	
2563	1985	Brazil	Railways	200.0	143.0	
2564	1985	ELETROBRAS	Power Transmission	400.0	320.1	
2565	1985	ELETROBRAS	Power Distribution	312.0	258.4	
2593	1985	Brazil	Land Tenure	100.0	76.6	
2623	1986	State of Santa Catarina	Urban Development	24.5	21.1	
2645	1986	Brazil	Urban Reconstruction	100.0	6.5	
2679	1986	Brazil	Agriculture	155.0	112.7	
2680	1986	Brazil	Irrigation Eng.	48.0	38.9	
2681	1986	Brazil	Urban Development	55.0	49.3	
2699	1986	Brazil	Health	59.5	55.1	
2718	1986	Brazil	Rural Development	92.0	74.8	
2719	1986	Brazil	Irrigation	57.0	45.7	
2721	1986	Brazil	Public Sector	29.0	24.3	
2727	1986	Brazil	Credit & Marketing Reform	500.0	180.3	

A. SUMMARY STATEMENT OF LOANS (Continued)
(As of September 30, 1988)

Loan #	Year	Borrower	Purpose	Amount less Cancellation (US$ Millions)	Undisbursed
2761	1987	Brazil	Rural Development	171.0	155.5
2762	1987	Brazil	Rural Development	78.0	69.3
2763	1987	Brazil	Rural Development	122.0	112.8
2810	1987	Brazil	Education	74.5	71.8
2822	1987	Brazil	Urban Transport	200.0	187.7
2830	1987	State of Sao Paulo	State Highway	174.0	163.0
2831	1987	Brazil	Ind.Pollution Control	50.0	50.0
2857	1987	FEPASA	Railway Rehabilitation	100.0	95.0
2860	1987	Brazil	Rural Development	60.0	54.6
2861	1987	Brazil	Rural Development	55.0	50.5
2862	1987	Brazil	Rural Development	84.0	78.1
2863	1987	Brazil	Rural Development	42.0	38.4
2864	1987	Brazil	Livestock Disease Control	51.0	47.0
2883	1988	Centrais Eletricas Brasileiras S.A.	Resettlement & Irrigation	132.0	78.6
2895 2/	1988	State of Minas Gerais	Forestry Development	48.5	48.5
2931 2/	1988	Brazil	Disease Control	109.0	109.0
2941 4/	1988	PORTOBRAS	Port Technical Assist.	20.0	20.0
2950 2/	1988	Brazil	Irrigation Subsector	195.0	195.0
2960 2/	1988	Brazil	Agro-Industries Credit	300.0	300.0
2971 2/	1988	Brazil	Agricultural Credit	300.0	300.0
2975 2/	1988	CEF	Rio Flood Reconst.	175.0	175.0
2983 2/	1988	CEF	Municipal & Low-Income	80.0	80.0
		Total		14,967.22 3/	
		Of which has been repaid to the Bank		3,676.22	
		Total now outstanding		11,291.00	
		Amount sold	45.8		
		Of which has been repaid	45.8	45.80	
		Total now held by Bank		11,245.20	
		Total undisbursed			4,810.44

1/ Although this loan is fully disbursed, and included under loans fully disbursed above, the initial deposit to the Special Account is currently in the recovery process. The loan will be removed from the list after the loan account closes.

2/ Not yet effective.

3/ No IDA credits have been made to Brazil.

4/ Became effective October 4, 1988.

Note: The status of the projects listed in Part A is described in a separate report on all Bank/IDA financed projects in execution, which is updated twice yearly and circulated to the Executive Directors on April 30 and October 31.

B. STATEMENT OF IFC INVESTMENTS
(as of September 30, 1988)

Fiscal Year	Obligor	Type of Business	Amount in US$ million		
			Loans	Equity	Total
1957	Siemens do Brasil Cia. de Eletricidade	Electrical Equipment	2.00	-	2.00
1958	Klabin Ltda., S.A. Celulose e Papel	Pulp and Paper	1.20	-	1.20
1958	D.L.R. Plasticos do Brasil, S.A.	Automotive Parts	0.45	-	0.45
1958	Willys-Overland do Brasil, S.A. - Industria e Comercio	Motor Vehicles	2.45	-	2.45
1959	Companhia Mineira de Cimento Portland, S.A.	Cement	1.20	-	1.20
1964	Champion Celulose, S.A.	Pulp	4.00	-	4.00
1966/1968/1972	Acos Villares, S.A.	Steel	8.00	1.93	9.93
1966/1969	Papel e Celulose Catarinense, S.A.	Pulp and Paper	3.78	5.71	9.49
1967/1972	Ultrafertil, S.A. - Industria e Comercio de Fertilizantes	Fertilizers	8.22	3.03	11.25
1969	Petroquimica União, S.A.	Petrochemicals	5.50	2.88	8.38
1970	Polialeflnas, S.A. Industria e Comercio	Petrochemicals	5.50	2.88	8.38
1971	Usiteno, S.A. Industria e Comercio	Petrochemicals	4.60	1.44	6.04
1971	Rio Grande - Companhia de Celulose do Sul	Pulp	4.90	-	4.90
1972/1975/1981/1987	Companhia de Cimento Nacional de Minas	Cement	199.14	6.70	205.84
1973/74/77/81/83/84	Companhia Siderurgica do Guanabara - COSIGUA	Steel	76.97	15.27	92.24
1973	Capital Market Development Fund - FUNCAP	Capital Market Development	5.00	-	5.00
1973/1978/1983	Empresa de Desenvolvimento de Recursos Minerais - CODEMIN,S.A	Nickel Mining and Refining	85.00	8.74	93.74
1974	Industrias Villares, S.A.	Elevators & Ind. Equipment	6.00	-	6.00
1974	Fabrica de Tecido Tatuape, S.A.	Textiles	39.80	-	39.80
1975/1979	Cabuava Carbonos Industrias Ltd.	Carbon Black	6.18	1.19	7.37
1975	Usiteno Nordeste, S.A.	Petrochemicals	10.00	-	10.00
1976	Santista Industria - Textil do Nordeste, S.A.	Textiles	6.45	1.00	7.45
1976/1980	Tecsner S.A. - Textil Catarinense do Nordeste	Textiles	16.20	-	16.20
1977	FMB S.A. Productos Metalurgicos	Iron & Aluminum Castings	20.00	-	20.00
1977	Mineracao Rio do Norte S.A.	Mining	15.00	-	15.00
1978	Cimetal Siderurgia S.A.	Iron and Steel	8.38	3.00	11.38
1979	Volvo do Brasil Motores e Veiculos, S.A.	Motor Vehicles	60.00	6.95	66.95
1980	Hering do Nordeste S.A. - Malhas	Ready-made Garments	2.00	-	2.00
1980	Dendo do Para S/A - Denpasa - Agricultura, Industria e Comercio de Oleaginosas	Palm-Oil	3.50	1.00	4.50
1980	Villares Industrias de Base S.A. - VIBASA	Iron and Steel	5.00	-	5.00
1980	PPH - Companhia Industrial de Polipropileno	Chemicals & Petrochemicals	31.00	2.00	33.00
1980	Destilaria Cienorte S.A.	Chemicals & Petrochemicals	-	0.25	0.25
1980	Sotave Amazonia Quimica e Mineral S/A	Fertilizers	35.00	6.00	41.00
1980/1981/1987	Poliol Petroquimica	Chemicals & Petrochemicals	43.00	6.00	49.00
1981	Brasilpar	Money & Capital Markets	-	1.50	1.50
1981	Companhia Brasileira de Agropecuaria - COBRAPE	Food and Food Processing	5.50	3.00	8.50
1981	Triunfo	Chemicals & Petrochemicals	46.00	4.10	50.10
1982	Cimento CAUE	Cement & Const. Materials	40.00	5.00	45.00
1982	Agrilessing S.A.	Money Capital Market	30.00	0.45	30.45
1983	Cia Riograndense de Participacoes (CRP)	Money Capital Market	-	0.12	0.12
1983	Atlas Frigorifico	Food and Food Processing	13.00	-	13.00
1983	Companhia Dendo do Amapa (CODEPA)	Palm Oil	6.10	-	6.10
1983	PISA - Papel de Imprensa S.A.	Pulp & Paper Products	82.00	9.87	91.87
1983	Socaco/SA	Food and Food Processing	3.00	2.50	5.50
1983	CIMAO	Cement & Const. Materials	35.00	-	35.00
1986	Nitrocior Produtos	Chemicals & Petrochemicals	3.00	5.07	8.07
1984	Companhia Alcoolquimica Nacional	Chemicals & Petrochemicals	20.00	4.00	24.00
1985	Quimica da Bahia	Chemicals & Petrochemicals	3.50	1.80	5.30
1987	Sao Paulo Alpargatas	Textiles and Fabrics	30.00	-	30.00
1987	Amapa Florestal e Celulose - AMCEL	Pulp and Paper Products	14.00	-	14.00
1988	Fabrica Carioca de Catalisador - FCC	Chemicals	20.50	-	20.50
1988	Equity Fund of Brazil	Capital Market Institutions	-	20.00	20.00
1988	S.A. Comercio e Industrial - PERDIGAO	Food and Food Processing	20.00	-	20.00
1988	Banco Bozano	Development/Finance	20.00	-	20.00
1988	Banco Itau	Development/Finance	30.00	-	30.00
1988	Mineracoes Brasileiras Reunidas	Mining	20.00	-	20.00
1988	Unibanco - União de Bancos Brasileiros	Development/Finance	30.00	-	30.00
1988	Duratex, S.A.	Pulp and Paper Products	7.37	-	7.37
1988	Cobrasco	Money & Capital Markets	40.00	5.00	45.00
1988	Brasital	Textiles and Fibers	0.10	-	0.10
1988	Sanbra	Textiles and Fibers	3.20	1.30	4.50
1988	Malwee	Textiles and Fibers	4.00	-	4.00
1988	Teka	Textiles and Fibers	1.90	-	1.90
	Total Gross Commitments		1,253.80	140.31	1,393.90
	Less Cancellations, Terminations, Repayments and Sales		947.81	46.88	994.38
	Total Commitments Now Held by IFC		306.08	93.43	399.84
	Total Undisbursed		166.20	8.95	175.15

ANNEX X
Under Revision

BRAZIL
ENVIRONMENTAL REFORM AND ENERGY CONSERVATION
LOAN
Project File

The following Documents are in the Project File:

1. Electric Power Sector Environmental Master Plan, November 1986 version;

2. Electric Power Sector Environmental Master Plan, December 1987 version.

3. Electric Power Sector Environmental Master Plan; Progress report on project action programs and special studies, December 1987

4. For Studies underway for the improvement of guidelines of the EMP:

- Terms of Reference and Draft studies on Riverine Populations, Regional Insertion, Coal Fired Plants, Flora and Fauna, and Indians;

- Several Progress Reports on Studies for 1988, and an update of April 1989;

5. The ELETROBRAS "Manual for Studies of Environmental Effects of Electric Systems" of June 1986;

6. General Guidelines for the Preparation of RIMAs;

7. 1988 interim reports and updatings of guidelines and for the preparation of RIMAs;

8. Oficio 020 of SEMA, of October 26, 1988, sent to ELETROBRAS, inviting DEMA to participate in a governmental working group, with the objective to adjust environmental legislation relevant to hydroelectric projects, in the context of the National Environmental Legislation (of August 31, 1981), to the Constitution which was promulgated on October 5, 1989.

9. For the CCMA: Recommendation made in 1988/ Comments on the December 1987 version of the EMP;

10. For COMASE:
- Portaria 511 of April 26, 1988, of the Minister of Mines and Energy;

- "Regimento Interno", of July 14, 1988:

- Minutes of meetings;

11. For the Institutional Strengthening Program (ISP) of federal and state-level environmental, Indian, forestry and fisheries agencies (to be received at negotiations) detailing:

(a) by project and task (specifying timing and expertise requirements) the expected contributions of each agency to the implementation of the EMP;

(b) specifying any additional staffing or contracting of services will be necessary, in order to assure a timely and satisfactory implementation of the specified tasks by the respective agencies .

12. The Commitment Letters of the ELECTRIC Power Sector Companies;

13. Copies of Convenios between the Electric Power Sector and federal agencies referred to under the ISP;

14. The Nossa Natureza Program (Decree of April 6, 1988), and subsequent related legislation;

15. The Decree for the creation of the IBMA;

16. Environmental Laws under SISNAMA and the National Environmental Policy;

17. The environmental chapter of the Brazilian Constitution of October 1988;

18. The Indian Chapter of the Brazilian Constitution of October 1988;

19. The Plano 2010 (Plano Nacional de Energia Eletrica 1987/2010, Ministerio das Minas e Energia, Centrais Eletricas Brasileiras S.A.-ELETROBRAS;

20. Updated 1988-1991 Generation Expansion Plan of November 1988;

21. Terms of Reference and Progress Report for the Working Group on Environmental Accounting, October 1988;

22. Terms of Reference and Progress Report for the Working Group on Environmental Licensing, October 1988;

23. Terms of Reference and Progress Report for the ELETROBRAS system of environmental monitoring of projects, October 1988

24. CNEN and FURNAS: Various Background Materials on the regulatory framework and environmental and civil safety, for the ANGRA Nuclear Power Plants.

25. PROCEL: Programa Nacional de Conservacao de Energia Eletrica; Documentacao Basica.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

1:00 Hills' Lunch

Brazil

DATE: April 17, 1989

TO: Mr. Barber B. Conable

THROUGH: Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 39001

SUBJECT: Briefing on the Trade and Foreign Investment Situation in Brazil

1. This note responds to your request for information on the trade and foreign investment situation in Brazil. The Bank has been heavily involved in analyzing Brazil's trade policy and discussing a trade policy reform project, but less involved in issues of direct foreign investment.

Trade Performance and the Debt Crisis in the 1980s

2. Brazil's foreign debt burden and the lack of new money from the commercial banks meant that the habitual trade deficits of the 1970s were no longer sustainable in the 1980s. The Government's response, from the early 1980s, was: one the one hand, to reduce imports through domestic deflation and the imposition of draconian import controls; on the other, to stimulate exports through a more depreciated domestic currency and by partially linking individual firms' import entitlements to their export performance. Within this overall policy thrust, trade policy has been cyclical, with alternating periods of import restraint to achieve a trade-surplus target and import liberalization to dampen inflationary pressures. Brazil's export performance has been helped by a revival of world trade in recent years, hindered by growing nontariff barriers in industrialized countries, and achieved in spite of a substantial reduction (from 1979 to 1984) in Brazil's formal export subsidies, largely under the pressure of GATT and the US.

3. In all, the external sector's response to the debt crisis has been remarkable: a trade deficit of 1.2 percent of GDP in 1982 was turned into a trade surplus of 6.2 percent by 1984. But this achievement has been costly: tight foreign-exchange controls (through the "import programs") and a severe import-licensing process have meant that: domestic producers face virtually no competition from imports, and can thus enjoy excessive profits or high levels of inefficiency; importers have to pay a high price in "red tape" to import, or else are condemned to use inferior local inputs. Thus import policies have been a brake on investment in technologically-up-to-date techniques.

Trade Policy Reform

4. Due in part to domestic recession, Brazil has recently experienced larger-than-planned trade surpluses -- US$19 billion in 1988 and at least $15 billion expected for 1989. A cautious process of trade reform has been underway since late 1987, a process permitted by these surpluses and impelled both by demands from the enterprise sector for greater liberty in

commercial policy and by the Government's need to counter the inflationary effects that the trade surpluses have had on the level of reserves. The most important measures of trade reforms undertaken have been:

- a May 1988 tariff reform, consolidating tariffs, reducing their average and variance, and eliminating some of the concessionary-tariff regimes;

- a liberalization in 1988 and 1989 of the import programs, both by raising the size of foreign-exchange allocations to firms and by raising the annual limit up to which firms can import without requiring such a program;

- a substantial reduction, since late 1987, in the list of prohibited imports; and

- an alleviation of the conditions of mandatory foreign financing of certain imports (particularly capital goods).

5. In spite of the Government's commitment, the reform process, explicitly gradual and selective, has so far remained cautious to the point where it risks being easily reversed. This caution is notably evident in the Government's reluctance to dismantle the pervasive system of foreign-exchange budgeting and controls.

The Bank's Project on Trade Policy Reform

6. The Bank has been discussing a trade-policy adjustment loan with the Government since mid-1987. The Bank appears to have reinforced the reform process, both through these discussions and through an April 1988 conference it helped organize in Sao Paulo which disseminated the major results of a Bank research project (on "the timing and sequencing of a trade liberalization policy") and stimulated debate on Brazilian reform.

7. The Government has since, partly because of the Bank's involvement, advanced some aspects of its trade reform program, but it remains hesitant on foreign exchange decontrol, particularly in view of current economic and political uncertainties. The Government may agree to more ambitious decontrol measures in the coming months, but we believe that the most likely outcome is a more modest measure to consolidate recent reforms with an undertaking to free a significant proportion of smaller importers from the binding constraints of the import programs and import licences. In these circumstances, a Bank loan for trade reform, recognizing the value of reforms already undertaken, would be concerned to require safeguards guaranteeing, as far as feasible, the free availability of this pool of foreign exchange for all small importers (by reducing the controls on these imports to a minimum and providing a mechanism that would continue to make foreign exchange available in the event of a balance-of-payments crisis). Such a loan (which could only be presented to our Board under conditions of reasonable macreconomic stability) could help put Brazil's fragile trade reform on a firmer footing (i.e. reducing the risks of reversal) so that a new Government could continue the reform process after March 1990.

Recent Trends in Direct Foreign Investment

8. Net direct foreign investment in Brazil reached a peak (US$ 1.42 billion) in 1981, to decline drastically afterwards. By 1986 a record net outflow (US$ 1.44 billion) was obtained. This reversal can be at least partly explained by the international debt crisis precipitated by the Mexican case in August 1982. However, domestic events like the failed stabilization attempt of 1986 (the Cruzado Plan) and the anticipated moratorium on external debt the following year are important factors. The overall economic and political uncertainty prevailing from 1988, and the record premium in the black market foreign exchange market, have accounted for a record outflow of capital in the form of profits and dividends. Such funds may have been partly repatriated via the official foreign exchange market, and used in both formal and informal debt-for-equity transactions.

9. Recent restrictions on informal debt-equity swaps for public enterprises, the limited size of the official debt-equity swap program, the stagnation of the economy, and constitutional changes have added to the decline in foreign investment in the last five years. The constitutional changes ban foreign-controlled firms from investment in mineral exploration and extraction and in hydroelectric facilities (Article 176). Foreign-owned banks already operating in Brazil have been granted substantially the same privileges, following discussions related to the Bank's proposed financial reform loan, as national banks. The Government is working with Congress to establish the legal framework for the entry and operation of new foreign-owned banking entrants according to Article 192III of the Constitution.

c.c Armeane Choksi, LA1DR; Demetris Papageorgiou, LA1TF

for Carla Hills
lunch 4/17

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/04/17 DUE DATE : 00/00/00
LOG NUMBER : 890418005 FROM : S. Husain (MAQ)
SUBJECT : Briefing on the Trade and Foreign Investment Situation in Brazil

OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
_____ PLEASE HANDLE
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_____ FOR YOUR REVIEW AND RECOMMENDATION
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_____ PLEASE DISCUSS WITH _____
_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS :cc: Mrs. haug

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: April 17, 1989

TO: Mr. Barber B. Conable

THROUGH: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 39001

SUBJECT: Briefing on the Trade and Foreign Investment Situation in Brazil

1. This note responds to your request for information on the trade and foreign investment situation in Brazil. The Bank has been heavily involved in analyzing Brazil's trade policy and discussing a trade policy reform project, but less involved in issues of direct foreign investment.

Trade Performance and the Debt Crisis in the 1980s

2. Brazil's foreign debt burden and the lack of new money from the commercial banks meant that the habitual trade deficits of the 1970s were no longer sustainable in the 1980s. The Government's response, from the early 1980s, was: one the one hand, to reduce imports through domestic deflation and the imposition of draconian import controls; on the other, to stimulate exports through a more depreciated domestic currency and by partially linking individual firms' import entitlements to their export performance. Within this overall policy thrust, trade policy has been cyclical, with alternating periods of import restraint to achieve a trade-surplus target and import liberalization to dampen inflationary pressures. Brazil's export performance has been helped by a revival of world trade in recent years, hindered by growing nontariff barriers in industrialized countries, and achieved in spite of a substantial reduction (from 1979 to 1984) in Brazil's formal export subsidies, largely under the pressure of GATT and the US.

3. In all, the external sector's response to the debt crisis has been remarkable: a trade deficit of 1.2 percent of GDP in 1982 was turned into a trade surplus of 6.2 percent by 1984. But this achievement has been costly: tight foreign-exchange controls (through the "import programs") and a severe import-licensing process have meant that: domestic producers face virtually no competition from imports, and can thus enjoy excessive profits or high levels of inefficiency; importers have to pay a high price in "red tape" to import, or else are condemned to use inferior local inputs. Thus import policies have been a brake on investment in technologically-up-to-date techniques.

Trade Policy Reform

4. Due in part to domestic recession, Brazil has recently experienced larger-than-planned trade surpluses -- US$19 billion in 1988 and at least $15 billion expected for 1989. A cautious process of trade reform has been underway since late 1987, a process permitted by these surpluses and impelled both by demands from the enterprise sector for greater liberty in

commercial policy and by the Government's need to counter the inflationary effects that the trade surpluses have had on the level of reserves. The most important measures of trade reforms undertaken have been:

- a May 1988 tariff reform, consolidating tariffs, reducing their average and variance, and eliminating some of the concessionary-tariff regimes;

- a liberalization in 1988 and 1989 of the import programs, both by raising the size of foreign-exchange allocations to firms and by raising the annual limit up to which firms can import without requiring such a program;

- a substantial reduction, since late 1987, in the list of prohibited imports; and

- an alleviation of the conditions of mandatory foreign financing of certain imports (particularly capital goods).

5. In spite of the Government's commitment, the reform process, explicitly gradual and selective, has so far remained cautious to the point where it risks being easily reversed. This caution is notably evident in the Government's reluctance to dismantle the pervasive system of foreign-exchange budgeting and controls.

The Bank's Project on Trade Policy Reform

6. The Bank has been discussing a trade-policy adjustment loan with the Government since mid-1987. The Bank appears to have reinforced the reform process, both through these discussions and through an April 1988 conference it helped organize in Sao Paulo which disseminated the major results of a Bank research project (on "the timing and sequencing of a trade liberalization policy") and stimulated debate on Brazilian reform.

7. The Bank working with the Government for about two years has been successful in advancing some trade reforms. As a result from continuing discussions with the Government on more substantial reforms, the Government is about to agree to more ambitious measures of trade reform in the coming months by freeing a significant proportion of imports from the binding constraints of import programs and import licences. Therefore, a bank loan for trade reform would be based primarily on import liberalization and on policies to safeguard this import liberalization as well as the trade reforms of the recent past that have been implemented with the Bank's advice. Such a loan (which could only be presented to our Board under conditions of reasonable macreconomic stability) could help put Brazil's fragile trade reform on a firmer footing (i.e. reducing the risks of reversal) so that a new Government could continue the reform process after March 1990.

Recent Trends in Direct Foreign Investment

8. Net direct foreign investment in Brazil reached a peak (US$ 1.42 billion) in 1981, to decline drastically afterwards. By 1986 a record net outflow (US$ 1.44 billion) was obtained. This reversal can be at least partly explained by the international debt crisis precipitated by the Mexican case in August 1982. However, domestic events like the failed stabilization attempt of 1986 (the Cruzado Plan) and the anticipated moratorium on external debt the following year are important factors. The overall economic and political uncertainty prevailing from 1988, and the record premium in the black market foreign exchange market, have accounted for a record outflow of capital in the form of profits and dividends. Such funds may have been partly repatriated via the official foreign exchange market, and used in both formal and informal debt-for-equity transactions.

9. Recent restrictions on informal debt-equity swaps for public enterprises, the limited size of the official debt-equity swap program, the stagnation of the economy, and constitutional changes have added to the decline in foreign investment in the last five years. The constitutional changes ban foreign-controlled firms from investment in mineral exploration and extraction and in hydroelectric facilities (Article 176). Foreign-owned banks already operating in Brazil have been granted substantially the same privileges, following discussions related to the Bank's proposed financial reform loan, as national banks. The Government is working with Congress to establish the legal framework for the entry and operation of new foreign-owned banking entrants according to Article 192III of the Constitution.

c.c Armeane Choksi, LA1DR; Demetris Papageorgiou, LA1TF

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/03/31 DUE DATE : 00/00/00
LOG NUMBER : 890331029 FROM : Husain (MAQ)
SUBJECT : BRIEFING: Meeting with Finance Minister, Mailson da Nobrega, Brazil, on Saturday, April 1, 1989 at 4:00 pm
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
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_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS :cc: Mrs. Haug, JVolk

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: March 31, 1989 **CONFIDENTIAL**

TO: Mr. Barber B. Conable

THROUGH: Mr. Moeen A. Qureshi, Senior Vice President, Operations

FROM: S. Shahid Husain, Regional Vice President, LAC

EXTENSION: 39001

SUBJECT: BRAZIL - Briefing Note for Your Meeting with Finance Minister Mailson da Nóbrega

DECLASSIFIED
OCT 20 2023
WBG ARCHIVES

1. You are scheduled to meet with Finance Minister Mailson da Nóbrega on Saturday, April 1, 1989, at 4 p.m. It appears that the basic reason for the request is that Minister Mailson wishes to reaffirm the good relations between Brazil and the Bank, following the recent negative press that the Bank has received in Brazil. This, as you may recall, has arisen in the context of the difficulties surrounding negotiations of the Second Power Sector Loan. In this context, frequent references have been made by the Brazilians (particularly the press, but also some very senior officials) to the negative net transfers from the Bank to Brazil in CY87 and CY88. These references have also raised the Brazilians' concern that net transfers should not be allowed to be negative for CY89.

2. It is also likely therefore, that during your conversation with Minister Mailson, (i) the Brazilian lending program will be discussed. Other topics of possible relevance for the meeting are: (ii) the difficulties facing the Summer Plan, and (iii) the Bank's role in debt reduction, as it might apply to Brazil. Each of these three topics is briefly dealt with below.

FY89 Lending Program

3. This was the subject of intense discussions between the Bank and Brazil during Mr. Choksi's recent visit to Brasilia. In this visit, the lending program was restructured once again to make it consistent with the Government's current priorities. (An earlier restructuring occurred, at the Brazilians' request, in November 1988). The FY89 Lending Program now consists of six investment loans for US$707 million, and two adjustment loans for US$700 million, for a total of US$1.4 billion. The two adjustment loans are the Energy-Environmental Policy and Conservation Loan for US$300 million, and the Financial Sector Loan for US$400 million. You should know that the Government of Brazil has formally requested US$400 million for the Energy-Environment Loan and US$500 million for the Financial Sector Loan.

4. You should be aware that the FY89 program remains difficult and risky. This is because for two investment loans totalling US$380 million, the Federal Government still has doubts about the states' capacity to borrow, and the adjustment loans are subject to a satisfactory macroeconomic situation.

5. With respect to the Energy-Environment Loan, our formal position to the Brazilians has been that it is an alternative to the Second Power Sector Loan. Thus, by agreeing to move forward with this, they have implied that the Second Power Sector Loan should be dropped. You should know that they have not formally asked for the Power Sector II Loan to be dropped. We understand this to be a face-saving stance. Given the substantial contribution to environmental reforms that this loan would make, we expect to move forward to Board presentation with the Energy Environment Loan as rapidly as feasible. Also, the Energy-Environment Loan was presented to the Brazilians as one of three potential loans in the sector for the FY89 and FY90 Lending Programs. The other two loans are investment loans, each for US$350 million, each of which will have to be negotiated and approved separately. They are for project-financing related to transmission and distribution, and for conservation and distribution, respectively. This is entirely consistent with our strategy of avoiding adjustment loans in the power sector, and concentrating only on investment loans.

6. With respect to the Financial Sector Loan, we are in the process of pre-negotiation discussions with the Brazilians. We hope to have agreement on sectoral conditions that would justify a US$400 million loan, and to have negotiated the loan by end-May 1989. However, we have yet to reach full agreement on the sectoral conditions needed to justify a US$400 million loan. Furthermore, the macroeconomic situation concerns us (see paras. 7-9 below). We will have to keep the macroeconomic situation under review. We will be sending a macroeconomic mission in April and the IMF is in Brazil starting this week. If it is in the judgement of both institutions that the macroeconomic situation is beginning to improve, if the IMF moves forward with its standby program, and if negotiations on the Financial Sector Loan are successfully completed, then we would proceed with Board presentation of this loan. Any changes from this route would only be justified on risk management grounds.

The Macroeconomic Situation

7. On January 15, 1989, the Brazilian authorities undertook a new heterodox shock - the Summer Plan. The plan was designed to avoid the errors of the last two heterodox shocks undertaken in 1986 (Cruzado Plan) and 1987 (Bresser Plan). In particular, it had frozen credit to the public and private sectors, restricited expenditures to levels financeable by revenues, and adopted a tight monetary policy based on high real interest rates. When the Plan was launched it faced some difficulties. The failure of past stabilization attempts had reduced the authorities' credibility and as a result the new Plan was received with some skepticism. The problems associated with implementing difficult economic measures in a presidential election year, the lack of specifics on fiscal policy, wage policy, and how to procceed with the transition out of the freeze, added to the general uncertainty.

8. Two-and-a-half months after the Plan was announced we are concerned about its outcome. The present economic strategy is centered on a price freeze and high real interest rates that are raising the fiscal deficit. Although no official target for the 1989 operational deficit has

been announced, it is likely that the defict will be higher than in 1988 (4% of GDP). The authorities have not presented a clear strategy on how to move the economy out of the price freeze, and the future conduct of wage and exchange rate policies remains to be outlined. Some price adjustments were permitted in late March. Inflation in March was about 6.0%, exceeding earlier official projections. The combination of anticipatory behavior by the public, rising consumption, and the government's move to reduce interest rates so as to lower the fiscal deficit, are all factors that can jeopardize the transition out of the freeze.

9. You may wish to ask Minister Mailson about the government's overall strategy to move the economy out of the price freeze. More specifically, you may wisk to ask for his views on the future conduct of wage policies and exchange rate policy. In the context of recent price adjustments and the reduction in real interest rates, you may wish to ask how the government sees the possible inflationary effect of these measures. Given the government's unclear stance regarding fiscal policies, you may wish to ask Minister Mailson about the government's targets for 1989, and whether any further fiscal actions to reduce the deficit are being considered.

Debt Reduction

10. Minister Mailson may raise the question of the scope for Bank assistance on debt reduction for Brazil. In addition to any general Bank views on the subject, you may wish to indicate that the Bank stands ready to assist Brazil with implementable debt reduction schemes within the context of a mutually agreed upon overall adjustment program. You may also indicate that the Bank is prepared to undertake substantial analytical work in this area, centered on the financial and economic consequences for Brazil, of various debt reduction instruments. The Bank would be happy to collaborate very closely with Brazil on developing and analysing these issues.

cc: Messrs. Choksi (LA1DR o/r), Papageorgiou

GNankani/RCoutinho:el

~~LM~~
~~BBC~~
~~JWS~~

March 23, 1989

Mr. Barber Conable, President

Harry K. Nicholas, EXTDR

74541

Brazil energy use

When you told the Brazil/Southern California energy use tale at the RAMS luncheon, I thought I recalled hearing that it was not correct. I have checked. Alastair McKechnie of the Industry and Energy Department is cited as authority for the following: in the late 1970s Brazil's total energy usage was less than the energy consumed in all of California. But that is no longer so. Brazil's electricity consumption has expanded and is now 10 percent higher than in all of California. Brazil's use of power is about 10 percent of the consumption of the United States, according to IEN.

THE NEW YORK TIMES, SUNDAY, MARCH 19, 1989

23B

GROWTH VERSUS INFLATION

Mr. Greenspan, Lower Rates Now!

By COLBY H. CHANDLER

WE cannot claim we have not been warned. Federal Reserve Board chairman Alan Greenspan has been unusually explicit for months. The economy is at full capacity and inflation is rising. There are only two ways to deal with this problem: raise interest rates or reduce the budget deficit.

Higher interest rates are the last thing this country needs. In fact, they are already high by historical standards. But, unfortunately, we are likely to get higher rates since there appears to be little interest in a budget deficit reduction program this year.

Higher interest rates to reduce inflation will raise the cost of borrowing for consumers and industry alike. Already interest rates have risen more than three percentage points since last spring. With the recent sharp rises in the Producer and Consumer Price Indexes, further increases surely are on the way.

While the Federal Reserve clearly does not want a recession, fine tuning the economy with monetary policy alone is a tight-rope act. If, inadvertently, there is too much tightening, recession is a certainty. It is one thing to reduce the deficit when the economy is growing; but how are we going to cut spending and raise taxes in a recession, when the deficit will be much larger, unemployment will be higher, and the demand on government resources much greater?

Rising interest rates will cause the dollar to go up. As we learned early in the decade, capital flows where the rate of return is highest. A strengthening dollar, while good for fighting inflation, hurts manufacturing exports. We need a lower dollar to help recapture export markets and jobs lost in the early 1980's.

The last two years show how critical the exchange rate is to American manufacturing. American exports grew by some 30 percent in response to the lower dollar. Recently, as the dollar has risen, export growth has stalled and so has improvement in our trade deficit.

American exports grew 30 percent as a result of the low dollar.

Higher interest rates also exacerbate the already precarious state of Latin economies. The recent riots in Caracas, Venezuela, are a forceful reminder that the debt problems of Latin countries are not going away. Higher interest payments to creditors are not only economically unfeasible but also politically unacceptable for these countries.

For American manufacturing, higher interest rates are particularly devastating. Our cost of borrowing is already substantially above that of our competitors. The prime lending rate in Japan is just over 3 percent, in the United States it is 11.5 percent, a differential far in excess of the difference in inflation rates. This puts an huge burden on our manufacturers.

Higher interest rates will force American industry to forgo investment or to move it off shore. The American economy needs much more investment not less, yet our current policies will guarantee that we continue to underinvest in our economic future.

WE need to pay special attention to the effect of economic policies on manufacturing because of the important role manufacturing plays in the overall economy. Purchases by manufacturing companies represent 40 percent of gross domestic product, their shipments nearly 60 percent. When manufacturing unemployment rises 1 percent, unemployment in the rest of the economy goes up an average of 2 percent.

Manufacturing is also responsible for 95 percent of all private research and development. R. & D. is the key to new products, processes, higher productivity and, hence, higher living standards. Since 1970, productivity growth among manufacturers has exceeded that of other business sectors by ten times. If manufacturing's investment in R. & D. slips, the entire economy will suffer from the loss.

Furthermore, manufactured goods constitute the bulk of our trade. Despite our emphasis in the multilateral trade negotiations on improving opportunities for American services and agriculture, manufacturers' trade makes up more than 80 percent of the total. Therefore, adjustment of the trade deficit must come in one of three ways: from a substantial growth in American manufacturers' exports; a shift by American consumers away from buying imported manufacturers' goods to domestic ones, or, as is most likely, a combination of both.

Hence, for a manufacturer, the choice is clear. Deficit reduction, even if it means some increase in taxes, is preferable to rising interest rates.

The economy needs lower interest rates, not higher. But that can happen only if the budget deficit is reduced.

Virtually every recession in the postwar period has been the result of failure by government to act soon enough on the budget, forcing the Federal Reserve to step in. Today, it is not yet too late, but there is not a lot of time. The situation calls for leadership by the President and action by the Congress. ■

Objections by Debtor Nations Suggest Hard Bargaining Ahead for Brady Plan

By PETER TRUELL
Staff Reporter of THE WALL STREET JOURNAL

AMSTERDAM – Debtor nations have raised serious objections to aspects of U.S. Treasury Secretary Nicholas Brady's debt strategy, indicating that hard bargaining lies ahead before the proposals can be implemented.

At the annual meeting of the Inter-American Development Bank this week, officials from several countries criticized the proposals' call for more debt-for-equity swaps and further economic reforms. They contended that the deteriorating economic and political climates in their countries require a faster remedy than the proposals appear set to bring. Furthermore, Mr. Brady's endorsement of debt reduction, along with recent interest-rate increases, are complicating certain debt negotiations now under way.

Assistant U.S. Treasury Secretary David C. Mulford, addressing the conference, said "the heart of the problem is still the reform of economic policies to produce key structural changes and sustain economic performance" in heavily indebted countries. "Viable" debt-equity swaps are "an integral part of the new Brady approach to the debt problem," he added.

But debtors disagree. Mexican Finance Minister Pedro Aspe outlined at the conference the substantial economic adjustments already made by his country and spoke out forcefully against most debt-equity swaps, though he welcomed Mr. Brady's emphasis on reducing the crippling debt load in Latin America. "For us, the solutions must be arrived at soon," he said. "It's evident that our people can't, nor should they, wait longer."

Brazil has recently reduced its debt-equity swap program, and Argentine officials have spoken out against such swaps and have resisted creditor bank attempts to establish larger programs.

Mr. Mulford said Mr. Brady's proposals constituted a suggested approach rather than a definite plan, and said this would allow for a period of discussion and debate before the meetings of the International Monetary Fund and the World Bank in early April.

But with expectations aroused, some big debtors seem to want to move more quickly. Venezuela hasn't been able to secure a projected $600 million loan because banks wanted the country to pledge oil to back the planned credit, a request that Venezuela refused. In reaction, Venezuela has said it is reorganizing the committee of banks with which it negotiates its $29 billion of foreign bank debt. It also is seeking a 50% debt reduction, compared with U.S. Treasury figures indicating a 20% target over three years.

Mexico also is looking to halve its interest bill, to $7 billion from an estimated $14 billion this year. That would imply either 50% reduction in debt principal or interest payments.

So, the U.S. may come nowhere near satisfying the expectations that it has aroused. Moreover, even a substantial reduction in debt or debt service may only get Mexico back to where it was a year ago. In the past 12 months, the London interbank offered rate, the interest rate to which most Latin loans are pegged, has risen to 10.5% from 7%. That 50% rise has added more than $3 billion in annual interest costs to Mexico's debt service.

These divergent interpretations and ambitions regarding debt reduction make it important that some substantial and successful reduction programs are agreed to soon, Latin debt negotiators and creditors say. This, they argue, would give focus to the expectations that have been raised by the Bush administration's decision to revise the international debt strategy.

Mr. Brady's announcement two weeks ago of his proposals seems to be affecting credit flows to Latin America. Colombian officials say their country and others in Latin America have experienced some tightening in trade credit recently. Some Latin American officials even ascribe the unwillingness of banks to lend to Venezuela as another indication of the increasing difficulty of raising loans in the wake of the debt-strategy revision. A senior Mexican government official says that at least until the strategy becomes clearer, it will be increasingly difficult for the region to receive credit.

But if debt reduction is to be "voluntary," as the U.S. Treasury maintains, banks may be just as reluctant to reduce debt as they are now to lend money. Many bankers say they will only agree to give up claims on Latin American countries in exchange for credit enhancements or local equity investments. The Brady plan does include some credit enhancements in the form of special financial guarantees for principal and interest from the World Bank and the IMF, but those may not prove enough to get banks' support for the plan.

But Mexico, which is likely to be the test case for the Brady strategy, this week set out its reasons for opposing most debt-equity swaps. "They stop investment," said Mr. Aspe, citing the Mexican resort of Cancun, where hotels stand half finished as investors wait for the subsidies they expect from a renewed debt-equity swap program. He added that these swaps are inflationary and deplete reserves under certain conditions. Mexico halted its debt-equity swap program in the fall of 1987, and it remains reluctant to reinstitute any such program.

FINANCIAL TIMES WEDNESDAY MARCH 22 1989

Brady plan on debt aid encourages Philippines

By Richard Gourlay in Manila

THE Philippines plans to reduce its request to commercial creditors for new loans from around $1.6bn (£940m) when it meets banks next month, but hopes at the same time to benefit from the initiative to reduce Third World debt announced last week by Mr Nicholas Brady, US Treasury Secretary.

Mr Vicente Jayme, the Philippine Finance Secretary, said: "It (our package with commercial banks) is likely to be a combination of new money and debt reduction although for the country it will mean a lower level of debt payments,"

He welcomed the Brady initiative as one more weapon with which to cut the burden of the country's $27.9bn of international debt.

The Philippines is able to begin talks on new loans following agreement on a new $1.3bn International Monetary Fund programme last week.

Mr Jayme and Mr Jose Fernandez, the Central Bank governor, yesterday signed the agreed letter of intent and memorandum of economic policy and sent it to the Fund's executive committee for formal approval.

Banks and aid donors have been waiting for the IMF programme as a sign that the Philippines is prepared to follow sound economic policies. Mr Jayme has previously said the Philippines will need $1.6bn-$1.8bn from commercial creditors over the next three years to meet its financing needs.

Creditor bankers claimed in December during the first new money talks that the Philippines needs far less.

Mr Jayme also said he hoped talks with the Paris Club of official creditors to reschedule $1.9bn of debt could begin before the IMF executive board gives its formal approval.

AP adds: President Corazon Aquino of the Philippines yesterday praised her army for freeing hundreds of villages from communist rebel influence and appealed to Congress for more funds to bring "a swift and conclusive end" the 20-year insurgency.

Armed forces statistics sho that rebels were active in 1 per cent of the country's mo than 41,000 villages last year. decrease of 6.8 per cent fro the 1987 figure.

Brady Proposes

lending had become a greater and greater burden as the countries, under agreement with the I.M.F., sought to squeeze their economies to make payments.

I.M.F. Shift Suggested

In spite of his defense of the I.M.F., which debtor country populations accuse of pressing economic austerity to achieve economic revision too hard, Mr. Brady suggested a significant easing of a major feature of I.M.F. policy.

Sometimes months after the I.M.F. determines that a country qualifies for a loan, it holds back the money until banks come aboard with their own loans, he noted. "We question whether the international financial institutions should delay their initial disbursements until firm, detailed commitments have been provided by all the other creditors to fill the financing gap," he said.

Mr. Brady made no specific mention of loan guarantees. But he proposed means by which the I.M.F. and the World Bank could expedite debt reduction. He suggested, for example, that they might collateralize conversions, at significant discounts, of bank debt into debt or equity that could be sold to investors or the debtor country.

Ranking the World's Debtors

By external debt to public and private entities.

Country	Total Debt 1988 (In billions)	Per Capita G.N.P. 1987	Ratio of Debt Service to Exports
Brazil	$120.0	$2,020	26.7%
Mexico	107.0	1,820	30.1
Argentina	60.0	2,370	45.3
Venezuela	35.0	3,230	22.4
Nigeria	31.0	370	10.0
Philippines	30.0	590	22.7
Yugoslavia	22.0	2,480	13.3
Morocco	22.0	620	23.4
Chile	21.0	1,310	21.1
Peru	19.0	1,430	12.5
Colombia	17.2	1,220	30.7
Cote d' Ivoire	14.2	750	19.6
Equador	11.0	1,040	20.7
Bolivia	5.7	570	22.1
Costa Rica	4.8	1,590	12.1
Jamaica	4.5	960	25.8
Uruguay	4.5	2,180	24.4

Source: World Bank

Brazil

The World Bank
Washington, D.C. 20433
U.S.A.

MOEEN A. QURESHI
Senior Vice President, Operations

March 20, 1989

(1) MH (copy given)

(2) Mr. Conable

Regarding Pedro Malan's note to you, my suggestion is that you call him on the telephone and tell him that your intention was (and is) not to hold back funds but rather to convey that the Bank is anxious to assist Brazil, in projects such as the Power Sector Loan and the Financial Sector Loan, but that the Brazilian Government has to go ahead and do the things it has indicated it intends to do, for us to go ahead and take these loans to our Board.

***IMPORTANT**

3/20 Told him as above by phone. He was gracious — BC.

~~LPM~~
~~MH~~

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/03/16 DUE DATE : 00/00/00
LOG NUMBER : 890317001 FROM : Pedro Malan
SUBJECT : Re: BBC's interview with the "Christian Science Monitor".

OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

O/r

ACTION:

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_____ RETURN TO _____

COMMENTS :Note: Mr. Conable will call Mr. Malan on Monday, March 20th.

cc: Messrs. Qureshi, Thahane, Aguirre-Sacasa

✓ done 3/17 CP

***IMPORTANT**

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Document Date	Document Type
March 16, 1989	Letter

Correspondents / Participants
To: Mr. Barber B. Conable, President
From: Pedro S. Malan, Alternate Executive Director

Subject / Title
Copy of today's Christian Science Monitor featuring your interview

Exception(s)

Additional Comments
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Withdrawn by	Date
Shiri Alon	October 26, 2023

RECORTES DA IMPRENSA NORTE-AMERICANA. DIA 16/03 /89.
THE CHRISTIAN SCIENCE MONITOR

(BAN)

WORLD BANK CHIEF SPEAKS

Dealing with Third-World Debt

Barber Conable considers possible solutions, while urging continued attention to poverty

By David R. Francis
Staff writer of The Christian Science Monitor

WASHINGTON

BARBER CONABLE, president of the World Bank, was at first a little reluctant to talk about the third-world external-debt problem.

"Debt is not the central issue," says the head of an institution that, with its affiliates, made some $20 billion in development-loan commitments last year. He sees the bank's greatest goal as alleviation of poverty: 90 million poor people in Latin America, where debt impedes economic growth; 280 million "absolute poor" in Africa, where the need is for more schools, roads, and other infrastructure; and 600 million in Asia where debt is not a serious problem.

Nonetheless, the World Bank and its sister institution, the International Monetary Fund (IMF), are expected to play a key role in the revised United States strategy for dealing with the $1.2 trillion in developing-country debts owed to the commercial banks and governments of industrial nations.

That altered strategy, outlined March 10 by Treasury Secretary Nicholas Brady, envisions three ways to reduce the debt burden of debtor nations. In one case, bank loans would be swapped for "exit bonds" of lower face value. The banks would take a loss on a portion of these loans. In a second case, bank debts would be traded for similar bonds, but with equ face value and a lower interest rate. The banks would lose on interest payments. Third, debts could be swapped for part ownership of businesses in the debtor nation.

How the bank and IMF will be involved in this process is not entirely clear. Bank officials expect details of the [illegible] approach to be fleshed out [illegible] precedents to be set when the debts of indivi[illegible] countries are reschedule[illegible] primary candidate for a te[illegible] this approach is Mexico with $102 billion in foreign debts.

Mr. Conable spoke just before Secretary Brady last Friday at a meeting of the Bretton Woods Committee, saying: "A good place to start would be with Mexico. Mexico has indicated a willingness to engage in major reform, it has substantial prospects but substantial debt, and it has lived up to its obligations."

In an interview here, he said, "There's interest on all sides in letting the thing evolve some, in trying to include debt-reduction components in the workout schemes that we are trying to put together for these countries."

Since the US federal government with its huge budget deficit finds itself in no position to accept any transfer of loan losses from the commercial banks, it will expect the World Bank, the IMF, and the Inter-American Development Bank to help in rescheduling deals. These institutions most likely will guarantee some "exit bonds" or a portion of new commercial bank loans that such debtor nations as Mexico need to assure future economic growth.

These multilateral institutions will also be expected to inject money into the debtor countries with what are called "adjustment loans." These are not tied to any development project, such as a dam, but are used to help cover international-payments deficits in return for domestic economic reforms in the debtor countries.

However, Conable warns that any such measures must not bankrupt either the commercial banks or the multilateral institutions, "or dissipate unnecessarily capital they need for their other responsibilities."

The former US congressman undoubtedly had in mind the safety of the bank's capital, which a needed majority of the bank's 151 member nations agreed to nearly double last year.

Some commercial bankers have hoped that with the capital increase the World Bank could rapidly increase its lending. This would help the debtor nations grow faster and ease their debt-servicing burden.

However, Conable questioned whether the bank itself (minus such affiliates as the International Development Association, which makes easy-term loans to the poorest countries, and the International Finance Corporation, which makes equity investments in private companies in developing countries) could grow 10 percent a year as originally thought. That growth rate would increase its annual loan commitments from $15 billion now to $20 billion in the early 1990s.

Conable's caution stems from the bank's greater emphasis on protecting the environment, helping women progress, and stimulating the private sector in making new development loans.

Protecting the environment is necessary to sustain the resource base and development, he says. Nor can development proceed properly by ignoring women, half the human race.

These greater emphases require more work on the part of the staff of the World Bank, as well as more coordination with the developing countries, the bank president notes.

He also says the bank's "member countries," presumably in this case some industrial nations, do not want the development institution "to go all out and grow the way we used to."

Morgan Guaranty Trust Co. charges the bank with a "timid approach" to its nonproject-related lending, that it does not provide adequate support to developing countries undertaking economic reforms. It points out that these countries are making more interest and capital payments to the World Bank than they are receiving from the bank. Thus in the first nine months of 1988 there was a net inflow to the bank of $1.63 billion.

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THE CHRISTIAN SCIENCE MONITOR

This, explains Conable, is partly because nations that have progressed enough in economic terms to "graduate" from receiving bank loans are still making repayments on old loans. South Korea (though not graduated) is using it huge international payments surplus to repay old loans.

Further, a country like India with a "big bureaucracy" is slow in actually disbursing the loan money that has been approved by the bank for various projects. India has committed but undisbursed bank loans exceeding $10 billion, he says.

Another factor in slow disbursement has been the failure of some key debtor nations to live up to their promises of economic reforms.

Conable noted that Brazil has not met its "conditionality requirements," and thus the bank has held back some loan funds.

The same is true of Argentina. The World Bank agreed last October to make loans of $1.25 billion to Argentina. It was controversial because, with the approval of the United States and some other industrial countries, the bank sidestepped the IMF, which normally takes the lead in providing major loans of this type.

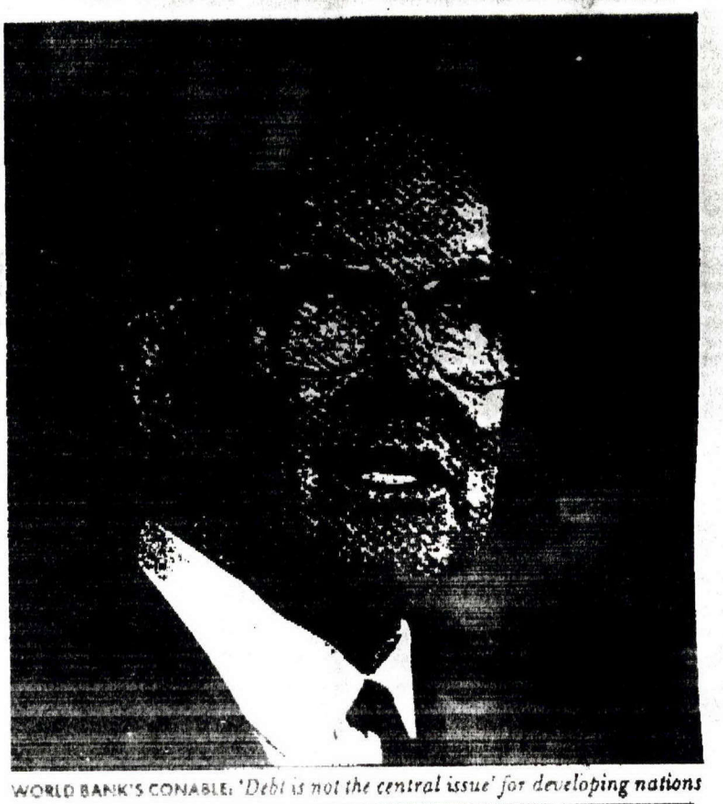
Early this month the bank suspended further loan disbursements when Argentina failed to meet specific loan conditions for economic policy reforms. Because of a forthcoming election, Conable has doubts that Argentina will make the necessary reforms soon.

Such required reforms, he emphasizes, are intended to bring about conditions for economic growth, not to cause shrinkage.

The Argentine loan was one sign of a certain rivalry between the bank and the IMF. "There are various stresses and strains between the two agencies," admits Conable. "But I wouldn't overstate it."

This stems from some overlap in their jurisdiction, he explains. The IMF provides short-term stabilization loans to countries with balance of payments problems. The bank makes longer-term development loans. However, both institutions have moved into the area of medium-term loans to developing countries.

"We can manage the overlap by major consultation, cooperation, and coordination of our activities," he says.



WORLD BANK'S CONABLE: *'Debt is not the central issue' for developing nations*

CANAL ZONE

Noriega Pressures US Residents

By Brook Larmer

Staff writer of The Christian Science Monitor

QUARRY HEIGHTS, PANAMA

FOR 132 schoolchildren in this once-cloistered American community, March 3 began like any other day.

The children – all sons and daughters of United States servicemen or Panama Canal Commission employees – gulped down their breakfasts, jumped on buses, and chattered noisily with friends on the way to school.

But their ride took a dangerous detour.

Armed troops from the Panamanian Defense Forces of Gen. Manuel Antonio Noriega forcibly stopped and impounded nine buses because the bus company had failed to meet Panama's tightened tax requirements.

The commanding colonel, angered at the tax evasion encouraged by the US in its effort to topple General Noriega, even had one bus hooked to a tow truck – with children still on board.

The US responded quickly to the threat, dispatching an Army liaison to negotiate with the indignant colonel. Two US Army helicopters buzzed the scene of the confrontation. And at the nearest US Army base, one of 12 that make up the 11,000-strong US Southern Command here, combat troops and armored vehicles were quickly mobilized.

The episode lasted only an hour. No shots were fired and the children returned safely to their classes.

But the incident, part of a pattern of increasing harassment against US Army personnel and Panamanian workers at the Canal, has shaken the morale of the 40,000 American residents here.

For many US citizens, it shows how the effects of Panama's 20-month-old political crisis are seeping further into this once-idyllic community of trimmed lawns, tree-lined streets, and tennis courts.

For others, however, the bus "hijacking" has even deeper sig-

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(6701)

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How the bank and IMF will be involved in this process is not entirely clear. Bank officials expect details of the Brady approach to be fleshed out as precedents to be set when the debts of individual countries are rescheduled. A primary candidate for a test of this approach is Mexico with $102 billion in foreign debts.

Mr. Conable spoke just before Secretary Brady last Friday at a meeting of the Bretton Woods Committee, saying: "A good place to start would be with Mexico. Mexico has indicated a willingness to engage in major reform, it has substantial prospects but substantial debt, and it has lived up to its obligations."

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THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

March 2, 1989

Sir Jeremy:

I want to thank you for your letter providing me with information about the meeting you and Sir Kit McMahon had with the Director of Friends of the Earth, Jonathon Porritt, regarding the Brazilian Power Sector loan. This loan has aroused a great deal of interest and concern, and I was most interested to receive and read carefully the Friends of the Earth proposal, which I have passed on to others here at the Bank.

As you know, the World Bank is committed to sustainable development, and we strongly support the strengthening of social and environmental safeguards for investments in Brazil's power sector. The decision of how best to meet the electricity needs of an expanding population and industrial society, while at the same time protecting fragile ecosystems and the Amerindian population from the adverse effects of power projects, is a major challenge facing Brazil. We believe that the Bank's involvement in Brazil's power sector will help to ensure that environmental and social considerations are given greater attention when difficult choices are made in meeting the country's future power needs.

Environmental interest groups, such as Friends of the Earth, are increasing public awareness of and concern about environmental values which, in turn, makes governments generally more amenable to the constructive influences the Bank can bring to bear on project design and implementation. The agreements we have reached with the Brazilian Government to include environmental safeguards in the power sector are among the most far-reaching ever negotiated by the Bank with a developing country, but it is clear that much remains to be done.

Although I know you are well informed about the Bank's involvement in the Brazilian power sector, I am enclosing a briefing note which traces our involvement and discusses the objectives and status of the proposed second power sector loan.

Again, thank you for passing along this communication from Friends of the Earth for my special consideration. Do let me know when you will be in Washington. Best wishes.

Sincerely,

Barber Conable

Enclosure

P.S. I see on my calendar we will be meeting on March 20th; I look forward to continuing our discussion.

Sir Jeremy Morse
Chairman
Lloyds Bank Plc
71 Lombard Street
London EC3P 3BS

cc: Mr. Cassell, Mr. Choksi, Mr. Aguirre-Sacasa

BRIEFING NOTE

On The World Bank's Involvement In Brazil's Power Sector

1. The First Power Sector Loan was approved in 1986. This loan supported the development of an Environmental Master Plan for the power sector; the Master Plan establishes guidelines for the treatment of environmental, resettlement and tribal matters, and provides for specific project-by-project social and environmental action plans. It also provides for measures for institutional strengthening, financial support, and monitoring and evaluation in connection with the implementation of guidelines and project specific action programs. The Environmental Master Plan is intended to be a dynamic instrument; it is updated on an annual basis.

2. Prior to 1986, there had been only limited progress on environmental protection in the power sector. In the last two years, however, the quality of the Government's efforts in this area has steadily improved. We believe that World Bank operations and our ongoing dialogue with the Government have helped to expedite this process. The development and implementation of the Environmental Master Plan have led to a significant strengthening of social and environmental safeguards in the power sector. The Government has created special departments of the environment in ELETROBRAS (the holding company in the power sector) as well as in other major power utilities. Some 200 environmental experts have been hired to oversee the environmental implications of all major decisions in the power sector. In 1986, a first set of guidelines for environmental, social and tribal matters was developed and agreed upon within the power sector. These guidelines were approved in 1987 by the responsible federal agencies. In 1987, six major studies were commissioned by ELETROBRAS; these address questions related to Amerindians, riverine populations, river basin planning, flora and fauna, water quality and coal fired plants; the studies will serve as the basis for further improvement of sectoral guidelines under the Environmental Master Plan. New parameters for environmental licensing of power projects were established by the Federal Government in 1987. In 1988, the National Environmental Council approved resolutions for mandatory public hearings for all power projects, and the government passed legislation which makes it mandatory that at least 1% of the total cost of any power project be allocated for environmental conservation purposes.

3. Finally, project-level studies and action plans were developed and implemented by the regional power companies. For projects at the inventory and feasibility stages, the environmental and social analyses led to important design adjustments. For projects at more advanced stages of planning, action programs were begun to eliminate or mitigate environmental and social costs (for example to assure local participation in resettlement planning, to demarcate Amerindian areas in the vicinity of proposed projects, and to initiate conservation and archeological salvage operations). For projects which were close to completion, and which therefore did not allow for overall design adjustments, mitigatory interventions (to the extent that they were still feasible) were stressed.

4. The proposed Second Power Sector Loan would build on progress achieved under the previous loan. The second sector loan would be a quick-disbursing adjustment operation; the proceeds of the loan would be used to finance general country imports. The loan is designed to help the Federal Government and the state governments undertake a series of policy and institutional reforms, financial measures and tariff increases which are required to enable the sector to achieve agreed investment and financial targets. The loan would also support strengthened environmental and social safeguards in the identification, planning, construction and operation of power projects.

5. This loan would not finance any specific investments in the power sector; it would thus not finance hydro-power projects in the Amazon. Moreover, this loan would not finance the construction of nuclear power plants. The Government of Brazil has not asked us to finance any of its nuclear plants, and we have no intention of doing so. Nuclear investments would be explicitly excluded from reimbursement under this loan.

6. The proposed Second Power Sector Loan would support the strengthening of federal and state agencies that are by law responsible for environmental licensing of power projects, and for supervising and/or implementing actions provided for under the power sector's Environmental Master Plan. Implementation of the Master Plan would be strengthened in the folllowing ways:

(a) All sector utilities would make detailed commitment to project-by-project action programs.

(b) ELETROBRAS' social and environmental monitoring and evaluation systems would be put in place.

(c) A separate accounting system would be developed for environmental and resettlement expenditures.

(d) Staffing of the environmental units in key agencies would be completed.

(e) Recommendations made by a sectoral working group analyzing environmental assessment and licensing procedures would be implemented.

(f) Procedures for timely land acquisition for resettlement programs would be established.

(g) A working group would be established to propose operational mechanisms for river basin management schemes.

(h) ELETROBRAS would sponsor a study of ways in which Amerindians affected by power projects could be provided with independent legal assistance.

We believe that we have made substantial progress with the Brazilian Government in the design and implementation of environmental safeguards in the power sector. The agreements we have reached are among the most far-reaching ever negotiated by the Bank with a developing country.

Energy Conservation

7. In the past several years, the Brazilian Government has given serious attention to energy conservation measures as an alternative to investments in new capacity. These efforts have been strongly supported by the Bank. Currently, energy conservations is achieved through a variety of methods, including pricing, load management, system loss reduction, improvement of industrial processes, and advertising campaigns. These measures have met with considerable success, although much more remains to be done. For example, through the introduction of efficient marginal cost pricing, electricity consumption has been reduced by about 5% from original projections, leading to savings in new investment of at least $150 million in 1987. Furthermore, in order to reduce system losses, a considerable effort has been made to upgrade distribution networks; the World Bank alone has made loans totalling some $650 million for the distribution system in the past several years. Consequently, system losses are expected to fall from 12.9% of new generation in 1987 to 11.3% in 1991 (which represents a savings of about $105 million/year). Though the Second Power Sector loan does not finance specific investments, it will reinforce our ongoing dialogue with the Brazilian Government in the power sector, and facilitate subsequent conservation activities that will be the focus of future Bank lending.

Status of the Second Power Sector Loan

8. Negotiations on the proposed $500 million loan are ongoing and, as is usual in large operations of this type, the negotiations are complex. Nevertheless, the Bank and the Government of Brazil have already made a good deal of progress, especially on the environmental aspects of the loan. The Bank is now awaiting the Government's decisions on a number of other issues. When these negotiations are concluded, the loan will be transmitted to the Bank's Executive Directors for their consideration.

External Affairs
World Bank
February 7, 1989

Lloyds Bank

Lloyds Bank Plc
71 Lombard Street
London EC3P 3BS

Chairman

Dear Barber,

As you well know, the Brazilian Power Sector loan has engaged the interest and concern of both environmentalist groups and ordinary people in this country as well as in the U.S. One of the leading groups here is Friends of the Earth, and Sir Kit McMahon and I saw its director, Jonathon Porritt, before Christmas.

As a result of this meeting he has written me a letter, a copy of which I enclose. I do not know how practical his idea is, but I thought that it was worth passing on as one of the more reasonable communications on this subject that I have received. I am also sending it to our government people.

Writing at this time, I would like to send you all good wishes for 1989. I hope that I may be able to see you when I am visiting Washington in the week before Easter.

Yours sincerely,

Jeremy Morse

Mr. Barber B. Conable,
President,
The World Bank,
1818 H Street, N.W.,
Washington D.C. 20433,
USA

Registered in England no 2065
Registered office:

12 JAN 1989

Sir Jeremy Morse
Chairman
Lloyds Bank Plc
71 Lombard Street
London EC3P 3BS.

12th January 1989.

Friends of the Earth Limited
26-28 Underwood Street
London N1 7JQ
Telephone 01-490 1555

Dear Sir Jeremy,

RE: POWER SECTOR LOAN TO BRAZIL

Thank you for the meeting of the 21st of December, 1988, in which we had the opportunity to discuss with yourself and Sir Kit McMahon, the involvement of the Lloyds and the Midland banks in co-financing Brazil's Power Sector. I was heartened that both you and Sir Kit expressed a keen awareness of the need to protect the Amazon rainforests, and that we appear not to be at odds over the environmental and social destruction which will be consequent upon the Power Sector loan. I enclose a short summary of our environmental and social concerns in relation to the loan.

I did not go as far as saying this. JT

During the meeting you suggested that it would be technically within the bounds of the Brazil Creditor Advisory Committee to reshape the loan, rather than to completely renegotiate the co-financing part of the rescheduling package. We feel that by investing in energy efficiency options for the Power Sector, Brazil can meet its energy targets cheaply and efficiently, whilst avoiding irreversible damage to its natural resources by greatly reducing the need for new dams over the next 15 years. The World Bank will benefit by achieving its objectives, namely: the rehabilitation of Brazil's Power Sector; encouraging genuinely sustainable development; and neither compromising its environmental and tribal policy guidelines nor the reputation of its new environmental unit. From the perspective of the commercial banks, they will be investing in a financially 'sounder' option which will guarantee a more rapid rate of return.

The potential and progress for energy conservation in Brazil has been detailed by Brazilian and American scientists in the international journal 'Energy' (Geller et al, Electricity conservation in Brazil: potential and progress, Energy 13(6), 1988). The main conclusion of the paper is that by investing in energy efficiency in the six major end uses for electricity (industrial motors, domestic refrigerators, domestic lighting, commercial motors, commercial lighting and street lighting), which together account for two-thirds of the total projected energy consumption in the year 2000, almost 20% of the total projected energy demand could be saved. This could eliminate the need to construct nearly 19GWh of power capacity, equal to about two-thirds of the new capacity that must be completed by the year 2000.

cont/.

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The savings would be considerable. Investment in new capacity (dams under the Power Sector), would cost utilities at least $38 billion, whereas the required investment in greater end-use efficiency is estimated to be of the order of $8 billion.

The benefits of improving the efficiency with which electricity is used have been summarised by Geller et al. (1988):

(i) Expanding electricity supply is highly capital intensive.

(ii) Increasing end-use efficiency is less costly than increasing electricity supply.

(iii) There are major opportunities for increasing the efficiency of electricity use in a cost effective manner.

(iv) Adopting more efficient end-use equipment holds down electricty bills and can lead to improved standards of living.

(v) Increasing the efficiency of end-use equipment can strengthen Brazil's growth and export potential.

(vi) Slowing the rate of electricity supply expansion has positive environmental impacts.

Within the overall objective of providing least cost energy services, Brazil's energy authorities and utilities need to make a commitment to a comprehensive program of energy conservation investment. The role of the commercial banks would be to provide loans to industries, commercial building owners, public utilities and municipalities for electricty conservation. For example, government municipalities could be financed to install energy efficient street lighting. A variety of mechanisms could be envisaged for banks to guarantee a rapid return on their investment, for example, banks could buy and distribute the necessary equipment, such as high pressure sodium lamps, and receive their returns through the amount saved by municipalities on their electricty costs.

Banks could provide loans for industries to manufacture or install energy efficient equipment. In addition to being cost-effective for industries to adopt energy efficiency measures, there is considerable potential for exporting energy efficient goods.

It is important to note, as concluded by Geller et al., that "The energy efficiency strategy involves no reduction in economic growth or energy services. In fact, by providing these services in the most cost-effective manner, economic output and standards of living can rise more rapidly. A brief summary of the 'energy use' and 'savings potential' sections of Geller et al's. paper is attached.

cont/.

I feel that we are mutually agreed as to the end goal, that of protecting the Amazon rainforests and encouraging truly sustainable development. The energy efficient option seems to me to be a thorough, positive and practicial mechanism for achieving that goal. I hope that you will feed this idea into the system with all due haste, since decisions on the loan are imminent.

I have sent a copy of this letter to Sir Kit McMahon.

Yours sincerely,

Jonathon Porritt
Director

THE BRAZILIAN POWER SECTOR II LOAN

1.THE SOCIAL AND ENVIRONMENTAL IMPACT

Memorandum prepared by Friends of the Earth

23rd December 1988.

A. SOCIAL AND ENVIRONMENTAL IMPACT OF THE POWER SECTOR II LOAN.

1. Will the Power Sector II Loan support the construction of dams?

Sector loans are quick disbursing and general payments, not tied to specific projects. The loan will provide balance of payments relief and disburse against general country imports. The purpose of the Power Sector II Loan is to continue to support rehabilitation of the Electric Power Sector initiated under the First Power Sector Loan. According to documentation supplied to the commercial banks, the loan is intended to 'focus on removing bottlenecks in transmission and distribution of electricity and could also include power generation projects'.

Serious environmental objections were made to the Power Sector Loan by two Executive Directors (including the US ED), at the World Bank ED meeting on July 9th, 1986. The link between the sectoral loan and specific projects, ie dams, was therefore clear to the World Bank.

2. Specific Projects.

The Bank itself has highlighted the links between specififc projects and the Power Sector. In its note to the Development Committee Meeting (April 13, 1988, 'Environment and Development: implementing the World Bank's New Policies'), the Bank specifically mentions its loans to the Brazilian Power Sector as an example of a loan ' which contains certain conditions concerning resettlement of affected populations in power project areas, staffing and equipping environmental protection agencies, and use and designation of wetlands'. More concretely, a project designed to mitigate the social impact of the Itaparica dam by providing a resettlement plan for displaced peoples, was a direct result and indeed condition of World bank funding to the Power Sector.

3. The Environmental Master Plan.

The elaboration of an Environmental Master Plan was a condition of the Bank's first loan to the Brazilian Power Sector. In the event, a satisfactory Master plan was never produced during the term of the First Power Sector Loan. To date, it is still not complete. The first volume of the Plan has been made available to Non Governmental Organisations in the UK, and a detailed critique sent to the World Bank (October 1988). No reply has yet been received. In the view of Friends of the Earth, the Plan fails to provide; specific measures to protect the environment; programs to strengthen the Power Sectors environmental capacity; or a timetable for implementing the Plan. These are all specific requirements of the loan agreement. The second volume of the Master Plan is undergoing revision, and the third volume has been scrapped.

It is also clear from discussions with both the Environment Department and Latin American Unit of the World Bank, that they themselves see serious shortcomings in the Plan as it stands:

i) That the Bank considers the resettlement and regional planning guidelines to be deficient and in need of updating.

ii) That the Bank considers that the guidelines on the Indian components in the sector are not ready, neither are they specific enough in their present form.

iii) That the Bank considers that the guidelines on water quality, coal-fired plants, flora and fauna are not ready.

iv) That the Bank considers that there should be improvement in specific measures for the structured representation by the local populations.

4. Implementation of the Master Plan.

The Master Plan does not provide for the institutional safeguards and structures necessary to implement the environmental and social standards required under the loan agreement. Existing government agencies (and the regional Power Companies) are either inadequate, or incapable of meeting environmental and social conditions agreed under the loan. Since October 1987, FUNAI, the government Indian Agency, has been under investigation by the Attorney General following allegations that it has been engaged in corrupt dealings with timber on Indian lands. Brazil is at present in flagrant violation of World Bank loan conditions on the Carajas Iron Ore Mine and railway, by allowing the licensing of 22 Blast furnaces to be fuelled by charcoal produced from pristine rainforest. The 1988 US Senate Appropriations Bill states that: 'If within four months of the enactment of this provision, substantial progress in implementing the Carajas environmental provisions has not been demonstrated, the US Executive Director to the World Bank is directed to seek delay in consideration, and if necessary oppose future loans to Brazil'.

5. Social Impact.

Projects that are already underway will displace some 56,000 people, while the total numbers to be displaced by the projects in the 'Plano 2010' are estimated at around 500,000, including numerous Indian peoples.

6. Environmental Impact.

By their very nature, dams destroy forests and displace people. Projects under the Brazil's Power Sector have been beset by a catalogue of environmental problems, ranging from the use of dangerous, toxic herbicides for forest clearance, through massive water fouling, to loss of uninventoried forest and species extinction. Disruption and elimination of river fisheries, disruption of downstream hydrology, impairment of water quality and spread of water associated diseases have all been features of dams financed by the First Power Sector loan.

The negative effects on water quality and hydrology can to some extent be circumvented by careful planning before, during and after construction, but the experience of the First Power Sector Loan casts grave misgivings on the ability of the regional executing agencies to implement a Master plan aimed at mitigating them.

The negative effects on fauna and flora are not so easy to circumvent, and in most cases in the Amazon, because of the high level of endemism (species occuring in one location and no other), irreversible damage to unique flora and fauna is inevitable.

As the World Bank itself states, 'The rate of destruction of the world's surviving tropical rainforests is a matter of great and growing international concern' and its' protection is of the 'highest priority'. What is alarming about the Power Sector is the scale of the destruction envisaged. The most serious immediate effect of hydro-development is the destruction by inundation of unique forests and other valuable ecosystems. Scientists working in the Amazon estimate that the area of land to be flooded during hydroelectric development in Brazilian Amazon is 150,000 square kilometres (Johns, 1988, Ambio 17,5). This figure accepted by groups working in Brazil, is considerably more than the already large estimate given in the Master Plan, of 25,994 square kilometres. It should be noted that the 'official' figures have consistently underestimated the areas of inundation in existing projects.

The Altamira-Xingu hydro-power complex, presently comprised of two dams, Babaquara and Kararao, is expected to flood a total area of nearly 7,000 square kilometres of unique primary rainforest. Much has been made of the fact that 'original plans for Babaquara have been droped', but there is no inidication that an alternative site will be found or that the alternative plan will be any better. In all probability, Babaquara will simply be re-instated.

Pleistocene refugia are not only areas of high biodiversity, but are centres of concentrated endemism - containing many species occuring in that one location and nowhere else. In such cases it is a nonsense to suggest that establishing compensatory tracts of forest is in any way satisfactory Wildlands management. The Altamira site within the Assurini do Xingu and Arawete territories will be flooded by the Babaquara dam. The 'Caxinduba' site on the Rio Xingu, is also a First Priority area which will be inundated if Electronorte opts, as planned, for the integral use of the Xingu basin. Even if the Pleistocene refugia are only partially affected, with the wave of colonisation and development following the hydro project, it is pure folly to believe that any effective protection can be secured for these sites. Of the more spectacular, known species that are threatened around and east of the Xingu river, biologists are particularly concerned about the bearded saki, the white-whiskered spider monkey, and the hyacinth macaw.

These unique and threatened Pleistocene refugia should be given immediate and complete protection. As recommended by the World bank (Environmental Policies and Procedures of the World Bank, OMS 1984), 9; "In environmental work, prevention is preferable and generally less costly than remedial actions which may not always be possible", and 4; "The Bank endeavours to ensure that projects with unavoidable adverse consequences for the environment are sited in areas where the environmental damage is minimized, even at somewhat higher initial costs".

It is clear that the Altamira-Xingu complex, among other hydro schemes, is set to maximise irreversible environmental damage and extinctions. The only option which satisfies the Bank's own criteria is to withold disbursement of the Second Power Sector Loan, or re-orientate the funds towards projects which don't harm the environment. That the first volume of the Master Plan fails to address the need to designate the above sites as 'Wildlands of Special Concern' is clearly unsatisfactory, and on these grounds alone, the plan should be rejected.

Robert Goodland of the Bank's environment unit has stated that the first policy element of the "Wildlands" policy is that; "The Bank normally declines to finance conversion of wildlands of special concern (which)...include...specific geographical priorities". In case of exceptions, the third policy element is that; "all deviations must be explicitly justified. The options must be aired outside the implementing Ministry and should include NGOs". No such justification for totally disregarding the Bank's Wildlands Policy is contained within the Master Plan. Options have not been discussed, nor have Brazilian NGOs or affected communities been involved in discussing them.

THE BRAZILIAN POWER SECTOR II LOAN

2.ENERGY EFFICIENCY OPTIONS.

Memorandum prepared by Friends of the Earth

23rd December 1988.

Summary from Geller et al., "Electricity conservation in Brazil: potential and progress (Energy 13(6) 461-536, 1988).

Improving the efficiency with which electricity is used is desirable for the following reasons:

(i) Expanding electricity supply is highly capital intensive.

(ii) Increasing end-use efficiency is less costly than increasing electricity supply.

(iii) There are major opportunities for increasing the efficiency of electricty use in a cost effective manner.

(iv) Adopting more efficient end-use equipment holds down electricty bills and can lead to improved standards of living.

(v) Increasing the efficiency of end-use equipment can strengthen Brazil's growth and export potential.

(vi) Slowing the rate of electricity supply expansion has positive environmental impacts.

ENERGY USE.

Electricity demand forecast

Year	Electricity Demand (Twh)	Capacity required (GW)
1980	114.5	30.5
1985	165.9	41.6
1990	237.5	57.3
1995	320.1	74.7
2000	420.7	95.3

SAVINGS POTENTIAL.

A. Industrial Sector

1. More efficient motors.

a) Manufacturers in Brazil produce high quality motors that are typically 4-5% more efficient than standard motors at smaller sizes (<20 h.p) and 2-3% more efficient at larger sizes.

b) Improving the efficiency of motors in the commercial and industrial sectors by only 3% could save an estimated 5.8 TWh by the year 2000.

c) Although more efficient motors cost approx. 25% more than standard motors, the payback period is generally <3 yr and the internal rate of return on the first cost is in excess of 40%/yr.

2. Motor speed controls.

a) For many motor applications, there are substantial energy losses during part-load operation. Variable speed drives (VSDs) can be used to increase efficiency of motors during part-loan operation.

b) Studies in the US indicate savings potential of up to 7.3% for many motor applications. Assuming similar savings in Brazil, full implementation of VSDs by the year 2000 could reduce baseload electricity by about 30 TWh, thus obviating the need for nearly 6.6 GW of installed generating capacity.

c) VSDs are expensive in Brazil, but even so, the capital cost for reducing demand is about half that for supplying demand with hydroelectric power at accepted discount rates of 10-15%.

3. Industrial Structure.

a) A high proportion of electricty consumption in Brazil is for low 'value-added' industries such as non-ferrous metals. The seven most electricity-intensive industries account for 52% of industrial electricity use but only 13% of industrial value added. Moving economic development away from basic materials processing towards fabrication and finishing could be an important means of containing growth in electricity consumption in Brazil.

B. Residential Sector.

1. Refrigerators.

a) Without any improvement in efficiency, refrigerators could consume 25 TWh by the year 2000. If the most efficient models available worldwide are used, this would reduce electricity demand for refrigerators by 60%, holding electricity demand for this sector at 10 TWh.

b) Efficient models cost about 10-15% more, but the payback period is less than 3 years on the extra cost and internal rates of return in excess of 40%.

c) Producing and selling more efficient refrigerators should be very cost effective for bot consumers and society as a whole.

2. Hot Water Heating.

a) Private companies in Brazil already produce small heat pump water heaters (HPWHs) for export and for the domestic market. Potential exists for lowering peak demand using HPWHs, thus saving utilities investment costs for other heating methods. At present only wealthy households can afford to use HPWHs.

3. Lighting.

a) Residential lighting could consume 16.5 TWh by the year 2000 assuming that lighting accounts for 20% of residential electricity demand that year. The widespread use of fluorescent lamps could reduce demand for electricity by 50%, thus obviating the need for about 1.9 GW of generating capacity.

C. Commercial and public services sector.

1. Indoor lighting.

a) Electricity consumption for lighting in commercial buildings can be reduced in a number of ways, including: (i) reduced illumination levels, (ii) use of more efficient lamps, (iii) use of more efficient ballasts, (iv) use of improved light fixtures, (v) use of lighting-control systems.

b) Combining these measures using sensors and controls, and more efficient lighting can reduce electricity consumption by up to 60%. The conservation measures are cost effective for consumers, with paybacks of 3 years or less. Direct savings in the year 2000 would eual 15 TWh.

2. Air conditioning.

a) Air conditioners represent a growing fraction of peak energy demand.

b) One major Brazilian producer is assembling efficient room air conditioners in Brazil for export only. The export models consume 20-25% less electricity than domestic models.

3. Outdoor lighting.

a) Outdoor lighting accounts for about 4% of total electricity consumption in Brazil.

b) High Pressure Sodium lamps consume 80% less electricity than incandescent lamps. Fully implementing HPS lamps could save 6.7 TWh of demand in the year 2000.

c) HPS lamps will be cost effective for municipalities.

D. Overall Savings Potential.

1. Major end-uses.

a) The six major end-uses described; (i) Industrial motors, (ii) Domestic refrigerators, (iii) Domestic lighting, (iv) Commercial motors, (v) Commercial lighting, and (vi) Street lighting, will account for two-thirds of total electricity consumption in the year 2000.

b) Total savings already described could save 83.8 TWh, almost 20% of the total electricity demand projected for 2000.

c) The savings can be obtained through technologies that are technically and economically feasible, and in many cases already available in Brazil.

2. Savings on new generating capacity.

a) Reducing electricity demand in 2000 by 83.8 TWh could eliminate the need to construct nearly 19 GWh of power capacity, equal to about two-thirds of the new capacity that must be completed by the year 2000 (that is not already under construction).

b) Avoiding the need for 19 GWh of new capacity would save utilities from having to invest at least $38 billion.

c) The required investment in greater end-use efficiency, on the other hand, is estimated to be on the order of $8 billion.

Friends of the Earth

Brazil

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 89/01/17 DUE DATE : 00/00/00
LOG NUMBER : 890117012 FROM : Mr. Choksi (thru Hus
SUBJECT : BRIEFING: Meeting with Mr. Ricardo Santiago, Secretary General, SEPLAN on Wed. Jan. 18, 1989 at 11:00 am.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
_____ PLEASE HANDLE
_____ FOR YOUR INFORMATION
_____ FOR YOUR REVIEW AND RECOMMENDATION
_____ FOR THE FILES
_____ PLEASE DISCUSS WITH _____
_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS :cc: Mrs. Haug, JV (follow file)

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: January 17, 1989

TO: Mr. Barber B. Conable

THROUGH: Mr. S. Shahid Husain

FROM: Armeane M. Choksi, Director, LA1DR

EXTENSION: 31811

SUBJECT: BRAZIL - Your Meeting with Mr. Ricardo Santiago, Secretary General, SEPLAN

1. On Wednesday, January 18, 1989, at 11:00 a.m., you will meet Mr. Ricardo Santiago, Secretary General of the Ministry of Planning (SEPLAN). Mr. Santiago is expected to discuss the recent economic program formally announced by President Sarney on January 15, and the status of the Power Sector Loan.

The Economic Program

2. The increase in inflation in October 1988, raised inflationary expectations and had a destabilizing effect on financial markets. Faced with the initial stage of a shift from financial assets into real estate, dollars and gold, the Government joined ongoing talks between labor and business groups with the purpose of establishing an improved framework for wage and price increases. On November 3, representatives of the Government, business and labor groups signed a Social Pact establishing ceilings for wage and price increases for the last two months of 1988. However, it soon became clear that this attempt to reduce inflation by pre-setting wage and price increases was running into serious obstacles and further anti-inflationary measures were needed. The outcome of these efforts was the new plan unveiled by President Sarney on Sunday, January 15, and dubbed the "Summer Plan" (a detailed description of the Plan is presented in the Annex).

3. The Summer Plan is the third major anti-inflationary program of the Sarney Administration. The previous two major stabilization attempts were the Cruzado Plan (February 1986) and the Bresser Plan (June 1987). The new program includes a wage and price freeze, credit controls, the end of monetary correction and several fiscal measures. Moreover, immediately prior to the freeze several prices and public sector tariffs were raised and a 17% devaluation of the domestic currency was undertaken. A new currency was created--the New Cruzado--which is equivalent to one thousand cruzados. Most of the measures included in the Summer Plan, namely, those related to the deindexation of the economy, the change in the wage law and the creation of the new currency will have to be approved by Congress within thirty days, otherwise they will be nullified. Overall, the plan represents an important effort to substantially reduce inflation. However, only after all the details are unveiled and Congress approves the Plan can a complete assessment be prepared. Nevertheless, the implementation of the plan will determine in large measure the outcome of this latest stabilization effort. The main components of the Plan are the following.

4. Wages. Starting February 1989, the present system of monthly wage adjustments based on past inflation will be abolished, and salaries will be frozen. After the freeze, salaries in the private sector may be readjusted in the context of Social Pact negotiations. The success of the program will depend in large measure on how the transition from the freeze to market determined wages will be accomplished. The Plan leaves those steps to be determined in the context of Social Pact negotiations. You may wish to ask Mr. Santiago if the Government has any concrete proposals to present to the other Social Pact members regarding the transition period.

5. Prices. The prices of all goods and services are frozen for an undetermined period. The Plan took some precautions to align relative prices prior to the freeze. You may wish to ask Mr. Santiago if the Government intends to establish procedures that will permit further relative price adjustments. Moreover, you may wish to ask Mr. Santiago about any government proposals on how to achieve a smooth transition from a price freeze to market-determined prices.

6. External Sector. The domestic currency was devalued by 17%. However, the exchange rate is not frozen and the Central Bank can announce at any moment another devaluation. In an effort to reduce monetary pressures relending operations are suspended for one year and debt conversions will be delayed. The above measures are expected to provide strong support to the stabilization effort. However, the devaluation will contribute to the already substantial trade surplus (US$19 billion in 1988) and it will have some inflationary impact. You may wish to ask Mr. Santiago on his views regarding the above points and further steps the Government intends to take concerning trade policy.

7. Monetary Policy. Credit to the private sector is limited to the December 31 level (a similar measure already existed for credit to the public sector). Interest rates will be raised to the level necessary to control liquidity. Monetary correction will be phased out and passbook savings will remain the only indexed financial asset. The outlined monetary policy represents a very positive contribution to the stabilization program. However, some of the measures will not be easy to implement, such as the ceilings on private sector credit, and the effects of deindexation on the financial sector will need to be carefully monitored. To enhance the credibility of the plan and to assess its implementation it may be important to set quarterly targets for the expansion of the main monetary aggregates. You may wish to ask Mr. Santiago about his views regarding the establishment of such targets.

8. Fiscal Policy. The Government proposes cuts in federal expenditures which, however, are not explicitly outlined. An administrative reform is proposed reducing the number of ministries from 27 to 22, abolishing several government agencies and resulting in layoffs of several thousand public workers. It is difficult to evaluate the fiscal outlook. Congress will have to review parts of the 1989 budget and the effectiveness of some the measures announced in the Plan will depend on their implementation. You may wish to ask Mr. Santiago if the Government has a specific target for the 1989 fiscal deficit and if further fiscal measures are seen as necessary to achieve the target.

The Power Sector Loan

9. This proposed operation (US$500 million) was renegotiated in October-November 1988 and an agreement was reached on all major issues except the nuclear issue (construction of the Angra III Nuclear Power Plant). The hiring of environmental experts outside the power sector needed to carry out agreed environmental protection was also an issue at the time the Brazilian delegation left Washington, but high-level government officials indicated to the Bank shortly thereafter that the Bank position may be acceptable to them. It is important to note that we have reached agreement on all other environmental issues including those associated with the nuclear plants. This agreement is probably one of the most far-reaching ones that the Bank has reached with a developing country on environmental matters. You may wish to compliment the Brazilians on this.

10. The Bank's position on the nuclear issue is that Angra III is uneconomic. Our preliminary calculations indicate that it is significantly more costly than the alternative hydropower solution. The Brazilian delegation will probably argue that the Bank's calculations do not take into account all costs, notably the costs of resettlement and environmental protection associated with some hydropower projects. You may wish to answer that the Bank's technical staff will be happy to examine any evidence or proposals from the Brazilian side, but that we cannot compromise on the principle of insisting on the least-cost solution for all major investments in the power sector if we are to make an adjustment loan for the sector.

11. Even if an agreement is reached with the Government on the nuclear issue, we cannot go to the Board with this (or any other) adjustment operation, unless the macroeconomic situation in Brazil is propitious. This means that, at minimum, a credible stabilization program is in place and is being successfully implemented. Mr. Santiago is well aware of this point. As mentioned above, the Brazilians have announced another economic program. We expect to visit Brazil shortly to analyze this program. Even though the program represents a substantial effort to address the current problems, implementation will be the key to its success. You may wish to emphasize that point.

Investment Lending This Fiscal Year

12. Excluding the two adjustment loans totalling about US$800m (Power US$500m and Finance US$300m), the Bank, this fiscal year, has been prepared to lend about US$1.6 billion in investment loans--a level higher than last fiscal year. However, because of the new Constitution, the 1989 budget, the political disagreements between the center (President Sarney) and the State Governors, and the transfer of responsibility for World Bank operations from the Ministry of Finance to that of Planning, the Government has shifted its priorities and has been incapable of making decisions that would facilitate investment lending. For example, the Northeast Basic Health II project (US$275m) was appraised last April, and the Invitation to Negotiate was sent in July. The Brazilians have delayed negotiations continuously and have now informed us that this project has not been included in the 1989 budget; it is now no longer a priority for the Minister of Health. As another example, the Rondonia Natural Resource

Management Project (an environmental project in the Northwest of Brazil, US$150m) was scheduled for appraisal in October 1988 and then delayed to November, December, January, February and now March. By now the Board should have approved US$440m of already appraised projects rather than the current US$71m.

13. It would be very useful if you would inform the Brazilians that the Bank is willing to accommodate the shifting priorities of the Government due to the current uncertainties in Brazil, but they should recognize that this could result in an investment lending program to Brazil of US$700-800m this year--a distinct possibility as several investment loans have now been affected. The Brazilians probably believe that by reducing the level of investment loans, the Bank will be under pressure to make compromises on the power and finance adjustment loans in order to boost Bank lending. You may wish to inform Mr. Santiago that the Bank will not sacrifice quality in order to increase lending and that our requirement for a satisfactory macroeconomic environment and agreement on sectoral policies will continue to be essential. It would be very helpful to us if you could reinforce the messages we have been giving the Brazilians.

Attachment

RCoutinho/DAKlaus/AMChoksi:nev/va

WORLD BANK BRASILIA OFFICE

Date: January 16, 1989

To: Mr. Armeane Choksi, Director, LA1DR
Mr. George Papadopoulos, Resident Representative

From: Maria E. Freire, Sr. Economist

Subject: Brazil Summer Program -- The Announced Program

1. President Sarney announced yesterday the entirety of the Summer Program which is to be implemented today. The program (which is the third anti-inflationary program of Sarney's administration) aims at combating inflation and avoiding the threat of hyperinflation. It combines a freeze on prices and wages with the extinction of monetary correction, tight credit policies and a change in monetary unit. The main policy measures are the following:

a. Prices of all goods and services are frozen for an undetermined period. Beginning today, ceiling prices for a basket of 180 basic products (food products, hygiene and cleaning items) are published in 26 lists distributed to all retail stores. The ceilings are modal prices practiced during 6-10 January and vary among states and main towns. Prices of all other products are frozen at the level of January 14th. Stores were closed this morning to remark prices and correct for any last minute remarking. Consumers have been alerted to complain against any deviation from the program, and a telephone number has been advertised. The control of prices will be exercised by the Receita Federal, Labor officials, Sunab, and Banco do Brazil.

b. A new currency, the Cruzado Novo (NCz$), has been created. It is equivalent to 1,000 old cruzados. The currency was devalued by 17%. The new cruzado, is now equivalent to US$1 at the official exchange rate.

c. Wage Policy. The URP, still in vigor in January, will be extinct in February when salaries will be adjusted by the average of the last 12 months. As a starting point, all salaries (including public and private sector) will be synchronized to avoid losses in relation to the 1988 average real wage. To this end, salaries of each professional category in January 1989 will be computed on the basis of the 1988 average (expressed in OTNs) adjusted by the URP of January (26.05%). [1] Adjustments in wages of some professional categories will take place if the new salary is lower than the 1988 average. It

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1/ Total salaries received by each category in 1988 will be converted in OTNs (the salary of January by the OTN of February, and so on) and averaged for the whole year. This 1988 monthly average will then be converted in OTNs of January 1989 (or equal to NCz$6.92) and adjusted by the January URP (26.05%). This will be the salary of January 1989.

will be frozen if it is equal or greater than the average. [2] After this freeze, salaries in the private sector may be readjusted in the context of the Social pact. For the public sector, there will be no adjustment, except if expenditures with personnel were less than 65% of Treasury recurrent revenue (as included in the Constitution) and if there were no other priorities to attend with the available resources.

d. Monetary Correction. The OTN fiscal was extinct today. The contracts based on this OTN, such as the CDB, are corrected on the basis of the OTN value of last Friday (NCz$6.92). The monetary OTN will be fixed at that same value until February 28th, when it will be extinct. With the extinction of the OTN, the monetary correction scheme created 24 years ago comes to an end. Contracts can now be negotiated freely, but the parties are banned from using a foreign currency or the minimum wage as an index. All contracts in OTN will have to be transformed in IPC (official price index).

e. Foreign exchange: The currency was devalued by 17% -- equivalent to the accumulated mini-devaluation that would have been done until the last day of January. The exchange rate is not frozen; the Central Bank can announce at any moment another devaluation without pre-fixed date. It was decided to **centralize foreign exchange** in the Central Bank as a precautionary measure to avoid possible problems that may affect the level of reserves, but payments to external creditors continue to be made automatically. Suspension of interest payments on the external debt can be considered in the case its payment will lead to an excessive decline in reserves. (This point is still unclear and no specific targets have been set.) **Relending** operations are suspended for one year. **Debt conversion** in investment will be maintained but the level of conversion will be a function of the results of the economic program. The schedule for the next public auctions is unknown; debt auctions planned for January have been cancelled.

f. Interest rates will be increased (on Wednesday) at the level necessary to control overall liquidity. The measure will be temporary to avoid speculations and the impact on the domestic debt.

g. In the context of a strict credit policy, **compulsory reserves** on demand deposits will increase up to 100%; as a first step they have increased to 80%. For the other deposits the rate is 60%. **Credit to the private sector** is now limited to the level of last December 31, except for credits to housing, export and agriculture. Consumer credit has been drastically affected by a 2/3 reduction in financing periods; these have been reduced from from 36 to 12 months for new cars; from 24 to 8 months for used cars; from 9 to 3 months for any other consumer credit. For credit cards, the first installment has increased from 25% to 50% of outstanding credit.

h. Deposits on **passbook accounts** are the only financial assets which continue to be indexed. Only CDB at more than 90 days will have a post-fixed

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2/ The proposed adjustment corresponds to an average adjustment of about 20% (according to Ms. Werneck) compared with the 58% adjustment (the difference between the accumulated CIP and URP in 1988) demanded by the labor representatives.

remuneration. The system of indexation for passbook deposits is the following: the interest due between 14 and 31 January is paid according to the OTN fiscal of 1-16 January or 12.19% plus 0.5% interest; after January 18, deposits will be remunerated at the overnight rate; in February and March, at a rate equal to inflation plus 0.5% or to the overnight rate, whichever is higher; and beginning in April, at a rate equal to inflation plus 0.5%. Between January 18-31, deposits in old accounts are suspended. Only new accounts are allowed but deposits will be frozen for 6 months

i. All debts due after January 15 and expressed in Cruzados will be reduced by a conversion factor now published in a new **"tablita"** (created during the Cruzado Plan) which includes the variation in real interest rates for the first for 15 days. It will be updated weekly by the Ministry of Finance. This conversion factor cannot be used to pay taxes, public utilities, and condominium fees.

j. The payments to the Housing Financing System will be readjusted when the wages will be readjusted. **Housing rents** are fixed in the same way as salaries. The current value is multiplied by a conversion factor which varies according to the month of the last adjustment. The conversion factor is computed so as to maintain average OTN level of 1988. School fees are frozen at the January level. The **minimum agricultural prices** will be adjusted by the OTN fiscal of last Friday.

k. New fiscal rules will be defined for the financial market and the Income Tax will be converted in cruzados at today's fiscal OTN.

l. Drastic **cuts in government spending**. Recurrent federal expenditures will be reduced by 50%. At the beginning expenditures would be limited to the level of revenues collected. Priority items to be paid include salaries, debt service, and social programs. Treasury paper will be issued only to finance the roll over of past debt. Salaries which were paid on the 20th of each month will be paid on the 10th of the following month.

m. An **Administrative reform** including:

(i) reduction of the number of ministries 27 to 22[3] with the extinction of five ministries (Housing, Science and Technology, Land Reform, Irrigation, and Public Administration);[4]

3/ 17 ministries and 5 agencies with ministerial status: Civil and Military Cabinets, SNI, National Defense Secretariat, and Seplan.

4/ The Ministry of Industry and Commerce which includes now the ex-ministry of Science and Technology has been renamed as Ministry of Industrial Development, Science and Technology. The Ministries of Land Reform and Irrigation have been merged into Agriculture, and the Secretariat of Administration (which had the status of ministry) was absorbed into the Ministry of Planning.

(ii) extinction of 42 agencies attached to the Central Government[5] -- implying the firing of 60,000 public workers recruited without public contest in the last five years. Firing will take place within 45-60 days, after a complete identification of of the public workers which fall under the above criteria.

(iii) reduction of 573 director positions; and

(iv) elimination of all positions "comissionados"

The composition of the new Cabinet is expected to be announced tomorrow. New names include: Ms. Werneck as Labor minister, Vicente Fialho (ex-minister of Irrigation) as minister of Mining and Energy; Vicente Amato, professor in the USP as Minister of Health, replacing Borges da Silveira; and Oscar Dias Correa (ex-president of the FST, Federal Superior Court) as Minister of Justice, replacing Mr. Brossard who heads now the FST.

n. A decree under preparation establishes the rules for **privatization of state enterprises** and the criteria for choosing the parastatals to be privatized in 1989. For parastatals that will not be privatized, the number of directors will be limited to six.

2. These reforms (including the administrative reform) are the subject of temporary measures (faxed to Headquarters) which need to be approved by Congress in 30 days. The administrative reform will be concluded during this week.

3. The Banks are closed today and tomorrow.

4. The meeting of the Social Pact scheduled for Wednesday (January 18) has been cancelled, as representatives of Labor and entrepreneurs are analyzing the measures announced yesterday and the reaction of the Congress is not known. No dates have been mentioned for the next meeting of the Pact. The Central Unica dos Trabalhadores (CUT), which was not represented in the Social Pact, is conducting conversations with Government separately.

Reactions

5. The Labor representative in the Social Pact (Mr. Medeiros) left the meeting with the President yesterday, declaring his intention to abandon the Social Pact and initiate a general strike in protest against the new salary policy. Other labor union leaders, Jair Meneghelli (CUT) and Joaquim Santos Andrade (CGT) have shown a more positive attitude and will meet this afternoon to examine the new measures.

6. Entrepreneurs have had different reactions. Some have no comments for lack of time to appreciate the package. Others, like FIESP, have accepted the price freeze and are glad to see that the package includes a reduction in the public deficit, their main preoccupation. Economists fear that the package will be

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5/ See attached list of agencies being closed.

recessive and have doubts on the effects of the price freeze. The "centralization" of foreign exchange for debt service, a new concept which implies the possibility of a moratorium, has pleased some academicians who fear that the program would fail without a new strategy to deal with the external debt problem.

7. President Sarney has encouraged the population to support the program and to exercise vigilance on prices remarking. A telephone number has been given to be use for reporting deviations from the new price policy. The legislation on economic delinquency is being prepared by the General Legal Council, Saul Ramos. Sarney has threaten to implement it if entrepreneurs do not abide by the new rules. Entrepreneurs have reacted against such legislation, on the basis that the success of the program depends on the voluntary adherence of the public to the new measures.

Brazil

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: December 6, 1988

TO: Armeane M. Choksi, LA1DR

FROM: Paul M. Meo, Chief, IECIT *Phalgas for P. Meo*

EXTENSION: 33802

SUBJECT: Barber B. Conable's Discussions with the Brazilian Delegation, December 6

At their request, Mr. Conable met with the Brazilian delegation to the Montreal Mid-term Review of the Uruguay Round. Mr. Conable was asked by the delegation leader, Paulo Tarso Flecha de Lima, for his support with the Bank's Executive Directors and governments on the pending power loan. Mr. Silva do Amaral mentioned he had had a recent meeting with Moeen Qureshi, and claimed all but the nuclear plant issue had been settled. Mr. Flecha de Lima and Mr. do Amaral were particularly concerned over the strong financial link between the power loan and commercial bank support. Mr. Conable, in response, only expressed a desire to assist in resolving the issue and to be flexible. He expressed support for Mr. Qureshi's treatment of the issue and said he would consult with Mr. Qureshi upon his return.

cc: Messrs. M. Qureshi (SVPOP), S. Husain (LACVP), S. Fischer (VPDEC); Mrs. M. Haug (EXC) ✓

Dictated by Paul M. Meo from Montreal on December 6, but not seen.

/ph

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: December 7, 1988

TO: Distribution Below

FROM: Timothy T. Thahane, SECGE

EXTENSION: 72185

SUBJECT: Recent Actions by the Brazilian Government on Environmental Issues

1. The attached documents are provided for your information. They were circulated to the Executive Directors by Mr. Malan in response to a request by Mr. Boehmer at the October 13, 1988, Board meeting.

Distribution:

Conable
Qureshi
Hopper
Shihata

cc: Mr. Malan

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
Country Files: Brazil - Correspondence 03	1779608

Document Date	Document Type	
October 24, 1988	Memorandum	

Correspondents / Participants
To: See Distribution Below
From: Pedro Sampaio Malan, EDS15

Subject / Title
Recent Actions of the Brazilian Govt on Environmental Issues

Exception(s)

Additional Comments
Declassification review of this record may be initiated upon request.

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	Date
Shiri Alon	October 26, 2023

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 88/11/08 DUE DATE : 00/00/00
LOG NUMBER : 881108014 FROM : MAQ/ Choksi
SUBJECT : BRIEFING - Brazil: The Macroeconomic Situation and the Second Power Sector; Outstanding Issues. Meeting for Nov. 9/88 at 3:30 p
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
_____ PLEASE HANDLE
_____ FOR YOUR INFORMATION
_____ FOR YOUR REVIEW AND RECOMMENDATION
_____ FOR THE FILES
_____ PLEASE DISCUSS WITH _____
_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS :cc: J. Tanaka, JV (follow file)

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: November 8, 1988

TO: Mr. Barber B. Conable

THROUGH: Mr. Moeen A. Qureshi

FROM: Armeane M. Choksi, Acting Regional Vice President, LAC

EXTENSION: 31811

SUBJECT: BRAZIL - The Macroeconomic Situation and the Second Power Sector: Outstanding Issues

1. As requested by you, this note addresses four issues:

(a) our assessment of the macroeconomic situation;

(b) the IMF's position and possible waiver of conditions;

(c) outstanding issues surrounding the Power Sector Loan and the conditions associated with the inclusion of the Nuclear Power component; and

(d) the status of the Brazilian Financing Package and the interrelationship between the timing of the next tranche release and Board approval of this loan.

A. The Macroeconomic Situation

2. Background. Following the failure of the Cruzado and Bresser plans (1986-87), a new economic team took office in January 1988. The major challenges it faced was to control the high fiscal deficit--which was projected to rise to 7-8% of GDP for the year--and to reestablish the credibility of the Government's economic policy. Several measures were taken in the following months, including ceilings on lending to, and wage controls in, the public sector, and a reduction of the wheat subsidy. A revised deficit of 4% of GDP was set for the calendar year 1988.

3. Current Assessment. The macroeconomic situation, over the first three quarters of the year, was fragile but remained under some measure of control. Inflation was high, but somewhat stable around 20% per month. Brazil's comprehensive indexation provisions meant the economy was able to accommodate those levels of inflation over the short run. As of September 1987, four of the five macroeconomic targets[1] agreed to with the IMF will be met, the exception being the nominal PSBR which will be exceeded because of the high inflation rate, now estimated to be around 900% p.a. by the end of the year. It is highly unlikely, unless substantial steps are

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1/ The five targets relate to: (a) the nominal public sector borrowing requirement (PSBR); (b) the public sector operational deficit; (c) net domestic assets of the Central Bank; (d) net international reserves of the Central Bank; and (e) net disbursements of external debt-related flows.

undertaken very soon, that the Government's own operational fiscal deficit target (of 4% of GDP) will be met at year-end. Our estimate is that the operational deficit will be between 4.5-5% GDP. On the other hand, the trade surplus, is expected to be about $18 billion, compared to a target of $13 billion.

4. On the inflationary front, the situation has deteriorated gradually but progressively over the course of the year. Despite some measures that have been adopted on the fiscal front, slippages have occurred on the wage front. The inflationary pressures have been exacerbated by higher than expected levels of the trade surplus, debt/equity conversions and relending, accompanied by an accommodating monetary policy. As a result, inflation has remained high and increasing, reaching 27.5% in October, with 29% and possibly over 30% being expected for November and December. With high inflation, the situation has become more volatile and uncertain, and the country has recently suffered simultaneous rapid swings in several key prices: interest rates, gold, the parallel dollar. As a result, public confidence in economic policy has also dropped.

5. Formulation of a New Package. In recent weeks, however, the Government has taken several initiatives to formulate a macroeconomic policy package, and to identify a suitable form of deindexation. Some such package is expected to be put in place sometime after the municipal elections of November 15th. The package is expected to have three main elements: fiscal, monetary and deindexation.

6. First, the Government's fiscal objective is to reach a zero deficit for 1989, rather than the 2% agreed with the IMF. These are the early days of preparation of any such package, and details are not available from the authorities as to how they intend to achieve this goal. Because of this, and in light of the powerful political constraints that have been in operation in recent months--including in some cases the undercutting of the economic team by powerful cabinet colleagues--a measure of prudent skepticism seems in order. Second, a more active monetary policy stance is also likely to be adopted as part of the expected package, including a more assertive control on the expansion of the monetary base together with the freeing of the overnight interest rate.

7. The third element in the equation to bring inflation under control would be a program of deindexation. Following consideration--and active public examination--of a range of options including a possible temporary wage and price freeze, the approach that has been adopted is to seek to establish a Social Pact between labor, business and Government, similar to the Mexican and Argentine approach. It would be based on a gradualist time-profile of agreed price and wage increases, "forward indexation" (against expected lower inflation in the following month) as has been proposed by former Finance Minister Simonsen amongst others.

8. Social Pact. The first formal Social Pact meeting took place on Thursday, November 4. It went very well and resulted in a 60-day agreement on price and wage increases, as a first step. It had a very calming effect on the market. Agreement has already been reached on: (i) price increases for the next two months not exceeding 26.5% (November) and 25.0% (December), with wage increases correspondingly limited to 21.5% and 26.5%, respectively; (ii) that a fiscal/monetary package will be presented to the

Pact on November 17th and to Congress on November 18th; and (iii) agreement, in principle, that success over the next 60 days would set the stage for a full review of the wage indexation formula.

9. Prognosis. In sum, the authorities have succeeded in arresting the immediate risk of a drift toward hyperinflation. There is breathing space to now finalize the much needed macroeconomic package. But the real test will come in the coming weeks, when the economic team seeks the approval for the needed underlying measures, on the fiscal front, on credit and interest rates, and in terms of how to further change indexation rules. Such approval will be needed from the President, the Social Pact and Congress. In all of this, the one measure of hope lies in their shared fear of hyperinflation. Even so, our view is that the weak political situation implies that we can, at best, be cautiously optimistic about the likely strength of the macroeconomic package that will be approved. The likelihood is that the approved package, while arresting hyperinflation (30+% per month) in the immediate future, will fail to lead to a successful elimination of chronic inflation (10+% per month) during 1989.

B. The IMF's Position

10. As indicated earlier, and based on statistics for the first nine months of the year, the IMF believes that its targets for end-September are being met with the exception of the nominal PSBR. Their main concern, as ours, is with the future: the compensatory measures to be introduced for the rest of 1988 and the 1989 program. The IMF is thus uncertain, at present, as to whether or not a waiver will be issued. This will depend on the package of new measures expected in November/December. If and when these are introduced, and if the IMF finds them satisfactory, the staff will recommend to the Board that a waiver be granted.

11. However, technically the Second Tranche of the Commercial Bank Parallel Facility does not require a waiver as such, but a letter from the Managing Director of the IMF to the Commercial Banks stating that there is satisfactory progress on the macroeconomic front. There is a possibility that the IMF may choose to issue that letter, yet not request a waiver from its Board until January/February 1989, once they have fully evaluated the 1989 program.

C. The Power Sector Loan and the Nuclear Power Component

12. The Overall Status of Dialogue. The overall dialogue with the Brazilian Government on the Power Sector II loan has a few outstanding issues, of which the most important are nuclear power-related. The issues raised by the nuclear power program are discussed below in detail. In the other areas, agreement is closest on loan conditions for sector investment, pricing and financial rehabilitation (which is the principal purpose of the operation), with only minor differences that can be resolved without much difficulty. In the (non-nuclear) environmental area, four main sticking points remain on loan conditions relating to: (i) protection of Amerindians (in power project areas); (ii) strengthening the environmental impact assessment (RIMA) process; (iii) improving the capability of institutions like SEMA and FUNAI to tackle power sector problems; and (iv) accelerating the staffing of power utilities in the environmental area.

13. The Nuclear Power Component. The Bank has never financed nuclear power plants in developing countries since this was invariably among the highest cost options available. Consequently, Bank guidelines in this area are sketchy and in-house expertise quite weak. The existing Sector Operations Directive (attached to OMS 3.72) essentially defers the principal responsibility in nuclear power matters to a sister organization--the International Atomic Energy Agency (IAEA).

14. However, the recent transfer of full responsibility for nuclear power to FURNAS (within the electricity sector in Brazil)--a decision made with the utmost secrecy at the highest levels of Government and without any prior consultations with the Bank--now requires the Bank to explicitly assess the financial, economic and environmental/safety aspects of nuclear energy, in the context of the proposed, Power Sector II loan.

15. Brazil's program for nuclear power generation comprises three plants in Angra dos Reis, some 80 miles south of Rio de Janeiro. Angra I (630 MW) became operational in March 1982. So far, a series of technical problems and repairs has interrupted its commercial operation, which is scheduled to resume in December 1988. Design and equipment for the Angra I plant have been contracted from Westinghouse under a Brazil/USA cooperation program. Angra II (1300 MW) is at an advanced stage of construction. Designs and generating equipment for this plant and for Angra III (which is only at the very initial stage of construction) have been contracted with Deutsche Kraftwerk Union of West Germany.

16. The set of nuclear power-related loan conditions that are to be negotiated in connection with the proposed Power Sector II project are set out in detail in Annex 1. These conditions were determined on the basis of comments and advice received on a comprehensive issues paper that was widely circulated and commented on throughout the Bank.

17. There are five high priority conditions for the Bank (see Annex I for details). Of these, the most critical for us is the economic condition (item 1 of Annex 1) that requires the Brazilian Government to undertake a study to determine the economic feasibility of Angra III and if it is found not to be economically viable (as is expected), to take measures to suspend and eventually cancel Angra III. This has given rise to serious objections on the Brazilian side. There are two conditions relating to environmental/safety studies, of which one is challenged (item 5 of Annex 1), while the other (item 4) is likely to be accepted by the Brazilians without difficulty. Finally, two conditions deal with financial adjustments to compensate for the impact of the nuclear plants on the sector (items 2 and 3 of Annex 1), both of which should present few difficulties.

18. Among the remaining conditions--also dealing with environmental/safety issues, the one concerning full scope IAEA safeguards (item 6) is the most difficult. Strengthening the capability of SEMA and FEEMA to deal with nuclear power problems is the subject of another condition (item 7) that faces moderate objections. Finally, a condition (item 8) requiring several other studies on waste disposal, decommissioning, catastrophic accident, and nuclear fuel transport, is also likely to cause moderate problems.

D. The Status of the Financing Package and Board Approval of the Power Loan

19. As you know, the New Money Facility associated with the Brazil financing package amounted to $5.2 billion. The first tranche of $4.0 billion is scheduled to be released on November 14th (although the Interim Agreement was implemented on November 4th and Brazil has now cleared its arrears in full). The timing of the release of the second and third drawdowns ($600 million each) is scheduled for on or after December 1, 1988 and April 1, 1989, respectively. Board approval and disbursement of the first tranche of the Power Sector II Loan is a condition of the second commercial bank drawdown, and disbursement of the second tranche of the Power II loan is a condition of the third commercial bank drawdown. The $500 million Power II loan will have $450 million Japanese cofinancing attached to it. Thus, this loan will be a trigger, over a period of 6-8 months, for the release of approximately $2.0 billion (including the two commercial bank drawdowns of $1.2 billion).

20. Assuming agreement is reached between the Bank and the Brazilians on all aspects of the sector loan, given the current macroeconomic situation, our position would be that we could not proceed with Board presentation of the Power Loan (estimated currently to be in mid-December) unless the Government announces a reasonably credible economic reform package. This is unlikely before mid-December. It is our understanding that the IMF also is unlikely to issue its letter or grant a waiver unless a reasonable economic reform package is announced. We would not proceed with the Board presentation if the IMF gives a negative report on the macroeconomic program.

21. Given the current uncertainties associated with the macroeconomic program and the difficult issues relating to the nuclear power component, there is a distinct possibility that either Board presentation of the loan is further delayed and/or the first tranche conditions take time to be ratified by the Brazilians, and/or we do not reach agreement on crucial sector conditions. If, as a result, there is a substantial delay in or cancellation of the second commercial bank drawdown, then we should expect to bear a number of costs:

- Minister Mailson's position, already weak, will be further weakened to the point that he may be forced to resign; this may set back our ongoing policy dialogue in the areas of trade, financial, capital markets, and privatization reforms;
- There will be increasing pressure within Brazil for a reconsideration of the current Brazilian debt strategy and possibly for a moratorium, including one on Bank loans;
- Bank net disbursements to Brazil for CY88 will be strongly negative and at a historic low; and
- Bank relations with Brazil will be severely strained.

Attachment

MMunasinghe/JSeade/GTNankani/AMChoksi/MAQureshi:sk/el/mv/nev

MATRIX OF PRINCIPAL LOAN CONDITIONS CONCERNING THE NUCLEAR POWER PROGRAM

			Condition for		
			Board Pres.	First Tranche	Second Tranche
High Priority Conditions for the Bank					
(SO)	1.	prepare and complete a detailed economic study to demonstrate whether completion of Angra II and III are economically feasible under terms of reference and methodologies satisfactory to the Bank; discontinue the construction of Angra III unless this detailed economic study demonstrates that the construction of the plant is economically feasible.			x
	2.	reimburse FURNAS for debt-service requirements of the nuclear program and capitalize other debt service obligations of the sector.	x	x	x
	3.	cover with Government funding all costs derived from nuclear plants which exceed the costs of the equivalent hydro-electric plant next in sequence in the Plano 2010 (such costs as determined in EM 007 of August 31, 1989).	x	x	x
	4.	prior to Board presentation, FURNAS/ ELETROBRAS will request an update of the IAEA 1985 Operational Safety Review (OSAR) for Angra I and II. IAEA will field the OSAR mission before January 1989. Submission of a final report and recommendations to the CCMA and to the Bank, and agreements on any follow-up steps which may become necessary in light of the findings.	x		x

NOTE: On the basis of preliminary feedback, items flagged "SO" are those for which Serious Objections are likely to be raised by the Brazilian Government that may potentially lead to a deadlock; and "MO" indicates Moderate Objections which could be overcome with some effort on both sides. The remaining conditions could be negotiated with minor difficulties.

			Condition for		
			Board Pres.	First Tranche	Second Tranche
(SO)	5.	A review of regulatory practices and safety standards related to nuclear power will be carried out. Submission of an interim report and recommendations to the CCMA and to the Bank as well as agreements on any follow-up steps which may become necessary in light of the findings, will be conditions for the release of the second tranche of the proposed loan.			x
		Other Conditions			
(SO)	6.	Government provides assurances that all facilities in the civilian nuclear power sector will be subject to full-scope IAEA safeguards.	x		
(MO)	7.	Government provides assurances to the Bank that with regard to the ways in which SEMA and FEEMA are equipped to license and monitor conventional environmental aspects of the nuclear power program, any improvements which may be found necessary by a Bank review will be carried out, as appropriate, by Government and/or ELETROBRAS under the EMP. Follow-through on agreements in this respect would become a condition for the release of the first and/or second tranches of the loan.	x	x	x
(MO)	8.	FURNAS/ELETROBRAS and CNEN agree to prepare detailed terms of reference for and to commission special studies on (i) nuclear waste disposal (this study should be undertaken under the auspices of IAEA's Nuclear Waste Advisory Program); (ii) decommissioning of Angra I and II; (iii) on civil safety in case of catastrophic failure; and (iv) safety aspects of the transport of nuclear fuel. Approval by the Bank of detailed terms-of-reference for these studies and their commissioning would be a condition for the release of the second tranche of the loan.			x
	9.	ELETROBRAS agrees that the draft RIMA for Angra II will be submitted for review to the CCMA and to the Bank.			x

10. FURNAS/ELETROBRAS agree to invite a review by the IAEA's Analysis of Safety Significant Events Teams to review any deviations, incidents and accidents that may have occurred in the Angra I plant (a report of the review team would become available for review by the Power Sector and the Bank prior to release of the second tranche of the Loan), and to report promptly any future accidents in the Angra plants (through decommissioning) to IAEA and to the Bank.	x	x	x
11. ELETROBRAS will appoint two nuclear safety experts of international standing to the CCMA.	x		
12. ELETROBRAS and Government agree to add a section on legal, institutional and operational aspects of civil and environmental safety under the nuclear power generation program to the next fully revised version of the EMP, which must become available prior to disbursement of the second tranche of the loan.			x

~~All~~

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 88/11/08 DUE DATE : 00/00/00
LOG NUMBER : 881115006 FROM : (thru MAQ) Mr. Choks
SUBJECT : Presidential Agreement: BRAZIL - Credit and Marketing Reform Loan (Ln. 2727-BR) Release of the Second Tranche.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
_____ PLEASE HANDLE
__✓__ FOR YOUR INFORMATION
_____ FOR YOUR REVIEW AND RECOMMENDATION
__✓__ FOR THE FILES
_____ PLEASE DISCUSS WITH _____
_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS : per MH - no action needed.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: November 8, 1988

TO: Mr. Barber Conable, President

THROUGH: Mr. Moeen Qureshi, Senior Vice President, SVPOP

FROM: Armeane Choksi, Acting Regional Vice President, LAC

EXTENSION: 31811

SUBJECT: BRAZIL - Credit and Marketing Reform Loan (Ln. 2727-BR)
Release of the Second Tranche

1. I attach a draft Memorandum notifying the Board of the release the second tranche of funds under the Brazil Credit and Marketing Reform Loan (also known as the Second Agriculture Sector Loan for Brazil). Based on the agreements reached with the Government of Brazil and the documentation submitted to the Bank, which confirmed that the actions taken fully met agreed conditions, the second tranche of US$175 million was released on November 1, 1988, with your authorization.

2. The loan, in the amount of US$500 million, was approved by the Board on June 26, 1988. The first tranche of US$300 million, released in September 1986, has been fully disbursed. US$25 million of the second tranche, earmarked for technical assistance and equipment, was released in May 1988. These funds were needed to finance key activities related to second tranche release, including a crop forecasting project to improve market information. US$100 million of the second tranche was disbursed upon tranche release on November 1, 1988. The attached draft Memorandum to the Board summarizes the achievements of the program to date and the Government's actions to fulfill the conditions for tranche release.

3. The main objectives of the Credit and Marketing Reform Loan are to support the process of making the agricultural credit system more market-oriented and of reducing rural credit subsidies, and to bring about a reform in trade and pricing policies for key agricultural commodities. To meet these objectives, the project supports important changes in Government policies affecting interest rates on official rural credit; trade and price controls; risk management and financing for holders of agricultural stocks; and market information systems. Loan funds are financing general imports (US$400 million), PROSTOCK (US$75 million), and technical assistance and equipment (US$25 million). PROSTOCK is a program operating through a discount window in the Central Bank and intended to provide initial liquidity to a new secondary market in bankers' acceptances.

Tranche Release Conditions

4. There were three sets of conditions for release of the second tranche. First, in the area of trade and price policy, the Government would agree with the Bank and take initial steps to implement a program of reform in trade and pricing policies for four major commodities (cotton,

soy products, maize and rice), including measures designed to liberalize trade, stabilize domestic prices, improve risk management, increase storage finance, simplify trade regulations and improve market information. Second, the Government would have approved regulations for PROSTOCK, a program designed to establish a bankers' acceptance market in Brazil to mobilize commercial finance for agricultural stocks held by the private sector. Third, the Government and the Bank would have agreed on a phased program of reductions in the budget allocations for subsidizing wheat production and consumption. These conditions have been fully met.

5. In June 1988 the Government of Brazil and the international banks reached agreement on a new financing package of US$5.2 billion, to be released in three tranches. Release of the first drawdown of US$4 billion, scheduled for the end of October 1988, is linked to disbursement of half of the second tranche (US$100 million of Ln. 2727), among other measures, and release of the second drawdown of US$600 million is linked to the disbursement of the remaining US$100 million. The target date for release of the second drawdown is December 1988.

6. The Loan Agreement has been amended, incorporating improvements in the Government's rural credit policy and changes in the design of PROSTOCK, based on the final regulations agreed between the Bank and the Government. Assurances were received from the Government at negotiations in May 1986 that rural credit interest rates would be maintained in accordance with the amendment to Loan 2348-BR (Agriculture Credit and Export Development Project, the first agriculture sector loan to Brazil). This amendment specified an interest rate formula based upon 180-day certificates of deposit (CDs). Because of increased inflation, however, 180-day CDs no longer exist in Brazil. More importantly, the Government has made further important revisions in its official interest rate policy, basing official credit terms on real interest rates (3 to 12% depending on size of farmer and subsector) corrected for inflation. This is a major improvement over the previous condition, and more than satisfactory for tranche release. Section 3.04 (a) of the Loan Agreement has been amended to reflect this policy change.

7. For technical reasons, however, funds (US$75 million) originally allocated for disbursement against credit contracts under PROSTOCK, which are part of the second tranche, cannot be disbursed. In the original loan documents, PROSTOCK was designed as an agriculture credit operation, rather than as a fully-functioning bankers' acceptance market. This was considered a second-best solution for establishing such a market in Brazil, and it was envisaged that PROSTOCK would evolve into a bankers' acceptance market in time. However, in discussions over the last year with the Central Bank of Brazil regarding the design of the PROSTOCK regulations, it was agreed to remodel PROSTOCK as a bankers' acceptance market. Final PROSTOCK regulations, therefore, provide for the operation of a discount window in the Central Bank, without credit contracts. Thus, we propose that the US$75 million be converted to fast-disbursing funds, with the Government agreeing to deposit the equivalent amount in cruzados in the Central Bank to capitalize the discount facility. We propose to notify the Board of Directors of this on a "no objection" basis, with a full technical presentation of the issue, in two weeks.

8. I request you to approve the attached memorandum to the Executive Directors informing them of the second tranche release.

Attachment

cw&cc: Messrs: Wijnand (LA1AG); Weissman (LA1DR)

cc: Messrs/Mmes: Stern (SVPFI); Hopper (SVPPR) Dubey (EASDR); Shakow (SPRDR); Rao (FRS); Holsen (CECDR - 2 cc); Petit (AGR); Husain (o/r), Segura, Selowsky, Quijano, Pimenta-Neves (LACVP); Vincent (LA1DR); Nankani, Schneider (LA1CO); Coirolo, Pomerantz, Ruivivar, Staab (LA1AG); Papageorgiou, Bale (LA1TF); Wessels (LATDR); McGarry (LATAG); J. Joyce (LA4AG); Glaessner (LATTF); Collell, Manley (o/r), Abbott (LEGLA); Barahona (LOA)

PCox/mg

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: November 8, 1988

TO: Mr. Barber Conable, President

THROUGH: Mr. Moeen Qureshi, Senior Vice President, SVPOP

FROM: Armeane Choksi, Acting Regional Vice President, LAC

EXTENSION: 31811

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3. The main objectives of the Credit and Marketing Reform Loan are to support the process of making the agricultural credit system more market-oriented and of reducing rural credit subsidies, and to bring about a reform in trade and pricing policies for key agricultural commodities. To meet these objectives, the project supports important changes in Government policies affecting interest rates on official rural credit; trade and price controls; risk management and financing for holders of agricultural stocks; and market information systems. Loan funds are financing general imports (US$400 million), PROSTOCK (US$75 million), and technical assistance and equipment (US$25 million). PROSTOCK is a program operating through a discount window in the Central Bank and intended to provide initial liquidity to a new secondary market in bankers' acceptances.

Tranche Release Conditions

4. There were three sets of conditions for release of the second tranche. First, in the area of trade and price policy, the Government would agree with the Bank and take initial steps to implement a program of reform in trade and pricing policies for four major commodities (cotton,

soy products, maize and rice), including measures designed to liberalize trade, stabilize domestic prices, improve risk management, increase storage finance, simplify trade regulations and improve market information. Second, the Government would have approved regulations for PROSTOCK, a program designed to establish a bankers' acceptance market in Brazil to mobilize commercial finance for agricultural stocks held by the private sector. Third, the Government and the Bank would have agreed on a phased program of reductions in the budget allocations for subsidizing wheat production and consumption. These conditions have been fully met.

5. In June 1988 the Government of Brazil and the international banks reached agreement on a new financing package of US$5.2 billion, to be released in three tranches. Release of the first drawdown of US$4 billion, scheduled for the end of October 1988, is linked to disbursement of half of the second tranche (US$100 million of Ln. 2727), among other measures, and release of the second drawdown of US$600 million is linked to the disbursement of the remaining US$100 million. The target date for release of the second drawdown is December 1988.

6. The Loan Agreement has been amended, incorporating improvements in the Government's rural credit policy and changes in the design of PROSTOCK, based on the final regulations agreed between the Bank and the Government. Assurances were received from the Government at negotiations in May 1986 that rural credit interest rates would be maintained in accordance with the amendment to Loan 2348-BR (Agriculture Credit and Export Development Project, the first agriculture sector loan to Brazil). This amendment specified an interest rate formula based upon 180-day certificates of deposit (CDs). Because of increased inflation, however, 180-day CDs no longer exist in Brazil. More importantly, the Government has made further important revisions in its official interest rate policy, basing official credit terms on real interest rates (3 to 12% depending on size of farmer and subsector) corrected for inflation. This is a major improvement over the previous condition, and more than satisfactory for tranche release. Section 3.04 (a) of the Loan Agreement has been amended to reflect this policy change.

7. For technical reasons, however, funds (US$75 million) originally allocated for disbursement against credit contracts under PROSTOCK, which are part of the second tranche, cannot be disbursed. In the original loan documents, PROSTOCK was designed as an agriculture credit operation, rather than as a fully-functioning bankers' acceptance market. This was considered a second-best solution for establishing such a market in Brazil, and it was envisaged that PROSTOCK would evolve into a bankers' acceptance market in time. However, in discussions over the last year with the Central Bank of Brazil regarding the design of the PROSTOCK regulations, it was agreed to remodel PROSTOCK as a bankers' acceptance market. Final PROSTOCK regulations, therefore, provide for the operation of a discount window in the Central Bank, without credit contracts. Thus, we propose that the US$75 million be converted to fast-disbursing funds, with the Government agreeing to deposit the equivalent amount in cruzados in the Central Bank to capitalize the discount facility. We propose to notify the Board of Directors of this on a "no objection" basis, with a full technical presentation of the issue, in two weeks.

8. I request you to approve the attached memorandum to the Executive Directors informing them of the second tranche release.

Attachment

cw&cc: Messrs: Wijnand (LA1AG); Weissman (LA1DR)

cc: Messrs/Mmes: Stern (SVPFI); Hopper (SVPPR) Dubey (EASDR); Shakow (SPRDR); Rao (FRS); Holsen (CECDR - 2 cc); Petit (AGR); Husain (o/r), Segura, Selowsky, Quijano, Pimenta-Neves (LACVP); Vincent (LA1DR); Nankani, Schneider (LA1CO); Coirolo, Pomerantz, Ruivivar, Staab (LA1AG); Papageorgiou, Bale (LA1TF); Wessels (LATDR); McGarry (LATAG); J. Joyce (LA4AG); Glaessner (LATTF); Collell, Manley (o/r), Abbott (LEGLA); Barahona (LOA)

PCox/mg

DRAFT

From: Senior Vice President, Operations November 7, 1988

BRAZIL - Release of the Second Tranche of the Credit and Marketing Reform Loan

1. The Credit and Marketing Reform Loan (Ln. 2727-BR) of US$500 million to Brazil was approved by the Board of Executive Directors on June 26, 1986, and the release of the first tranche of US$300 million was approved in September 1986 upon loan effectiveness. The first tranche has been fully disbursed to finance general imports. In addition, US$25 million of the second tranche allocated for technical assistance and equipment to support reform programs was released in May 1988. The loan supports the Government's program to reduce rural credit subsidies and reform trade and pricing policies for key agricultural commodities.

2. The main objectives of the program are to support the process of making the agricultural credit system more market-oriented and of reducing rural credit subsidies, and to bring about a reform in trade and pricing policies for major commodities (soy products, maize, rice and cotton). To meet these objectives, the project supports important changes in Government policies affecting interest rates on official rural credit; trade and price controls; risk management and financing for holders of agricultural stocks; market information systems; and the wheat subsidy. Over the past two years, discussions with the Government have been held periodically to review progress of the program. This monitoring has assisted the Government in sharpening the reform programs in the area of pricing and marketing policy in particular, and in encouraging consultations between the Government and the private sector on the impact of the reforms.

3. This memorandum summarizes the progress achieved under the project and the Government's fulfillment of the conditions for release of the second tranche, which amounts to the remaining US$175 million of the loan.

Questions on this document may be referred to Ms. Pamela Cox, Ext. 31817

Distribution

Executive Directors and Alternates
President
Senior Vice Presidents
Senior Management Council
Vice Presidents, IFC
Directors and Department Heads, Bank and IFC

US$100 million of the funds will finance general imports, and the remaining US$75 million will be used to support PROSTOCK, a fund to provide liquidity to the newly established bankers' acceptance market.

4. In June 1988 the Government of Brazil and the international banks reached agreement on a new financing package of US$5.2 billion, to be release in three tranches. Release of the first drawdown of US$4 billion is linked to disbursement of half the second tranche of Ln. 2727-BR (US$100 million), among other measures, and release of the second drawdown of US$600 million is linked to the disbursement of the remaining US$100 million. The target date for release of the first drawdown is mid November, 1988.

5. The conditions for release of the second tranche are stated in paragraph 2 (b) (B) of Schedule 1 to the Loan Agreement. These conditions concern three sets of actions in the areas of commercial policy reform; reduction of the wheat subsidy; and establishment of PROSTOCK. In addition, the Loan Agreement requires maintenance of satisfactory interest rates on rural credit. In a letter of development policy dated Octoberer 26, 1988, the Government has restated its commitment to the goals of the sector adjustment program and has outlined both actions taken to meet the agreed conditions and its medium-term goals in these areas. Having been satisfied with the fulfillment of the conditions of tranche release and the general progress of the adjustment program, I have authorized release of the second tranche of funds.

The Economic and Agricultural Context

6. The achievements of Brazilian agriculture over the last 15 to 20 years have been impressive. Nevertheless, the sector is operating below its potential, given its excellent resource base and rapidly evolving technology. This can be ascribed largely to shortcomings in Government policy, which has provided no consistent strategy for sectoral development and indeed, which has subjected the sector to an ever-changing and often contradictory system of incentives. The key to realizing the full potential of the agricultural sector is a policy framework which would make agriculture profitable without the subsidies designed to compensate the sector for adverse domestic terms of trade. The aim of reforms under the project has been to provide such a framework in the areas of commodity markets and rural credit. The framework emphasizes a reduction in Government intervention and financing of the sector, increased reliance on markets and market development, and mobilization of private finance, especially for storage. Reduction of subsidies to the agricultural sector (including wheat subsidies), which totalled an estimated 1.2% of GDP in 1987, is a vital step in the Government's macroeconomic adjustment program, to reduce Government expenditures and help control rampant inflation.

7. Agricultural production in the first half of the 1980s stagnated, due to a combination of abrupt cessation of credit subsidies, uncertain incentives, adverse international commodity price movements, and droughts in some years. Of particular concern was the slow growth of many basic commodities (maize, cassava, potatoes, beans, meat and milk). By 1986, slow and uneven growth had led to a leveling off in agricultural exports at around US$8 billion, a decline in per capita food production, and (in part due to droughts) an increase in food imports in 1986. In 1986/87, the

combination of the Government's price control and stabilization policies (the Cruzado Plan), favorable weather, and attractive domestic and international price trends resulted in record grain harvests and an annual sectoral rate of growth of 7.9%. In 1987/88, there were again record grain harvests leading the sector to outperform all other sectors of the economy. While some subsectors of the agricultural economy boomed, however, others faced serious problems, and agricultural subsidies have continued to strain the budget and contribute to serious deficit problems. The Government, in part through the sector adjustment program, has begun to address these constraints, through improving trade and pricing problems and slashing subsidies.

A. Commercial Policy Reform

8. Trade and pricing policy reform emphasized the creation of stable "rules of the game" designed to reduce the uncertainty of erratic Government intervention in the agricultural sector. Five working groups were established in areas affecting trade liberalization and pricing: trade and price stabilization; management of price risks; financing of agricultural stocks (PROSTOCK, which is discussed below, para. 15); simplification of trade regulations; and market information systems. Each group drafted a reform program, based on discussions with the private sector. The reform programs have been discussed between the Government and the Bank, and implementation of the reforms has begun, as outlined below.

9. In the area of trade and price stabilization, the Government has established a system of market safeguards for the three major domestic food crops (maize, rice and beans). This system outlines clear rules for Government intervention in domestic markets and sales of public stocks, based on minimum, maximum and target prices, which are adjusted daily for inflation. Minimum prices for 1988/89, announced in September 1988, are consistent with these price bands.

10. The Government has also liberalized trade of key agricultural commodities. Imports and exports of maize and rice (previously tightly controlled), cotton and soy products (beans, meal and oil) are now allowed, free of quantitative or qualitative restrictions, except for a very limited amount of products entering under the drawback system or under international agreements. Imports and exports would continue to be registered for purposes of foreign exchange control, but licenses would be granted automatically. For imports, tariffs linked to the domestic price bands (for maize and rice) or to domestic prices (for soy products and cotton) would equalize the landed cost of lower-price imports with domestic prices. These trade rules are an important action in moving Brazil from quantitative restrictions on agricultural commodity trade to a tariff-based, free trade system.

11. The Government's medium-term objective in this area is to reduce Government intervention in agricultural markets, while simultaneously encouraging the development of market-based means for price stabilization. Price bands will be reviewed annually, with the objective of sharing the price risks between producers and Government, and the methodology for establishing support prices will be further strengthened. Official stocks

have been reduced, and management of public stocks will continue to be improved. The Government intends to continue to ensure that official intervention in agricultural markets is transparent, that any changes in intervention policies are announced well in advance of effectiveness, and that overall Government trade and pricing policies remain stable. Finally, the Government is now carrying out studies to extend price and market reforms to other commodities, namely sugar, coffee and wheat.

12. To encourage agricultural trade, the Government is also seeking to simplify trade regulations. Steps have been taken to reduce or eliminate unnecessary agricultural inspections; to begin cutting down on customs red tape; and to establish better information systems within the Central Bank and CACEX (the external trade department of the Bank of Brazil, which regulates all trade). CACEX has decentralized decisions on trade licenses to its field offices and introduced a system of export registration that has speeded up soy exports. This system of automatic registration is now also being applied to maize, rice and cotton exports.

13. The Government's medium-term objective is to facilitate and encourage agricultural trade, removing unnecessary restrictions and streamlining procedures. Future actions include equating domestic grading and classification standards with international ones; linking the Central Bank and CACEX information systems; reducing licensing requirements; and progressively reducing tariffs.

14. In the area of management of price risks, Brazil is seeking to develop domestic futures markets as well as encouraging use of overseas futures markets (principally Chicago for soy products). Tax regulations discriminating against domestic futures trading have been removed. Foreign exchange and interest rate futures trading have been introduced and have expanded. Together with the domestic futures markets, the Government is developing a program of training for public officials and the private sector on futures markets and price risk management. The Government's medium-term objective is to promote thriving domestic futures markets to which international traders may have free access, as well as permitting access to Brazilian traders within the constraints imposed by foreign exchange regulations. Key steps include establishing an independent regulatory agency; examining means to allow foreign access to domestic markets; and establishing measures to enforce adequate control of foreign trading by Brazilian companies.

15. To support both futures and cash trading, the Government is beginning to improve market information systems. The Brazilian Institute for Geography and Statistics (IBGE) has begun an ambitious crop forecasting program, supported by the technical assistance funds of this loan (para. 1). IBGE is also working on improvement of agricultural statistics and timely dissemination of information, and, together with the Brazilian National Storage Company (CIBRAZEM), improving information on agricultural stocks. The Government intends to continue to expand and upgrade market information, through public sector agencies as well as through encouraging private sector systems, including integration of the cash markets.

16. The conditions for second tranche release for this component are:

-- agreement on a phased program of reform in each of the five policy areas covered by the commercial policy working groups;

-- first steps satisfactory to the Bank to initiate the proposed program in each area.

These conditions have been fully met.

B. Stock Financing (PROSTOCK)

17. A crucial component of price stabilization is encouraging the private sector to hold agricultural stocks, which in turn requires access to finance for stocks on terms comparable to those available to exporters. To date, the Government has largely provided this finance through its Minimum Price Program, modeled after the Commodity Credit Corporation in the US. However, the program is costly, imposes a heavy fiscal burden on the Government, and cannot provide adequate finance for the sector. The Government is therefore introducing a new financial instrument, the bankers' acceptance, backed by collateral in the form of storage warrants for agricultural commodities.

18. To support the development of a secondary market in bankers' acceptances, US$75 million from the second tranche would be available for PROSTOCK, a program in the Central Bank to provide liquidity to the secondary market in bankers' acceptances. In the loan documents, however, PROSTOCK was originally designed as an agriculture credit operation, a second-best solution for establishing a bankers' acceptance market in Brazil, and disbursement was to be against credit contracts. In the course of discussions between the Bank and the Central Bank of Brazil on PROSTOCK regulations over the last year, it was agreed to more closely approximate a true bankers' acceptance market and to operate PROSTOCK as a discount window, without credit contracts. This will require converting PROSTOCK funds to fast-disbursing to capitalize the discount facility. We will shortly submit to the Board of Directors, on a "no objection" basis, an amendment to the loan documents to accomplish this, together with a full technical explanation.

19. Brazil already has experience in the use of storage warrants in the coffee industry, as well as in grains. To encourage the use of warrants, better warehouse regulations and supervision must be developed, which is now being done. To encourage banks and other financial institutions to lend on the basis of warrants, the key is to develop a secondary market in bankers' acceptances. The Central Bank, in consultation with the financial community in Brazil and the World Bank, has developed a set of regulations to establish a bankers' acceptance market and govern the operation of PROSTOCK. Initial liquidity for the secondary market will be provided by PROSTOCK at market interest rates.

20. The condition of second tranche release is:

-- approval by the Government of regulations for PROSTOCK.

This condition has been fully met.

C. Wheat Subsidy

21. In recent years the annual fiscal cost of wheat subsidies (to both producers and consumers) has ranged from US$500 million to US$1.5 billion. As part of its program to reduce the public deficit, the Government cut wheat subsidies sharply in June 1987: consumer wheat prices were increased by 511% (to cover the costs of the Government monopoly distribution of domestic and imported wheat) and producer prices were cut from US$240/mt to US$185/mt equivalent for the 1987 buying season (September-December). A domestic price freeze between June and September 1987, and the increasing importance of higher-cost domestic wheat production (due to recent yield increases and good weather) in total wheat supply, increased subsidies again. Since late 1987, the Government has continued to adjust wheat prices, which are now intended to cover the costs of purchases and distribution. In the medium-term, the Government is seeking to withdraw from wheat marketing and distribution, allowing wheat markets to operate as other grain markets in Brazil do. A commission has been established to recommend the steps required to achieve this end. Likely steps would include removing quotas from the wheat mills, reducing producer prices to long-run international levels, including wheat in the minimum price program, and removing the Government monopoly.

22. The specific condition for second tranche release is:

-- agreement on a plan for a progressive reduction in fiscal allocations for subsidizing the wheat program.

As indicated, this condition has been fully met.

D. Rural Credit

23. At the time of negotiations, the Bank and the Government reached an agreement on agricultural credit policy, which was a condition for release of the first tranche. The highlights of this agreement were: (a) a set of interest rates which were substantially higher than in the past, though below market interest rates; (b) adjustment of interest rates every six months; and (c) reduction in total credit subsidies and explicit financing through the fiscal budget. The interest rate schedule was based on a reference rate of 10% per annum for all lending in the Center-South with reduced rates in the North/Northeast, depending on farm size and type. The base rate was to be adjusted every six months in accordance with changes in the rate on 180-day certificates of deposit (CDs) in the commercial banking system, with the same proportional discounts for the North/Northeast.

24. In July, 1987 the Government made major and important improvements to its rural credit policy. The formula basing interest rates on 180-day CDs had been invalidated by rapid inflation after the end of the Cruzado Plan, as 180-day CDs were dropped by the banking system. The new policy linked interest rates directly to inflation through use of the OTN

(Treasury note rate) as a proxy for inflation. Interest rates were set at 3% plus OTN for small farmers in the Northeast, 7% or 9% plus OTN for medium and large scale farmers, and 12% plus OTN for commercial farmers and for marketing credit. Subsidies were further cut, from an estimated US$557 million in 1986 to an estimated US$285 million in 1987. The Government intends to phase out rural credit subsidies completely, except for small farmers, over the next three years.

25. The specific condition for second tranche release is:

-- the Government be in compliance with the agreement above on rural credit.

As indicated above, the Government is in compliance with the intention of the agreement, in that interest rates are positive and adjusted for inflation. However, the actual formula agreed for setting interest rates has been improved. The Loan Agreement has been amended to reflect this. The condition has thus been met.

F. Conclusion

26. As described above, all the conditions for the release of the second tranche have been fully met. Since June 1986, the Government has made important and difficult decisions on freeing agricultural trade, agricultural price policy, reducing wheat subsidies, and reforming agricultural credit. These have already begun to have an impact on the agricultural sector, as well as on reducing fiscal deficits. Based on this progress, the Government of Brazil has been informed that the second tranche of the loan is available for disbursement.

Brazil
C.F.

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 88/10/24 DUE DATE : 00/00/00
LOG NUMBER : 881024009 FROM : Braziliam Emb.
SUBJECT : Biographical information of: Amb. Paulo Tarso Flecha de Lima.
for your Mon. Oct. 24, 1988 meeting at 4:45 p.m.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
_____ PLEASE HANDLE
__✓__ FOR YOUR INFORMATION
_____ FOR YOUR REVIEW AND RECOMMENDATION
_____ FOR THE FILES
_____ PLEASE DISCUSS WITH _____
_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS : cc: MH, JV

AMBASSADOR PAULO TARSO FLECHA DE LIMA

BIOGRAPHICAL INFORMATION

Ambassador Paulo Tarso Flecha de Lima, Secretary General of the Ministry of External Relations, was born in Belo Horizonte, Minas Gerais, on July 8, 1933. He is married to Lúcia Martins Flecha de Lima and has five children.

He graduated in his native city, received his degree from the Law School of the University of Brazil, in Rio de Janeiro and entered the Brazilian Foreign Service in 1955. He was always promoted by merit throughout his career.

He was a member of the President Juscelino Kubitschek' staff from 1956 to 1959 and Chief of staff of the Government of the State of Guanabara, in 1960.

He served as Secretary at the Brazilian Embassy in Rome in 1961 and 1962 and as Secretary and Deputy Representative at the Permanent Delegation of Brazil to the Latin American Free Trade Association (LAFTA), in Montevideu, from 1962 to 1966. At the Brazilian General Consulate in New York, from 1969 to 1971, as Deputy General Consul, he was the head of its Trade Promotion Sector.

In the Ministry of External Relations, he directed the LAFTA Division from 1966 to 1968 and, in 1971, was appointed head of its Trade Promotion Department. As the man in charge of the promotion of Brazil's international trade, for more than thirteen years, he completely remodeled, modernized and expanded

the services that, in Itamaraty, had been giving support to this activity. In 1984 he was appointed Under-Secretary General for Economic and Trade Affairs, and in 1985 reached the post of Secretary General of External Relations. In this quality, he has been Acting Minister of External Relations on different occasions during the last three years.

His missions abroad include participation in the Presidential parties on official visits to Uruguay, Mexico, FRG, Japan, Paraguay, Argentina, Chile, France, Portugal, Colombia, USA, Nigeria, Marocco, Spain, Bolivia and China and he was the Chief Executive of the Mission headed by President Tancredo Neves after his election in 1985.

In 1986 he was appointed Extraordinary and Plenipotenciary Ambassador on Special Mission for the Negotiation of the Resumption of Diplomatic Relations with Cuba, as well as Extraordinary and Plenipotenciary Ambassador on Special Mission for Negotiations with the United States of America on Economic and Trade Matters ob Bilateral Interest.

He is the chairman of Cabo Frio Foundation, Alexandre de Gusmão Foundation, the Institute of Research on International Relations and of the Scientific Research Support Foundation, this last one in his native state of Minas Gerais.

He has been awarded numerous national and foreign decorations.

Brazil

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 88/10/21 DUE DATE : 00/00/00
LOG NUMBER : 881021012 FROM : P. Loh/Thalwitz
SUBJECT : BRIEFING: Mtg. & visit of Mr. Paulo Tarso Flecha de Lima, Sec-Gen Ministry of Foreign Affairs, Brazil - Mon., Oct. 24/88 at 4:45 pm
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

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_____ RETURN TO _____

COMMENTS :cc: Mrs. Haug, JV (follow file)

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: October 21, 1988

TO: Mr. Barber B. Conable

THROUGH: Wilfried P. Thalwitz, Acting Senior Vice President, Operations

FROM: Ping-Cheung Loh, Acting Regional Vice President, LAC

EXTENSION: 38692

SUBJECT: Visit of Mr. Paulo Tarso Flecha de Lima, Secretary General, Ministry of Foreign Affairs, Brazil

1. On Monday, October 24, 1988, at 4:45 p.m., you will receive Mr. Paulo Tarso Flecha de Lima, Secretary-General (equivalent to Vice Minister) of the Ministry of Foreign Affairs of Brazil. Mr. Flecha de Lima will be in Washington primarily for bilateral discussions with the U.S. Government but also wanted to stop at the World Bank.

2. Mr. Flecha de Lima, 55 years old, is a career diplomat who has served in several diplomatic posts abroad. In Brazil, his activities within the Ministry of Foreign Affairs have been mainly in the areas of economics and trade. He was instrumental in creating and developing the Ministry's Trade Promotion Service, which he headed for a number of years. He was then Subscretary for Commercial Affairs, a post he held until he was appointed to the post of Secretary-General in March 1985, shortly before the civilian government was returned to power in Brazil. As Secretary-General, he has the title of Ambassador.

3. Mr. Flecha de Lima was a participant in the Bank-sponsored Conference on Trade Policy Reform held in São Paulo in April 1988, at which he delivered probably the single most important policy statement of the conference. The thrust of his speech was that in the long run, Brazil would benefit most from a gradual dismantling of trade barriers and free trade. In making these remarks, Mr. Flecha de Lima appears to have undermined the traditionally protectionist stance of the Ministry of Foreign Affairs.

4. Although we have been given no definite list of topics which Mr. Flecha de Lima may want to discuss, the following are likely candidates:

5. The Status of the Bank's Proposed Adjustment Operations. We have been working on three adjustment loans for Brazil for this fiscal year, as follows:

(a) The Second Electric Power Sector Loan. Progress on this operation was temporarily delayed when, in September, the Brazilian Government decided to transfer full responsi-bility for its nuclear power program into the electric power sector. This action had ramifications for all three major areas of conditionality of this operation--the sector investment program, sector financing, and the environment. Nevertheless, the operation is now back on track, and if the macroeconomic situation is favorable, we hope to be ready to present it to the Board in early December.

(b) The Financial Sector Adjustment Loan. The Bank and the Brazilian Government have reached substantial agreement on some of the needed reforms, and the Government has already implemented a number of measures. An appraisal mission is scheduled for mid-November. If the appraisal mission is successful in reaching agreement with the Government on the rest of a package, and if the macroeconomic situation is favorable, we would present this operation to the Board before the end of the fiscal year.

(c) The Trade Policy Reform Loan. There has been little apparent progress in the last few months because of disagreement between the Bank and the Government on how strong the measures should be to reduce non-tariff barriers. A Bank mission will be arriving in Brazil to continue discussions about the same time as you receive Mr. Flecha de Lima. We have some reason to believe that the Government may now be more forthcoming than it has been; the Secretary-General's earlier statement at the São Paulo conference seems to indicate that the Government may be changing its stance. You may wish to inquire what Mr. Flecha de Lima's views are in this area. An appraisal mission is scheduled for January 1989. If we can reach agreement with the Government on an acceptable package of reforms, and if the macroeconomic situation is favorable, we would hope to present this operation to the Board in mid-1989.

6. The Uruguay Round of GATT Discussions. As you know, the position of the Brazilian Government was originally that the Uruguay Round of GATT discussions was unnecessary. The Brazilian Government continues to take the position that nothing of value is resulting from the discussions. You were present at the opening of the Uruguay Round and made a speech favoring the discussions. Although there may still be little common ground, you may wish to ask Mr. Flecha de Lima:

(a) if the Brazilian Government now sees anything coming forward in the discussions which they view as constructive or as the beginnings of a useful dialogue;

(b) what the effects of a GATT agreement on agriculture, affecting primarily the United States' and the European Community's export subsidies, may be on developing countries, in general, and Brazil, in particular; and

(c) whether the Brazilian Government sees anything constructive in the Argentine proposal on services.

7. MIGA. At the initiative of Mr. Malan, Brazil is presently reconsidering its negative position regarding MIGA. Recently, Messrs. Terasawa and Voss discussed the matter in some detail with the Brazilian Ambassador to the United States (Mr. Marques Moreira) and Mr. Malan. Mr. Flecha de Lima has been advised by Mr. Malan to address the topic during his meeting with you and has been given a copy of a memorandum from Mr. Shihata to Mr. Malan explaining how Brazil's concerns would be overcome. If Mr. Flecha de Lima does not bring up the subject, it would be helpful if you could do so. You could refer to Mr. Teresawa's recent discussion with Messrs. Marques Moreira and Malan and point out that:

(a) MIGA could guarantee certain forms of Brazilian exports to other developing countries;

(b) MIGA's activities could be confined to insuring Brazilian exports abroad so that none of the traditional concerns would apply; and

(c) if Brazil wishes MIGA to guarantee foreign investments in Brazil, Brazil could exercise its approval power under the MIGA Convention to establish conditions that would accommodate its legal and political concerns along similar lines as the agreement between Brazil and the United States on the operations of OPIC in Brazil.

Finally, you might mention that we have received numerous indications of interest in MIGA from Brazilian business representatives, and you could express your desire soon to welcome Brazil as a member country of MIGA.

8. The Environment. On October 12, in an emotional speech, President Sarney announced new measures to protect the environment, particularly the Amazon Region. Promptly dubbed the "ecological package," the Program for the Defense of the Complex of Eco-Systems of the Amazon Region includes the suspension for 90 days of any new agricultural or cattle projects in the Amazon Region and the creation of a number of interministerial committees which are to develop, within the next two to three months, a series of subprograms for protecting the environment, in general, and the Amazon forest and Amerindians, in particular. On the negative side, however, Brazil's Environmental Protection Agency, SEMA, was recently transferred from the Ministry of Housing, Urban Development, and the Environment, where it had rather important status, to the Ministry of the Interior, whose Minister appears to be giving it minimal priority. SEMA's President resigned in protest shortly after the transfer took place. You may wish to ask Mr. Flecha de Lima how he views the situation vis-à-vis the environment evolving in Brazil, and what the consequences are for the proposed National Environmental Project you originally discussed with the Government during your visit in December of 1986.

9. The Macroeconomic Situation. Although the Government has recently undertaken new efforts to bring down its fiscal deficit, inflation remains very high, well over 20% per month (over 1,000% on an annual basis). In the last few days, the Government's economic team appears to have been steadily losing ground, as the Government's economic management is attacked from all sides, most recently by the State Governors. You may wish to ask Mr. Flecha de Lima his views on how the Government plans to deal with the macroeconomic situation, particularly since the Fund program, our adjustment lending, and future disbursements from the commercial banks all depend upon some signs of improvement.

cc: Messrs. Qureshi, SVPOP (o/r), Husain, LCNVP (o/r), Choksi, LA1DR (o/r), Nankani, LA1CO (o/r)

DAKlaus/JVoss:dak

Brazil

October 14, 1988

Mr. Conable

Barber -

Prepayments

The Board discussion ended shortly after lunch, and the seminar was able to start at 3:00 p.m., as scheduled.

There was general support for (i) the proposition that the waivers of prepayment premium should not be automatic, and (ii) the establishment of some criteria for the exercise of the prepayment premium waiver. However, there was no consensus on what these criteria should be, although Mr. Malan suggested that we could proceed, as proposed, provided we applied our criteria flexibly. However, I felt that it would be inappropriate, in light of the comments, to conclude on that basis today. Consequently, I promised a supplemental note reviewing the two sets of alternative criteria proposed and said that until there was agreement on the criteria to be used, management would not be in a position to waiver any prepayment premiums not already agreed to.

Ernest Stern

Brent

FORM NO. 75
(6–83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: November 3, 1988

NAME	ROOM NO.
2) ~~Mr. Conable~~	
1) ~~Marianne Haug~~	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
X	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		**URGENT**

REMARKS:

FROM:	ROOM NO.:	EXTENSION:
David R. Bock	D 1212	72942

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DFS LA1DR LA1CO
REF : TCP JK
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* DFS *
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248423:BAC37=D0701+ WORLDBANK
ATTN THE WORLD BANK
DAVID R. BOCK, DIRECTOR
ARMEANE M. CHOKSI, DIRECTOR
GOBING T. NANKAMI, DIVISION CHIEF
BT
TO: THE INTERNATIONAL FINANCIAL COMMUNITY

DATE: NOVEMBER 2, 1988

RE: BRAZIL FINANCING PLAN

THE FOLLOWING IS THE TEXT OF A JOINT PRESS RELEASE ISSUED THIS MORNING BY MAILSON DA NOBREGA, MINISTER OF FINANCE, THE FEDERATIVE REPUBLIC OF BRAZIL AND WILLIAM RHODES, CHAIRMAN OF THE BANK ADVISORY COMMITTEE FOR BRAZIL.

QUOTE

NEW YORK, NOVEMBER 2, -- THE GOVERNMENT OF BRAZIL AND BRAZIL'S COMMERCIAL BANK CREDITORS HAVE COMPLETED THE SIGNING OF AN APPROXIMATELY USD 82 BILLION NEW MONEY AND RESTRUCTURING PACKAGE, THE LARGEST EVER, THAT WILL SUPPORT THE COUNTRY'S EXTERNAL FINANCING PROGRAM AND NORMALIZE ITS RELATIONS WITH THE INTERNATIONAL FINANCIAL COMMUNITY, MAILSON DA NOBREGA, MINISTER OF FINANCE OF BRAZIL, AND WILLIAM R. RHODES, CHAIRMAN OF THE 16 MEMBER BANK ADVISORY COMMITTEE FOR BRAZIL, ANNOUNCED TODAY.

THE COMPLETION OF THE SIGNING MONDAY, OCTOBER 31, WILL ALLOW BRAZIL TO MAKE THE FIRST DRAWDOWN, TOTALING USD 4 BILLION, UNDER THE NEW MONEY FACILITIES, WITHIN THE NEXT TWO WEEKS.

MR. RHODES SAID THAT THE NEW MONEY FACILITIES, WHICH TOTAL USD 5.2 BILLION, WERE OVERSUBSCRIBED BY APPROXIMATELY USD 90 MILLION .
BANKS' COMMITMENTS WILL BE REDUCED PRO-RATA TO REFLECT THE OVERSUBSCRIPTION. MORE THAN 300 BANKS ARE PARTICIPATING, WITH EITHER NEW MONEY OR EXIT BONDS OR BOTH.

MR. RHODES SAID THAT THE EXIT BONDS IN THE PACKAGE WERE A SUCCESS, WITH OVER 100 BANKS SUBSCRIBING TO MORE THAN USD 1 BILLION WORTH AND WITH FURTHER COMMITMENTS EXPECTED. THE SUBSCRIBERS INCLUDE SOME BANKS THAT HAVE DECLINED FOR YEARS TO PARTICIPATE IN VARIOUS NEW MONEY PACKAGES, HE SAID.

MR. RHODES SAID THAT THE SYNDICATION, WHICH BEGAN IN LATE JUNE AND ENDED MONDAY, WAS THE FASTEST OF ANY MAJOR NEW MONEY AND RESTRUCTURING PACKAGE SINCE THE DEBT CRISIS BEGAN IN AUGUST 1982.

MR. NOBREGA AND MR. RHODES AID THAT AS A RESULT OF THE COMPLETION OF THE AGREEMENT, BRAZIL WILL BE COMPLETELY CURRENT ON ALL INTEREST PAYMENTS TO COMMERCIAL BANKS FOR THE FIRST TIME SINCE FEBRUARY 1987, THEREBY FULLY NORMALIZING ITS RELATIONS WITH THE INTERNATIONAL FINANCIAL COMMUNITY.

UNQUOTE

REGARDS,

WILLIAM R. RHODES
CITIBANK, N.A.
CHAIRMAN, BANK ADVISORY COMMITTEE

MICHAEL HUNTER
LLOYDS BANK, PLC
DEPUTY CHAIRMAN, BANK ADVISORY COMMITTEE

LEIGHTON H. :9)3.-,, JR.
MORGAN GUARANTY TRUST COMPANY OF NEW YORK
DEPUTY CHAIRMAN, BANK ADVISORY COMMITTEE

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Meeting: 09/24 @ 19:00

COUNTRY: **BRAZIL**

DELEGATION: Mr. Nobrega, Minister of Finance
Mr. Abreu, Minister of Planning
Mr. Camoes, President, Central Bank

You may start by noticing that the deteriorating macro environment, particularly in terms of inflation (estimated at 800%), has weakened the adjustment program. Principal slippages have arisen from wage policy, higher interest costs of government borrowing and lags in non-electricity tariffs. You may emphasize that unless the macro situation gets under control, it would be very difficult to undertake any adjustment lending. You may then ask: What are the additional measures being considered to reduce inflation?

- What revenue enhancing measures and expenditure cuts is Government planning to halve 1988 projected deficit in 1989? (2% target 1989 agreed with IMF)

- What measures are being taken to control impact of informal debt conversions?

- Undisbursed loan amounts reach $5 billion. You may stress that adequate measures to ensure counterpart funds are essential.

- Amerindian safeguards in areas of influence of Bank projects are not being observed. Need improved Government cooperation in this area.

- Deforestation has become a major concern (20 million hectares of land have burned this year, including 8 million of primary forest). Need to deal with fiscal incentives and subsidies for land clearing.

IF DELEGATION MENTIONS: **Net transfers**.
YOU MAY INDICATE THAT: Net transfers cannot remain positive over the long-term. Assuming macro program remains on track and progress in sectoral reform, net disbursements could increase significantly.

IF DELEGATION MENTIONS: Need for **quick disbursing assistance**.

YOU MAY INDICATE THAT: Bank is working on 6 sectoral adjustment operations. Key issues to be addressed include:
- on **Financial Sector Reform**, strategy for phase out of directed credit.
- on **Trade Policy Reform**, progress on removing non-tariff barriers.
- on **Privatization**, deregulation of steel sector.
- on **Social Sector Reform**, Bank awaiting Government proposals.
- on **Public Sector Adjustment**, Bank assessing feasibility based on review of expenditure issues and tax reform mission.
- on **Agriculture Reform**, considering reform in sugar/alcohol and coffee subsectors.

IF DELEGATION MENTIONS: **Bank Lending in hydrocarbon sector (PETROBRAS)**.

YOU MAY INDICATE THAT: Bank would not be able to justify lending. Bank can only lend if sufficient effort has been made to maximize non-Bank financing. Since 1982, Brazil prohibits foreign cooperation in petroleum development.

FY88 Commitments: $ 1,359 million
Disbursements : $ 1,031 million
Amortization : $ 963 million

GDP Growth: 1.8% (1988) 6.4%/yr. (1984-87)
Lending Program (FY88-92): $ 10.3 billion

WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: September 15, 1988

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OCT 20 2023

WBG ARCHIVES

TO: Mr. Barber B. Conable

THROUGH: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 39001

SUBJECT: BRAZIL: Current Macroeconomic Situation

The Current Situation

1. Between March and June 1988, Ministers Mailson and Abreu introduced an impressive set of economic measures: (i) a two-month wage freeze; (ii) ceilings on borrowing by all federal and local government bodies; (iii) specific expenditure cuts, including renewal of the interest subsidy; and (iv) liberal pricing policies.

2. There is now increasing evidence of slippages. The principal slippages have arisen from wage policy, higher than programmed interest costs of government borrowing and lags in non-electricity tariffs. In addition, expenditure slippages are frequent in the last quarter of the year, and revenue collection is expected to decline in real terms due to accelerating inflation. Inflation for 1988 is expected to be at least 800% (compared to a target of 600%), and our estimate of operational deficit to be at least 5% of GDP (compared to a target of 4%). The only bright spot is that the trade surplus is expected to be in the $16 to $18 billion range, rather than $13 billion. This has been a mixed blessing since it has contributed to inflation. There is also increasing evidence of capital flight with the parallel market exchange rate premium having recently risen from below 30% to well over 50% above the official rate.

The 1989 Budget Proposals

3. Congress is presently reviewing the 1989 budget proposals and is expected to weaken what is already a barely adequate budget (it has a 2.75% deficit target, not 2% as required under the IMF program). Revenue measures are yet to be defined and may reduce the deficit target to 2%. It remains to be seen whether the approved budget will mark a turning point.

The IMF Staff's Position

4. Informal discussions between Bank and Fund staff confirm that Fund staff share our concerns about both the 1988 performance and the 1989 proposals. With respect to 1988, they believe it is still technically possible that all but one of the Fund program's end-September targets will be met. If this were to happen, a waiver would be likely in November. However, their assessment of the 1989 program would be the critical test, and this would occur in December. Should the 1989 program prove to be weak, the standy-by arrangement would, in principle, have to be cancelled when the December review is undertaken by Fund staff.

Prognosis

5. The prognosis is for a continuation of muddling-through policies, perhaps with a price/wage freeze later in the year. Should another price/wage freeze be implemented soon, its fate would be similar to the 1986 and 1987 freezes--it would lack credibility and would fail on account of poor underlying fiscal policies. Even if the 1989 budget is approved by Congress without any changes, it is unlikely to meet the conditions required for a successful price/wage freeze. There is also a risk that the economy might drift into a hyperinflationary state, if policy slippages are not offset by additional measures before end-1988, and into 1989.

The Brazilian Position

6. The Brazilian authorities continue to feel that the 1988 operational deficit will not exceed 4% of GDP, although they recognize that inflation will exceed 600%. They are also optimistic about Congressional approval of the 1989 budget proposals, and that new revenue measures will help to attain an overall 1989 operational deficit of 2% of GDP. Our preliminary analysis suggests that they are overly optimistic. We are, however, currently reviewing the situation with them.

GTNankani:mv

ANNUAL MEETING BRIEF

Name of Country: BRAZIL Date: September 14, 1988

Meeting with: Mr. Mailson Ferreira da Nobrega, Minister of Finance
Mr. João Batista de Abreu, Minister of Planning
Mr. Elmo de Araujo Camões, President of the Central Bank

Population: 141.5 (1987) Est. Population
GNP per capita: $2,020 (1987 est.) Growth Rate: 2.5 (1987)

		($m)
Total Commitments to 6/30/88:		14,975.8
of which:		
Bank	(176)	14,975.8
IDA	(0)	0.0
Total Undisbursed:		4,956.5

FY88:		($m)
	Commitments:	1,359.5
	Disbursements:	1,031.4
	Amortization:	963.0

Summary Data	Average 1984-87	Est. 1988
GDP growth (%)	6.4	1.0
Export growth (%)	0.4	3.6
Import growth (%)	7.9	5.8
Current Account Deficit/GDP	-.005	.006
Gross Debt Service Ratio	77.6	80.7
Annual Inflation Rate (%)	210.0	900.0
Interest/XGS	.38	.31
Interest/GDP	.041	.033

Aid Group Meeting, n.a.
Last Meeting, n.a.
IMF Status of: 8/88
Standby Arrangement in place

Background: In 1987 Brazil's current account improved significantly but failure to contain the fiscal deficit pushed inflation to almost 400%, while growth slowed to 2.9%. In early 1988, after two failed heterodox attempts at stabilization, the authorities faced the threat of hyperinflation and a growing fiscal defict, in part as a result of sharp increases in real wages granted in late 1987. In an attempt to slow inflation, expenditure reduction measures were adopted, including cuts in current and investment outlays, ceilings on state and local governments' and public enterprises' borrowing and cuts federal employees' real wages. The authorities expected to reduce the 1988 operational deficit from the projected level of 7-8% to 4% of GDP and hold inflation to 600% per annum. However, slippages have occurred: public sector wages have been increased, tariff policy is lagging and interest costs have increased. Additional fiscal measures will be needed to meet the 1988 deficit target, inflation is expected to be between 800-1,000% per annum. For 1989 a fiscal target of 2% of GDP has been agreed with the IMF. The 1989 Central Government budget, presented to Congress on August 31, does not include enough measures to meet this goal, although the 1989 revenue measures have yet to be announced. In addition, the new constitution, which is expected to become effective in early October, will add to fiscal pressures as it gives Congress a more active role in the budgetary process, establishes a ceiling on real interest rates, restricts foreign investment in some sectors and substantially reallocates tax revenues to the states. On June 22, 1988 Brazil reached an agreement with the commercial banks on a medium-term financing package that included a multiyear restructuring of principal falling due during 1987-93 and "new" money in the amount of US$5.2 billion for the 1987-89 period. The new money will be provided through a menu of options that include parallel and cofinancing facilities with the World Bank and new money bonds. On July 26 the IMF approved a standby arrangement with Brazil for 19 months equivalent to SDR 1170 million and on July 30 the Paris Club agreed to reschedule payment of nearly US$5 billion due between January 1987 and March 31, 1990.

Issues likely to be raised by the delegation:
1. Level of Bank Lending to Brazil: FY89-90
2. Bank support for Brazil's adjustment program
3. Bank lending in the hydrocarbon sector

Issues to be raised by Bank Mgmt.:
1. The Macroeconomic program
2. Project implementation
3. Environmental issues

Attachments: Five year operations program: FY88-92 (FY88: actuals)
Biographical Information

Issues Likely to be Raised by the Delegation

1. Level of Bank Lending to Brazil, FY89-90. The Government hopes that the Bank, in addition to other actions in support of the Brazilian adjustment program, will maintain a "positive cash flow" to Brazil. The Government has been informed that net transfers cannot remain positive over the long term. The Bank's ability to keep net disbursements (and net transfers) positive in FY88-89 depends essentially on Government action to (a) address outstanding project implementation issues, particularly the timely provision of counterpart funds (para. 5 below); and (b) accelerate its reform program, for which Bank support is sought (para. 2 below). In FY88, net disbursements were barely positive and net transfers negative, but in FY89-90 net disbursements could increase significantly. Assuming there is progress on adjustment measures, and that the macroeconomic program remains on track, net disbursements in FY89 would be roughly $850 million and in FY90 about $250 million. Scheduled interest payments by Brazil to the Bank are about $800 million each year. You may wish to indicate to the Brazilians that more rapid progress in sectoral adjustment reforms under discussion with the Bank could raise net disbursements in FY90 to higher levels, while failure to address the funding issues impeding project implementation would lead to significant declines in net disbursements in both years (see also para. 5).

2. Bank Support for Brazil's Adjustment Program. The Government seeks Bank support for its adjustment program in the form of quick-disbursing assistance. The Bank has initiated preparation activities for six sectoral adjustment operations. The key issues for each loan envisaged and suggested responses are as follows:

(a) Second Electric Power Sector Loan. This loan would continue Bank support for the Government's efforts to financially rehabilitate the electric power sector and the implementation of a detailed project-specific environmental action plan. Negotiations had been scheduled for early September, but were cancelled by the Bank upon learning of the recent Government decision (August 31, 1988) to transfer responsibility for construction and financing of the nuclear generation program from NUCLEBRAS to an operating subsidiary of ELETROBRAS. The Brazilian decision affected the investment programs and the corresponding financing plans; raised questions as to the technical and economic justifications of the nuclear program; and required review of its environmental impact. The Bank has outlined to the Government the financial, economic, technical, and environmental information required to assess the nuclear generation program. Once the Bank has evaluated this information, a new loan processing schedule would be defined. Board Presentation is not expected before late November or early December 1988, assuming that the macroeconomic situation is satisfactory. Any delay beyond late November could lead to a postponement of the second commercial bank drawdown to which this loan is linked.

(b) Financial Sector Reform. Discussions between the Government of Brazil and the Bank regarding a Financial Sector Adjustment Loan I are now at an advanced stage. The proposed loan would support the following reforms: substantial reduction of the subsidies associated with directed and earmarked credit; elimination of mandatory applications of demand deposits; reduction and equalization of reserve requirements; rationalization of taxation of the financial institutions and instruments; creation of a deposit insurance scheme; and strengthening of banking competition by allowing freer entry into the system. The main outstanding issue is the Government's strategy for a phase-out of directed credit, on which we expect to agree on a medium-term program in our discussions in the coming

weeks. In addition to the Financial Sector Adjustment Loan I, the Bank is carrying out studies and has undertaken discussions to restructure the state banking system in a second Financial Sector Adjustment Loan.

(c) Trade Policy Reform. The Government has requested Bank support for a trade reform program which would lead to a system in which tariffs and a flexible exchange rate are the key policy instruments. A proposed first project would: reduce the extent of quantitative allocation of foreign exchange for imports; reduce product-specific nontariff barriers; reform the tariff schedule; install an anti-dumping mechanism consistent with the GATT; and introduce greater flexibility and liberalism into the term-financing conditions for imports. The Government recently restructured tariffs, reducing dispersion and overall levels, and has presented to the Bank a medium-term strategy for trade policy reform. You may want to (a) acknowledge that recent measures are in the right direction, but (b) stress that progress towards removing non-tariff barriers with an overall program of trade reform remains a condition for adjustment operations in this area.

(d) Privatization. The Brazilians may want to discuss a loan to support efforts to divest of public enterprises. You may want to respond positively, noting that the Bank is undertaking analytical work on capital market reforms and has completed an identification mission of the possible privatization of a large steel company (USIMINAS) and accompanying deregulation in the steel sector. You may want to emphasize that while the Bank is encouraged by the Government's commitment to privatization of USIMINAS, the Bank considers reforms in the capital market and deregulation of the steel sector necessary conditions for the success of the venture. Accordingly you may wish to urge the government to establish a timetable for capital market reforms, privatization and deregulation.

3. Bank Lending in the Hydrocarbon Sector. The Government and PETROBRAS are interested in Bank assistance to overcome the shortfalls in PETROBRAS' investment budget. The apparent preference of PETROBRAS is a loan for an oil development project. You may want to indicate to the delegation that under Bank policy, the Bank is only able to undertake such operations if it is satisfied that adequate efforts have been made to maximize financing from non-Bank sources. Oil production projects, generally with high rates of return, have substantial scope for mobilizing equity and/or debt financing from commercial sources, allowing scarce Bank resources to be used elsewhere. Brazil, since 1982, effectively prohibits foreign (multinational) companies to participate in petroleum development projects, limiting access to commercial funds. For this reason the Bank would not be able to justify lending for any petroleum development project at this point.

Issues to be Raised by Bank Management

4. The Macroeconomic Program. You may wish to emphasize to the Minister that the Bank can only undertake adjustment operations within the framework of an acceptable macroeconomic program. The objective of the expenditure reduction policies adopted in the spring was to stabilize the rate of inflation, laying the ground for further structural and fiscal measures to be implemented in 1989, which would substantially reduce the rate of inflation. Recent macroeconomic developments--particularly monthly inflation and wage policy--have involved a weakening of the adjustment program, and the recently proposed 1989 budget requires further expenditure reductions or revenue increases in order to meet the agreed 2% deficit target. While the Brazilian authorities are optimistic that the IMF targets can be met, we regard further fiscal adjustment as necessary for the

success of the anti-inflation or adjustment program. Thus, our immediate interest is in the measures planned for the rest of 1988 and 1989. You may want to ask (a) whether additional expenditure reductions are being considered this year in order to meet the year-end IMF targets; (b) about additional measures which are being considered to ensure that for the public sector as a whole the 1989 deficit will not rise above 2% of GDP; and (c) if measures are being considered to deal with the continuing increases in inflation. In addition, the recent commercial bank rescheduling could contribute to inflationary pressures if appropriate sterilization measures are not taken. You may wish to ask (a) whether such measures are anticipated; and (b) the government's views on the effects of the measures taken recently to control and reduce the impact on the parallel market of informal debt conversions.

5. Project Implementation. Currently, there are over 60 Bank-financed projects in execution in Brazil, and the total undisbursed loan amount is close to $5.0 billion. The major constraint to timely project execution has been late and insufficient provision of counterpart funds. The revenue shift in favor of the states mandated by the new constitution, and the Brazilian government proposals for transfering associated functions will further worsen the situation. The Bank is fully supportive of the Government's efforts to control the fiscal deficit and the principles of decentralization embodied in the new constitution. However, the Brazilian proposals to transfer existing and future Bank operations in rural development and the social sectors (except national level programs) directly to the states, without any provision of counterpart by the federal government and with provision for debt servicing only for the rural development loans, is not workable. Most states in Brazil are not currently creditworthy and are not likely to have the resources to keep our operations going or to service the loans. If the Brazilian proposals are not modified, the the consequences for the Bank's lending strategy and program in Brazil would be very serious. Twenty six bank operations would be affected, including most of our social sector operations, Northwest rural development and almost the entire program for the Northeast, the poorest region of Brazil. $1.4 billion in follow-up operations planned for the FY89-91 period would have to be dropped from the lending program ($425 million of this in FY89); we project that gross disbursements would be reduced by about $200 million over the next 12 months; and the Government would have to return to the Bank about $115 million in Special Account funds held in the Central Bank. From a longer term perspective, the lack of state creditworthiness and resources would effectively restrict our lending to the wealthier states, excluding the poorer northeast, and we do not consider this to be a viable lending strategy for the Bank in Brazil.

6. You may wish to suggest the following to the Brazilian Delegation as the Bank position on these problems:

(i) there should be a transition program under which some federal counterpart funding would be continued; and

(ii) the Bank cannot agree to direct lending to states for all state projects, or to renegotiate existing loans to transfer them to states. In addition to the lack of creditworthiness of the poorer states, the administrative burden of negotiating and administering separate operations in each state would be too great.

7. The Bank continues to observe setbacks in the implementation of Amerindian safeguards in the area of influence of Bank projects. These are reflected in increases in mortality and morbidity, which result from a lack of basic health care and protection measures. You may wish to stress that the Bank is put in an extremely difficult position when agreed safeguards are not fully implemented, and seek the Government's cooperation in this area.

8. Environmental Issues. You may wish to complement the Brazilians on the environmental actions proposed to be undertaken under the Second Power Sector Loan. May may wish to mention that for the support of environmental protection and management, the Bank attaches special importance to the proposed National Environmental Project, which would support institutional strengthening for federal and state level environmental agencies, and the protection of critical ecosystems. The main issue of concern for the Bank is the apparent recent acceleration in deforestation. According to Government figures deforestation of primary tropical rain forests in Legal Amazonia has increased about fourfold from 1986 to 1987. The report states that a total of 20 million hectares of land have been burned, of which 8 million hectares are estimated to have been primary tropical rainforest. While these figures are preliminary, they are nevertheless alarming both in themselves and because Brazil contains roughly one-third of the world's tropical rainforests, but appears to be accounting for more than two-thirds of estimated annual destruction of this resource. Against this background, the Bank should assure the Government that it stands ready to assist with any analytical work that may be necessary to fully understand the factors behind accelerated deforestation, and that it could also support policy reforms, natural resource management and environmental protection activities. The Bank should also stress its continued concern with the effects of fiscal incentives in the Greater Carajas Region, where charcoal derived from primary rainforests is being used on an increasing scale to produce pig-iron, and where the clearing of soils of low agricultural potential is being subsidized. The Bank might add that these incentive schemes tend to reverse achievements made under the environmental and Amerindian protection components of the now concluded Bank/EEC financed Carajas Iron Ore Project.

LATIN AMERICA AND THE CARIBBEAN REGION

COUNTRY: BRAZIL
FIVE YEAR LENDING PROGRAM: FY88-92
AS OF END JULY 88

SECTOR			FY88	FY89	FY90	FY91	FY92	FY88_92
AGRICULTURE	PA147-IRR SUB-SCTR I	L	195.0	.0	.0	.0	.0	195.0
	PA148-AGR CRD	L	300.0	.0	.0	.0	.0	300.0
	PA209-MINAS GER'S FRSTRY	L	48.5	.0	.0	.0	.0	48.5
	PA229-ITAPARICA	L	132.0	.0	.0	.0	.0	132.0
	PA251-AGRO-IND IV	L	300.0	.0	.0	.0	.0	300.0
	PA157-NE IRRI JAIBA-B	L	.0	71.0	.0	.0	.0	71.0
	PA235-LND MGMT I-PARANA-C	L	.0	63.0	.0	.0	.0	63.0
	PA241-NW CONSOLIDATN-C	L	.0	150.0	.0	.0	.0	150.0
	PA237-COMMRCIAL MRKTG-C	L	.0	.0	200.0	.0	.0	200.0
	PA240-NE IRRIG IV-C	L	.0	.0	200.0	.0	.0	200.0
	PA244-SUGAR SCTR ADJ-C	L	.0	.0	300.0	.0	.0	300.0
	PA254-AG RESEARCH III-C	S	.0	.0	65.0	.0	.0	65.0
	PA259-AG SCTR IV-C	L	.0	.0	.0	400.0	.0	400.0
	PA260-LND MGMT II-SANTA CA	L	.0	.0	.0	30.0	.0	30.0
	PA262-LND TENURE IMPROV II	L	.0	.0	.0	150.0	.0	150.0
	PA206-AG CREDIT II-C	S	.0	.0	.0	300.0	.0	300.0
	PA233-ENVIRONMNTL PRJ-C	S	.0	.0	.0	150.0	.0	150.0
	PA261-SAO PAULO LND MGMT I	L	.0	.0	.0	.0	100.0	100.0
	PA236-IRRG SUBSCTR II-D	S	.0	.0	.0	.0	200.0	200.0
	*SUB-TOTAL AGRICULTURE		975.5	284.0	765.0	1030.0	300.0	3354.5
EDUC + PHN	PA225-NE ENDEMIC DIS.CTL	L	109.0	.0	.0	.0	.0	109.0
	PA190-NE BASIC HLTH II-B	L	.0	275.0	.0	.0	.0	275.0
	PA226-AMAZON BASIN MALARIA	L	.0	150.0	.0	.0	.0	150.0
	PA151-INNOV BASIC ED-C	L	.0	.0	150.0	.0	.0	150.0
	PA214-NE BASIC ED II-C	S	.0	.0	200.0	.0	.0	200.0
	PA239-NE BASIC ED III-C	S	.0	.0	.0	200.0	.0	200.0
	PA267-HLTH SCTR PROG-C	L	.0	.0	.0	.0	200.0	200.0
	PA258-METRO HLTH II-C	S	.0	.0	.0	.0	200.0	200.0
	*SUB-TOTAL EDUC + PHN		109.0	425.0	350.0	200.0	400.0	1484.0
ENERGY + POWER	PA201-S.P. NTRL GAS DIST-B	L	.0	80.0	.0	.0	.0	80.0
	PA211-ELEC PWR SCTR II-B	L	.0	500.0	.0	.0	.0	500.0
	PA191-ELEC SEC TRNS & DIST	S	.0	.0	200.0	.0	.0	200.0
	PA250-ELEC SEC DISTR-C	S	.0	.0	.0	200.0	.0	200.0
	*SUB-TOTAL ENERGY + POWER		.0	580.0	200.0	200.0	.0	980.0
INDUSTRY + IDF	PA142-FIN SCTR ADJ I-D	L	.0	300.0	.0	.0	.0	300.0
	PA216-TRADE POL REF I-D	L	.0	300.0	.0	.0	.0	300.0
	PA183-FIN SCTR ADJ II-D	L	.0	.0	300.0	.0	.0	300.0
	PA238-DEREGUL&PRIVTZATN-D	L	.0	.0	300.0	.0	.0	300.0
	PA246-TRDE PLCY REF II-D	L	.0	.0	.0	500.0	.0	500.0
	PA247-TRDE PLCY RFM III-D	L	.0	.0	.0	.0	500.0	500.0
	PA256-DEV BNKNG IV-D	L	.0	.0	.0	.0	200.0	200.0
	PA257-DEREGULATN REFRMS-D	L	.0	.0	.0	.0	500.0	500.0
	*SUB-TOTAL INDUSTRY + IDF		.0	600.0	600.0	500.0	1200.0	2900.0
INFRASTRUCTURE	PA163-PORTS T.A. II	L	20.0	.0	.0	.0	.0	20.0
	PA224-W&S LOW INC/MUNIC	L	80.0	.0	.0	.0	.0	80.0
	PA278-RIO EMERG FL'D RECON	L	175.0	.0	.0	.0	.0	175.0
	PA231-RD SECI (HWY MAN)-C	L	.0	150.0	.0	.0	.0	150.0
	PA194-W&S SECTOR II-C	S	.0	.0	200.0	.0	.0	200.0
	PA222-URBN SCTR I (MET DEV	L	.0	.0	.0	200.0	.0	200.0
	PA165-RDS SEC II (FEED RDS	S	.0	.0	.0	200.0	.0	200.0
	PA166-NE RURAL WTR&SANIT-B	S	.0	.0	.0	.0	100.0	100.0
	PA184-CERRADO TRNSPRT-D	S	.0	.0	.0	.0	100.0	100.0
	PA234-PORTS SCTR-C	S	.0	.0	.0	.0	200.0	200.0
	*SUB-TOTAL INFRASTRUCTURE		275.0	150.0	200.0	400.0	400.0	1425.0
NON-PROJECT	PA281-STATE BNK RFRMS-D	L	.0	.0	200.0	.0	.0	200.0
	*TOTAL BRAZIL		1359.5	2039.0	2315.0	2330.0	2300.0	10343.5

MMcCarthy, LACCA
08/26/88

MR. MAILSON FERREIRA DA NOBREGA

Minister of Finance

Mr. Ferreira da Nóbrega was born in a small town in the interior of the small Northeastern state of Paraíba in 1942. He went to secondary school in the capital of Paraíba, João Pessoa, and then, in 1963, entered the Bank of Brazil, in which he spent the next 14 years (over half of his career to date). The Bank of Brazil gave him short courses in industrial credit and administration and also enabled him to gain a university diploma in economics in 1974 from the Faculty of Economics, Accounting, and Administration of the Federal District (Brasilia).

Mr. Ferreira da Nóbrega began his career in the Bank of Brazil in a small rural agency in his home state. After seven years, he moved to the Regional Directorate for the Northeast in Recife, and some five years later (after gaining his diploma in economics), he became Chief of the Projects Analysis Division (in Brasilia). The following year, he became Chief of the Technical Advisory Group to the Bank of Brazil's President.

In 1977, Mr. Ferreira da Nóbrega was invited to become Chief of the Economic Advisory Group to the Minister of Industry and Commerce, a post he held two years, following which he moved to the Ministry of Finance, where he spent about six years.

In the Ministry of Finance, he was Coordinator for Economic Affairs for four years and then, in 1983, became Secretary General for two years. He was concurrently the chairman of several Ministerial and inter-Ministerial committees, notably one on informatics and one which studied the National Treasury, the Central Bank, and the Bank of Brazil with a view to redefining and clarifying their roles and functions. He also served on various committees in areas as varied as rural credit, capital markets, aeronautics, data processing, steel manufacturing, and pension funds. He also attended all the World Bank's Annual Meetings in the years 1978-82 and 1985-86 as well as several of the Annual Meetings of the Inter-American Development Bank. He was part of the Brazilian Delegation which negotiated a program with the IMF in 1983-84, led the Brazilian delegation which negotiated a program with the IMF in 1983-84, and led the Brazilian delegation which renegotiated a bilateral agreement with Japan in the context of the Paris Club. In 1985, Mr. Ferreira da Nóbrega became Executive Director of the European Brazilian Bank in London, representing the Bank of Brazil, a post he held until he became Secretary General in the Ministry of Finance in May 1987. In January 1988, after Minister Bresser's departure he became Minister of Finance.

MR. JOÃO BATISTA DE ABREU

Minister of Planning

Mr. João Batista de Abreu was born in 1943 in a small town in the State of Minas Gerais. Prior to being appointed Minister of Planning in February 1988, Mr. Batista de Abreu was Secretary of Finance for the State of Minas Gerais. As Secretary of Finance, he was part of Governor Newton Cardoso's team, who took office in March 1987 following the 1986 gubernatorial elections. As Minister of Planning, Mr. Batista de Abreu has focused on the preparation of a medium-term strategy, structural reforms and a revision of the planning and budgetary process. Mr. Batista de Abreu has been able to attract competent and motivated staff to the Ministry.

Mr. Batista de Abreu developed his career primarily as a macroeconomist in the Federal Administration. After having been a professor for several years at both the Catholic University of Rio (PUC) and the University of Economics and Administration of Rio, as well as at the Military Engineering Institute, Mr. Batista de Abreu initiated his career at the Ministry of Finance as Deputy Chief of the Economic Advisory Group to the Minister, where he stayed until 1979. From 1979 to 1985 he was Chief of the Advisory Group to the Minister of Planning, Mr. Delfim Neto.

With the New Republic, Mr. Batista Abreu moved back to the Ministry of Finance under Minister Dornelles, as Special Secretary for Economic Affairs. In this capacity, he continued the work previously begun by Mr. Mailson da Nóbrega as Secretary General, on the reformulation of the budgetary process and its control, which was at the origin of the establishment of the Secretariat for National Treasury. This process of reordering the public finances ended with the recent unification of the 1988 Budget and the clear separation of functions between the Central Bank and the Treasury.

In September 1985, under Minister Funaro, he became Secretary General in the Ministry of Finance until he took office in the Government of the State of Minas Gerais. Mr. Batista Abreu is known for his views on the reform of the financial system, the modernization of the public administration, and the need for improving the technical expertise available to the planning system.

Mr. Batista de Abreu holds a Masters Degree in Economics from the Fundação Getulio Vargas in Rio de Janeiro, and did additional course work in international economics, monetary policy and applied mathematical economics.

MR. ELMO DE ARAUJO CAMÕES

President of the Central Bank

Mr. Elmo de Araujo Camões was born in Rio de Janeiro in 1927. He was appointed President of the Central Bank of Brazil in early 1988, following a career at the Bank of Brazil, where he retired from in 1978, after more than 30 years of service. During his career at the Bank of Brazil he served on the Exchange Transactions Division at the Central Bank where he participated in the reorganization of the exchange administration. In 1972 he became Director of the Bank of the State of São Paulo (BANESPA) in New York, while at the same time serving as Director of the USA-BRAZIL Chamber of Commerce and member of the Board of the Institute for Foreign Banking in New York. In 1976 he returned to BANESPA in Brazil as Director, where he remained until 1981. Mr. Camões then became a Board member of the Bank of Sogeral, of which he was President prior to his appointment to the Central Bank. He is a member of the Board of Directors of the Bank of Brazil. In addition, Mr. Camões is President of the Brazilian Association of Commercial Banks, Director of the Federation of Brazilian Banks, and member of the National Monetary Council, representing the private sector.

Mr Camões attended several international conferences on exchange and monetary issues. Mr. Camões is a technical specialist in administration by training, with a wide range of experience in financial/banking issues.

MH

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDENCE DATE : 88/09/15 DUE DATE : 00/00/00
LOG NUMBER : 880919002 FROM : S.Husain/MAQ
SUBJECT : Memo - Brazil: Current Macroeconomic Situation

OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
_____ PLEASE HANDLE
_____ FOR YOUR INFORMATION
__✓__ FOR YOUR REVIEW ~~AND RECOMMENDATION~~
_____ FOR THE FILES
_____ PLEASE DISCUSS WITH _____
_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS :

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: September 15, 1988

CONFIDENTIAL

TO: Mr. Barber B. Conable

THROUGH: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 39001

SUBJECT: BRAZIL: Current Macroeconomic Situation

DECLASSIFIED

OCT 20 2023

WBG ARCHIVES

The Current Situation

1. Between March and June 1988, Ministers Mailson and Abreu introduced an impressive set of economic measures: (i) a two-month wage freeze; (ii) ceilings on borrowing by all federal and local government bodies; (iii) specific expenditure cuts, including renewal of the interest subsidy; and (iv) liberal pricing policies.

2. There is now increasing evidence of slippages. The principal slippages have arisen from wage policy, higher than programmed interest costs of government borrowing and lags in non-electricity tariffs. In addition, expenditure slippages are frequent in the last quarter of the year, and revenue collection is expected to decline in real terms due to accelerating inflation. Inflation for 1988 is expected to be at least 800% (compared to a target of 600%), and our estimate of operational deficit to be at least 5% of GDP (compared to a target of 4%). The only bright spot is that the trade surplus is expected to be in the $16 to $18 billion range, rather than $13 billion. This has been a mixed blessing since it has contributed to inflation. There is also increasing evidence of capital flight with the parallel market exchange rate premium having recently risen from below 30% to well over 50% above the official rate.

The 1989 Budget Proposals

3. Congress is presently reviewing the 1989 budget proposals and is expected to weaken what is already a barely adequate budget (it has a 2.75% deficit target, not 2% as required under the IMF program). Revenue measures are yet to be defined and may reduce the deficit target to 2%. It remains to be seen whether the approved budget will mark a turning point.

The IMF Staff's Position

4. Informal discussions between Bank and Fund staff confirm that Fund staff share our concerns about both the 1988 performance and the 1989 proposals. With respect to 1988, they believe it is still technically possible that all but one of the Fund program's end-September targets will be met. If this were to happen, a waiver would be likely in November. However, their assessment of the 1989 program would be the critical test, and this would occur in December. Should the 1989 program prove to be weak, the standy-by arrangement would, in principle, have to be cancelled when the December review is undertaken by Fund staff.

Prognosis

5. The prognosis is for a continuation of muddling-through policies, perhaps with a price/wage freeze later in the year. Should another price/wage freeze be implemented soon, its fate would be similar to the 1986 and 1987 freezes--it would lack credibility and would fail on account of poor underlying fiscal policies. Even if the 1989 budget is approved by Congress without any changes, it is unlikely to meet the conditions required for a successful price/wage freeze. There is also a risk that the economy might drift into a hyperinflationary state, if policy slippages are not offset by additional measures before end-1988, and into 1989.

The Brazilian Position

6. The Brazilian authorities continue to feel that the 1988 operational deficit will not exceed 4% of GDP, although they recognize that inflation will exceed 600%. They are also optimistic about Congressional approval of the 1989 budget proposals, and that new revenue measures will help to attain an overall 1989 operational deficit of 2% of GDP. Our preliminary analysis suggests that they are overly optimistic. We are, however, currently reviewing the situation with them.

GTNankani:mv

FORM NO. 75
(6–83)

THE WORLD BANK/IFC

ROUTING SLIP	DATE: 6/7/88

NAME	ROOM NO.
Chitra	

	APPROPRIATE DISPOSITION		NOTE AND RETURN
	APPROVAL		NOTE AND SEND ON
	CLEARANCE		PER OUR CONVERSATION
	COMMENT		PER YOUR REQUEST
	FOR ACTION		PREPARE REPLY
	INFORMATION		RECOMMENDATION
	INITIAL		SIGNATURE
	NOTE AND FILE		**URGENT**

REMARKS:

For your files.

FROM:	ROOM NO.:	EXTENSION:
Tessie Marfori	I-7-187	31901

Brazil

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 27, 1988

TO: Mr. Barber B. Conable

THROUGH: Mr. Attila Karaosmanoglu AK

FROM: S. Shahid Husain

EXTENSION: 69001

SUBJECT: **BRAZIL - Northwest Development Program**
Letter to You from the Minister of the Interior

1. The Minister of Interior of Brazil, Mr. João Alves Filho, requested a recent Bank mission to deliver to you the attached letter from him, transmitting a document signed by the State Governor of Rondonia, Secretary General of the Ministry of Interior, Secretary General of the Ministry of Agrarian Reform and Development, and President of the Brazilian Institute of Forestry Development. An unofficial English translation of the originals is also attached. The letter and document refer to a series of policy and regulatory reforms which the Brazilian Government is planning to make in an effort to reorient the development of environmentally fragile areas in Rondonia.

2. For your information, these proposed policy changes stem from a growing awareness on the part of the Brazilian Government of the problems and long-term consequences of environmental degradation in the Amazon basin. They are based on agro-ecological zoning techniques which make it possible to distinguish subareas with good potential for sustainable agriculture from those suitable only for selective extractive activities and those which need to be preserved without exploitation. The State of Rondonia has been the first to complete its agro-ecological zoning exercise and develop a land use planning proposal. Other States are expected to follow shortly.

3. The Federal and Rondonia State Governments are now proposing a series of reforms to the existing policy and incentives framework, as well as modifications to their respective investment programs, in order to implement the agro-ecological zoning. We are analyzing, in the Brazil Department, the extent to which these changes provide a sufficient basis for the Bank to support a follow-up Northwest Consolidation Project. Such a project would continue financing economic development activities in the Northwest region, while avoiding some of the environmental problems encountered during implementation of the first set of POLONOROESTE projects. The attached documents from the Government are quite ambitious in scope, and clearly much remains to be done to convert the stated intentions into specific, implementable actions. However, we do feel they are moving into the right direction and, given the sensitivity of the subject and the fact that this letter represents an important and constructive step in our long dialogue with Brazil over environmental issues, an encouraging reply (even though noncommittal at this stage with regard to the issue of Bank financing) would be very helpful.

4. Finally, Mr. Alves, who was your host when you and Mrs. Conable visited the Bank-financed rural development project in the Northeast State of Sergipe, of which he was then Governor, also asked that the mission transmit his personal regards.

Attachments

cc: Messrs.: Choksi (LA1DR); Weissman (LA1DR); Wijnand (o/r) (LA1AG); Nankani (LA1CO)

AVISO/GM/Nº 178

29.04.88

Senhor Presidente

Apraz-me cumprimentar Vossa Senhoria e encaminhar, para seu conhecimento, anexo documento de Atribuições de Responsabilidades referente aos compromissos assumidos por instituições brasileiras com vistas a adoção de medidas de consolidação do Zoneamento Agroecológico do Estado de Rondônia, no âmbito da área de atuação do Programa de Desenvolvimento do Noroeste do Brasil (POLONOROESTE), como base para a política de desenvolvimento regional.

Aproveito a oportunidade para apresentar a Vossa Senhoria protestos de elevada consideração e profundo apreço.

João Alves Filho
Ministro de Estado do Interior

A Sua Senhoria o Senhor
Doutor Barber Conable
M.D. Presidente do Banco Internacional de
Reconstrução e Desenvolvimento (BIRD)
Washington D.C. (USA)

PROGRAMA DE DESENVOLVIMENTO DO NOROESTE DO BRASIL – POLONOROESTE

ATRIBUIÇÕES DE RESPONSABILIDADES

ANTECEDENTES

A experiência brasileira de intervenção governamental visando promover o desenvolvimento da Região Amazônica Legal tem mostrado, em grande parte das iniciativas efetivadas, resultados aquém dos desejados.

Entre os múltiplos fatores que têm contribuído, isoladamente ou associados, para esse desempenho das medidas governamentais adotadas, é possível destacar:

a) o nível ainda bastante incipiente do conhecimento científico e técnico sobre a realidade regional, a disponibilidade concreta de recursos produtivos, o potencial desses recursos e a forma mais adequada de manejo dos amplos recursos naturais existentes para que se possa transformar o potencial em desenvolvimento efetivo;

b) a necessidade de aprimoramento da Política Nacional de Desenvolvimento Regional, que tem se traduzido na adoção de medidas de política econômica de natureza espacial parciais, que necessitam de melhor articulação entre elas – como são os casos da política de incentivos fiscais, os grandes programas de investimentos governamentais na Região e os programas específicos executados – e, na maioria das vezes, sem compatibilizarem-se com as ações globais e setoriais implantadas;

c) a multiplicidade de instituições com jurisdição na Amazônia, com atribuições deliberativas e executivas no âmbito da administração do desenvolvimento, que estabeleceu um conjunto institucional complexo, caracterizado por disfunções e superposições de funções que encarecem e dificultam a condução do processo de desenvolvimento regional de forma racional e integrada; e

ções e superposições de funções que encarecem e dificultam a condução do processo de desenvolvimento regional de forma racional e integrada; e

d) o processo de evolução da República Federativa do Brasil que vinha, contínua e progressivamente, reduzindo a autonomia das Unidades Federadas, afastando-as do processo de tomada de decisões, justamente elas que detêm os maiores conhecimentos sobre a realidade dos problemas e das soluções para o desenvolvimento de suas coletividades, o que se espera regularizar com a edição da nova Carta Magna.

Neste contexto, a análise da história da política econômica implementada na Amazônia Legal revela que, apesar de se ter ampliado efetivamente a atividade produtiva regional, alguns resultados observados não podem ser considerados satisfatórios, principalmente em decorrência dos projetos de construção da infra-estrutura executados pelo Governo, fundamentalmente dos grandes eixos rodoviários que, na ausência de articulação com outras medidas requeridas, não promoveu a integração da economia regional, apenas fazendo avançar a fronteira econômica e facilitando a penetração do capital para explorar os recursos regionais tão-somente em benefício dos objetivos de outras regiões que não a Amazônia e, até mesmo, de outros países, sem, sequer, seguir um esquema ordenado de ocupação do espaço. Assim, a integração da Amazônia Legal tem se conseguido ampliando a dependência desta em relação ao centro capitalizado do País e em detrimento da via desejada da interdependência.

A implantação dos grandes projetos, sejam os de criação da infra-estrutura ou os diretamente produtivos, atrai, para os pontos mais avançados das áreas de fronteira, grande número de pequenos produtores rurais. Estes cumprem a função pioneira do desbravamento, preparando a terra para a atividade agropecuária. Seguem-se-lhes os grandes grupos empresariais que se apropriam da terra trabalhada, não raro para utilização apenas parcial, expulsando os trabalhadores rurais para áreas mais distantes.

Outrossim, muitas vezes, enormes extensões de terras são adquiridas apenas com propósitos especulativos, seja como reserva de valor seja como guarda de riquezas para exploração futura em ocasiões mais adequadas.

A conseqüência desse processo, na Amazônia, foi a aceleração da concentração da propriedade da terra, produzindo uma estrutura fundiária distorcida, impondo uma convivência conflituosa entre grandes empresas organizadas e pequenos produtores rurais estabelecidos em minifúndios, dificultando a implementação, com sucesso, de políticas que promovam o desenvolvimento rural e de todo o espaço regional.

Outra constatação, na Região, é a aceleração do crescimento demográfico que, geralmente, se torna explosivo em áreas remotas que passam a receber fluxos de novos investimentos os quais exercem enorme poder de atração sobre grandes contingentes humanos levados pela esperança de melhoria da qualidade de vida, expandindo sobremaneira os fluxos migratórios.

Finalmente, tem sido registrada, fruto da descoordenação das ações praticadas, a exploração assistemática e predatória do espaço regional, agravando a deterioração dos recursos naturais renováveis e degradando o meio ambiente. Este fato se ainda não é alarmante, é extremamente preocupante, quanto ao futuro, em função da velocidade com que vem se processando, a menos que se mude o comportamento em relação ao modelo de ocupação.

A REORIENTAÇÃO DO POLONOROESTE

Embora nem todas as observações anteriores digam respeito aos Estados de Mato Grosso e Rondônia, este Programa, cuja implantação teve início em 1981, através da Exposição de Motivos nº 028/81 e da emissão do Decreto nº 86.029, ambos de 27.05.81, e que conta com o apoio do Banco Mundial, apresentou inúmeras dificuldades em sua execução. Dificuldades que não necessitam aqui serem detalhadas em virtude de sua ampla divulgação, uma vez que contidas em diversos relatórios de acompanhamento realizados pelo Governo brasileiro e missões do Banco Mundial.

Recentemente têm sido envidados esforços para corrigir esse quadro e a concretização do estudo do Zoneamento Agroecológico, que no Estado de Rondônia já conta com sua primeira versão na escala 1:1.000.000, constituir-se-á, sem dúvida, em grande passo para eliminar um dos maiores empecilhos ao sucesso das medidas a serem adotadas; o nível incipiente do conhecimento científico e técnico sobre a realidade local.

O Zoneamento Agroecológico, já concluído, permite identificar as áreas com potencial de uso agrícola sustentável – culturas de ciclos curto e longo – áreas que somente poderão ser utilizadas para as atividades de extrativismo vegetal, as que se prestam para o uso agropastoril, as de uso agroflorestal, as de aproveitamento madeireiro sustentado e aquelas que deverão permanecer preservadas.

Este estudo permite, ainda, conhecer técnicas de manejo da terra mais apropriadas aos ecossistemas do Estado, o que proporcionará maior rendimento por área utilizada e que, associadas com a melhor adequação entre o tipo de exploração desenvolvida e o potencial da terra, levará a uma atividade compatível com a manutenção dos equilíbrios ecológicos, e, conseqüentemente, com a interativa renovação dos potenciais de desenvolvimento.

Assim, será possível propor programa coerente, integrado e que, portanto, deverá gerar base produtiva consistente de suporte aos desenvolvimentos rural e urbano do Estado, e que deverá contribuir para a indicação de soluções mais realistas e objetivas dos problemas econômicos e sociais da Região.

É propósito dos Governos Federal e do Estado de Rondônia assegurar um processo de ocupação ordenada que obedeça ao critério principal de se utilizar o território e seus recursos naturais de modo socialmente justo e adequado para garantir o bem estar da maioria das populações atual e futura. Para tanto, entendem que é preciso impedir a devastação dos recursos naturais e proteger o meio ambiente, através da concentração e intensificação das atividades nos solos mais férteis, procurando preservar e conservar os ecossistemas florestais frágeis ou detentores de atributos únicos e a diversidade de recursos genéticos vegetais e animais, indispensáveis aos equilíbrios ecológicos essenciais à manutenção da qualidade de vida das populações em níveis desejados.

Os Governos Federal e Estadual contribuirão decisivamente para a garantia das terras indígenas já demarcadas e para a demarcação das demais, ao tempo em que reafirmam sua vontade política de defesa dos interesses indígenas, em cumprimento à Constituição Federal e Leis Complementares, como o Estatuto do Índio (Lei 6.001/73).

AÇÕES CONCRETAS

O Zoneamento Agroecológico de Rondônia é instrumento básico para o planejamento regional que permita estabelecer estratégias de desenvolvimento de forma equilibrada evoluindo para um Zoneamento Econômico-ecológico, definindo critérios para os investimentos públicos e privados norteadores das ações que propiciem harmonizar as atividades humanas à manutenção dos equilíbrios ecológicos.

Consoantes aos princípios norteados pelo Zoneamento e cientes da necessidade de adotar medidas que garantam o direcionamento dos investimentos públicos e privados de forma compatível com a sua implementação, os Governos Federal e Estadual se propõem a tomar as seguintes providências:

NO ÂMBITO ESTADUAL

1 - definição da política de ordenamento ambiental da área rural de Rondônia, mediante diploma legal a ser aprovado até a data de 31.05.88. O diploma legal aprovará o Zoneamento Agroecológico do Estado e definirá os objetivos da Política de Ordenamento Ambiental harmonizando a utilização do espaço físico com a capacidade de desenvolvimento sustentado das distintas áreas do Estado; proverá a preservação de ecossistemas frágeis e proteção às comunidades indígenas; criará os mecanismos para a consecução destes objetivos, bem como direcionará os investimentos públicos e privados coerentemente com a implementação do Zoneamento. O diploma legal conterá mecanismos para que sejam contemplados futuros detalhamentos e necessárias adaptações advindas de aprofundamento dos estudos do Zoneamento;

2 - divulgação de matérias sobre o Zoneamento Agroecológico e a política do Estado para implementação do mesmo, em canais de imprensa falada, escrita e televisada, a partir de 15.10.88 . Para possibilitar o amplo conhecimento da política de uso da terra que o Estado está implementando, será produzido, até 31.07.88, e divulgado (tanto a nível Estadual quanto fora dele, em particular em áreas de futuros migrantes para o Estado), a partir de 15.10.88, matéria sobre o Zoneamento

Agroecológico e as Políticas do Estado para implementá-lo;

3 - revisão, até 31.08.88, do Programa Global de Investimentos do Estado, a fim de compatibilizá-lo com o Plano de Zoneamento Agroecológico. A revisão incluirá a listagem e o volume de recursos dos investimentos a serem efetuados por setor e localização, detalhando, ainda mais aprofundadamente, os investimentos oficiais para viabilizar a implantação do Zoneamento;

4 - elaboração, até 31.08.88, de proposta de atuação do Governo que direcione o setor privado ao cumprimento do diploma legal do Zoneamento Agroecológico bem como da legislação de proteção ao índio e suas reservas, da utilização das terras e sua divisão, preservação da flora e utilização da energia, do transporte, da água, mineração e pesca. Esta proposta detalhará a forma de atuação do Estado com relação aos mecanismos a seu alcance, tais como: crédito, impostos, atuação frente a Superintendência do Desenvolvimento da Amazônia – SUDAM e Superintendência da Zona Franca de Manaus – SUFRAMA, outras formas de incentivos, desincentivos e fiscalização, para assegurar que o comportamento dos investimentos privados seja coerente e coadjuvante com a implementação de um Zoneamento Econômico-ecológico;

5 - ativa colaboração do Estado na implementação, pelo Ministério da Reforma e do Desenvolvimento Agrário – MIRAD, do Programa Nacional de Reforma Agrária – PNRA e gerenciamento do Patrimônio fundiário do Estado, mediante a criação, até 30.09.88, do Instituto Estadual de Terras que definirá a política fundiária do Estado e que deverá ser coerente com o Plano de Zoneamento Agroecológico; e

6 - criação, até 15.10.88, de meios que transmitam aos migrantes amplo conhecimento sobre o direcionamento das atividades do Zoneamento e orientaçaõ das atividades econômicas compatíveis com as políticas de investimentos planejadas, e das ações que o Estado tomará para assegurar a sua implementação.

NO ÂMBITO FEDERAL

Até 30.09.88, o Senhor Ministro de Estado do Interior submeterá à consideração de Sua Excelência o Senhor Presidente da República, proposta de Decreto Presidencial que institucionalizará, a nível federal, o Zoneamento Agroecológico do Estado de Rondônia, disciplinará todos os investimentos da União naquele Estado de forma a compatibilizá-los com aquele Zoneamento e definirá o esquema de articulação institucional que assegure as medidas adotadas neste instrumento legal.

Com base no Zoneamento Agroecológico de Rondônia, o Ministério do Interior – MINTER, apoiará proposta que o Governo do Estado apresentará, até 31.08.88, ao Conselho Deliberativo da Superintendência do Desenvolvimento da Amazônia – SUDAM, para estabelecer normas para administração de incentivos, de forma que não se conceda estímulos fiscais e financeiros para atividades que contrariem o Zoneamento do Estado. Até 31.07.88, o MINTER preparará levantamento e análise de todos os projetos aprovados e em tramitação para fins de incentivos fiscais na SUDAM e SUFRAMA para o Estado de Rondônia. Nesta análise, avaliará a viabilidade econômica dos distintos tipos de investimentos, visando a definir critérios de prioridades para concessão ou não daqueles incentivos.

O MINTER proporá ao Conselho Monetário Nacional – CMN, até 30.09.88, regulamentação de todas as linhas de crédito disponíveis para o Estado de Rondônia, de forma a torná-las compatíveis com o Zoneamento Agroecológico.

Até 15.09.88, o MINTER definirá as linhas de ação da Política Indigenista para o Estado de Rondônia, em particular no que se refere a trabalhos de interdição, definição, delimitação, demarcação, homologação e fiscalização de áreas indígenas, bem como dos programas de atendimento educacional, sanitário e de apoio às atividades produtivas.

Até 31.07.88, o Instituto Brasileiro de Desenvolvimento Florestal – IBDF preparará proposta de apoio ao Governo de Rondônia para a efetiva implementação do Zoneamento Agroecológico. Esta proposta conterá:

a) programa conjunto do IBDF e Polícia Federal, para a fiscalização efetiva de Reservas Florestais e Biológicas, incluindo descrição de atividades, cronograma para sua implementação e a respectiva estimativa de necessidade de treinamento e reforço da capacidade fiscalizadora;

b) plano de ação conjunta entre IBDF e Governo do Estado, que assegure a aplicação da legislação brasileira sobre florestas, garanta implementação do Zoneamento Agroecológico e defina níveis de responsabilidades;

Até 31.07.88, com base no artigo 15 da Lei nº 4.771, de 15.09.65, o IBDF proporá Decreto Governamental de Regulamentação do Artigo 44 da referida Lei, tomando como referência o Zoneamento do Estado, no sentido de permitir, nas terras destinadas à agropecuária, uma utilização mais intensiva das áreas de maior fertilidade e reservas em bloco, naquelas de menor fertilidade (Zona 1).

Até 31.08.88, em articulação com o MIRAD, o IBDF definirá através de Portaria, que o desmatamento não será considerado como evidência de desenvolvimento (benfeitorias), para os efeitos de comprovação de ocupação nos processos de titulação e acesso a benefícios governamentais.

Até 30.06.88, o IBDF e o Governo do Estado prepararão proposta de fomento e extensão florestal no sentido de assegurar aos beneficiários práticas de manejo florestal compatíveis com suas atividades.

O IBDF definirá, até 31.07.88, mecanismos apropriados que assegurem a prática de reposição de florestas.

A Secretaria Especial do Meio Ambiente – SEMA, apresentará em documento separado, que passará a fazer parte do presente trabalho, as ações que por ela serão desenvolvidas direta ou em articulação com os demais signatários. Tal procedimento se deve a compromissos de seu titular no exterior, por ocasião das reuniões que deram origem ao presente instrumento de compromisso.

Com o propósito de contribuir para a consolidação do Zoneamento Agroecológico do Estado de Rondônia, o MIRAD se propõe a desenvolver as seguintes providências:

a) até 30.06.88, o MIRAD regulamentará sua ação no Estado de Rondônia, no sentido de não implantar e/ou expandir projeto de colonização e nem expedir licenças de ocupação, título e concessão de uso que não estejam de acordo com o Zoneamento, particularmente nos projetos Machadinho e Cujubim;

b) até 31.08.88, o MIRAD, em ação conjunta com o Estado, compatibilizará o Programa Regional de Reforma Agrária – PRRA com o Zoneamento Agroecológico, definindo áreas prioritárias de atuação, tipos de atividades e a utilização do Programa de Crédito Especial para a Reforma Agrária – PROCERA, com os respectivos cronogramas de execução;

c) até 31.08.88, em articulação com o IBDF, o MIRAD reformulará a Portaria que considera desmatamento como beneficiamento de áreas para efeito de regularização fundiária e titulação;

d) até 31.08.88, o MIRAD, em conjunto com o Estado, preparará proposta de assentamento extrativista, que contemple critérios e definição de responsabilidades para sua implementação;

e) até 31.08.88, o MIRAD analizará e proporá formas possíveis de como o Imposto Territorial Rural – ITR poderia contribuir para a implementação do Zoneamento no Estado;

f) até 31.07.88, o MIRAD elaborará levantamentos estatísticos da estrutura fundiária, detalhados por Municípios; e

g) nos casos de ocupação existentes e incompatíveis com as explorações recomendadas pelo Zoneamento, o MIRAD estudará propostas do Estado, visando as ações de desapropriação por interesse social, se for o caso.

Jayme Costa Santiago
Secretário-Geral do MINTER

Jerônimo Garcia de Santana
Governador do Estado de Rondônia

Delile Guerra de Macedo
Secretário-Geral do MIRAD

Antônio José Costa de Freitas Guimarães
Presidente do IBDF

Anexos: 1. Cronograma de Execução;
2. Mapa do Zoneamento Agroecológico
3. Relatório da Missão do Banco Mundial

C R O N O G R A M A

30 ABRIL | 31 MAIO | 30 JUNHO | 31 JULHO | 31 AGOSTO | 30 SETEMBRO | 31 OUTUBRO

NO ÂMBITO ESTADUAL

1. APROVAÇÃO DO ZONEAMENTO ATRAVÉS DE DIPLOMA LEGAL ——
2. DIVULGAÇÃO DE MATÉRIA SOBRE O ZONEAMENTO DE RONDÔNIA ——
3. PRODUÇÃO DE MATÉRIA PARA DIVULGAÇÃO, SOBRE O ZONEAMENTO DE RONDÔNIA ——————
4. REVISÃO DO PROGRAMA GLOBAL DE INVESTIMENTOS DO ESTADO ——
5. ELABORAÇÃO DE PROPOSTA DE INCENTIVOS, CRÉDITO E FISCALIZAÇÃO PARA CONSOLIDAR O ZONEAMENTO ——————
6. CRIAÇÃO DO INSTITUTO ESTADUAL DE TERRAS ——————
7. MATERIAL INFORMATIVO AOS MIGRANTES SOBRE AS AÇÕES DO ESTADO COM BASE NO ZONEAMENTO

NO ÂMBITO FEDERAL

1. PROPOSTA DE DECRETO PRESIDENCIAL DE INSTITUCIONALIZAÇÃO A NÍVEL FEDERAL DO ZONEAMENTO DE RONDÔNIA ——————

	30 ABRIL	31 MAIO	30 JUNHO	31 JULHO	31 AGOSTO	30 SETEMBRO	31 OUTUBRO
2. APOIO A PROPOSTA DO ESTADO AO CONDEL/SUDAM							
3. LEVANTAMENTO PELO MINTER DE PROJETOS DE INCENTIVOS FISCAIS NA SUDAM E SUFRAMA							
4. PROPOSTA AO CMN DE COMPATIBILIZAÇÃO LINHAS DE CRÉDITO AO ZONEAMENTO							
5. DEFINIÇÃO PELO MINTER DE POLÍTICA INDIGENISTA PARA RONDÔNIA							
6. IBDF PREPARA PROPOSTA PARA IMPLEMENTAÇÃO DO ZONEAMENTO DE RONDÔNIA							
7. ELABORAÇÃO DE PLANO DE AÇÃO CONJUNTA IBDF/GOVERNO DE RONDÔNIA							
8. REGULAMENTAÇÃO DO ARTIGO 44 DA LEI 4.771, POR PROPOSTA DO IBDF							
9. IBDF/MIRAD DEFINIÇÃO PORTARIA SOBRE DESMATAMENTO							
10. IBDF/GOVERNO DE RONDÔNIA ELABORAÇÃO DE PROPOSTA DE FOMENTO E EXTENSÃO FLORESTAL							

	30 ABRIL	31 MAIO	30 JUNHO	31 JULHO	31 AGOSTO	30 SETEMBRO	31 OUTUBRO
11. DEFINIÇÃO PELO IBDF DE MECANISMO APROPRIADO PARA REPOSIÇÃO FLORESTAL							
12. MIRAD REGULAMENTA SOBRE PROJETOS DE COLONIZAÇÃO E LICENÇAS DE OCUPAÇÃO COM BASE NO ZONEAMENTO DE RONDÔNIA							
13. MIRAD/GOVERNO DE RONDÔNIA COMPATIBILIZAÇÃO DO PRRA COM O ZONEAMENTO DO ESTADO							
14. MIRAD REFORMULA PORTARIA SOBRE DESMATAMENTO							
15. MIRAD/GOVERNO DE RONDÔNIA ELABORA PROPOSTA DE ASSENTAMENTO EXTRATIVISTA							
16. MIRAD ELABORA PROPOSTA DE APLICAÇÃO DO ITR COM BASE NO ZONEAMENTO DE RONDÔNIA							
17. MIRAD ELABORA DETALHAMENTO DA ESTRUTURA FUNDIÁRIA POR MUNICÍPIO							

June 1, 1988

Dear Mr. Minister:

Thank you for your letter of April 29, 1988, along with the document on the Government's proposals for modifications to the policy and regulatory framework affecting the implementation of the Northwest Program (POLONOROESTE) in the State of Rondonia.

Your proposals represent an important step toward the solution of problems encountered during the execution of the Northwest projects. The impressive scope and the relatively short implementation schedule are indications to us of the strong political commitment of the Federal and State Governments to these changes.

Over the coming months, the staff of the Bank's Brazil Department will be reviewing the proposals in detail. They will interact with you and your staff concerning implementation of the policy and regulatory changes with a view to making a recommendation for a possible follow-up project which would support economically and environmentally sound development of the Northwest Region.

I wish you every success in your effort.

Sincerely,

(Signed) Barber B. Conable

Barber B. Conable

Exmo. Sr.
Dr. Joao Alves Filho
Ministro de Estado do Interior
Esplanada dos Ministerios
CEP. 70.048 - Brasilia- DF
Brazil

cc: Messrs.: Malan (EDS), Qureshi (SVPOP), Husain (LACVP), Choksi (LA1DR)

LCoirolo:tgm

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDANCE DATE : 88/05/13 DUE DATE : 00/00/00
LOG NUMBER : 880516009 FROM : S. Husain
SUBJECT : BRAZIL: Visit of Minister of Education scheduled for Wednesday, June 15 at 2:30 pm.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
_____ PLEASE HANDLE
_____ FOR YOUR INFORMATION
_____ FOR YOUR REVIEW AND RECOMMENDATION
_____ FOR THE FILES
_____ PLEASE DISCUSS WITH _____
_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS :M. Haug, J. Volk (FF)

A detailed briefing will be prepared shortly.

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 13, 1988

TO: Mr. Barber Conable

THROUGH: Mr. Moeen Qureshi

FROM: Shahid Husain

EXTENSION: 69001

SUBJECT: BRAZIL: Visit of Minister of Education

This is to confirm that, at the request of the Brazilian Government, we have made arrangements for the Minister of Education (Mr. Hugo Napoleão) to meet with you on Wednesday, June 15, 1988, at 2:30 p.m. We consider this meeting important as a means of stressing the Bank's commitment to human resource development in Brazil, the inadequacy of which constitutes a major impediment to long term economic development in Brazil. Specifically we are preparing two projects in the Northeast which will require significant changes in the management and organization of the education system; we are also preparing a social sector adjustment loan. Discussion of these and other items would constitute the agenda of your meeting.

A detailed briefing paper will be prepared shortly.

cc: Mr. Choksi, LA1DR

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDANCE DATE : 88/06/09 DUE DATE : 00/00/00
LOG NUMBER : 880610004 FROM : Shahid Husain
SUBJECT : BRAZIL: Brief for mtg. with Hugo Napoleao, Minister of Education on Tuesday, June 21 at 5:00 pm.
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

ACTION:

_____ APPROVED
_____ PLEASE HANDLE
_____ FOR YOUR INFORMATION
_____ FOR YOUR REVIEW AND RECOMMENDATION
_____ FOR THE FILES
_____ PLEASE DISCUSS WITH _____
_____ PLEASE PREPARE RESPONSE FOR _____ SIGNATURE
_____ AS WE DISCUSSED
_____ RETURN TO _____

COMMENTS :cc: M. Haug, J. Volk (FF)

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: June 9, 1988

TO: Mr. Barber B. Conable

FROM: Mr. S. Shahid Husain, Acting Sr. Vice President, Operations

EXTENSION: 69001

SUBJECT: BRAZIL: Visit of Hugo Napoleão, Minister of Education

1. On Tuesday, June 21, 1988, at 5:00 p.m., you will receive Mr. Hugo Napoleão, Minister of Education of Brazil. Mr. Napoleão is a sitting Senator from the poor northeastern state of Piaui and has been Minister since November, 1987. Biographical data are summarized in Annex 1. Mr. Napoleão will be accompanied by Mr. João S. Fontenelle Filho, head of the Minister's Cabinet, Mr. Jose Raimundo Carvalho, Secretary for Basic Education, and Mr. Jose Camilo S. Filho, Secretary for Higher Education. The Minister will spent most of June 21 and part of June 23 meeting with Bank managers and staff involved in Brazilian education and will also attend a luncheon hosted by Mr. Choksi (as acting Vice-President) and Mr. Malan, Executive Director for Brazil (see annex 2 for proposed schedule). On June 22, 1988 he will also meet with key figures in the Interamerican Development Bank and the Organization of American States. As we previously informed you, this meeting is important as a means of stressing the Bank's commitment to human resource development in Brazil, the inadequacy and inequity of which are critical constraints to economic growth and poverty alleviation in Brazil. The meeting will also serve to highlight some of the difficult policy issues which must be dealt with to make education more effective and more fairly distributed.

2. Background. Despite its middle income status, levels of human resources development in Brazil are strikingly low. Only 36% of Brazilian children complete the eight year primary school system, a figure which is lower than anywhere in Latin America except El Salvador and Nicaragua. Only 21 percent of Brazilian children attend secondary school, compared to 35 percent in Mexico, 49 percent in Colombia and 91 percent in Korea. The situation is worst in the Northeast, where teacher qualifications are very low, management capacity weak, and traditions of political patronage greatest. In one Northeastern state about 40 percent of all teachers on the payroll cannot be located and apparently receive salaries without providing any service to the state. However, even in advanced states such as Sao Paulo repetition and dropout rates are unacceptably high. Throughout Brazil one third of all school children repeat the first grade of primary school.

3. In addition to being ineffective, the education system perpetuates the poor distribution of income and the current stratification of Brazilian society between the privileged and the poor. The poor have little access to quality secondary education, most of which is private. The middle class and the rich capture much of the benefit of government expenditures for higher education, since the bulk of funds go to support an elite system of free public higher education, accessible almost exclusively to children whose families can pay for private secondary education. In addition, in most states, primary education is characterized by the existence of a dual system consisting of relatively better off state-run schools, located in urban areas, and sub-standard municipal-run schools mostly located in rural areas.

4. The Bank's Education Program in Brazil. The Bank has recently completed a rural basic education project for Northeast Brazil and is currently supervising an urban basic education project in the North and Center-West regions. These two projects have provided the basis for a sound understanding of basic education and have contributed to meeting the physical and teacher requirements in these two poor regions of the country. Other ongoing projects include two in technical/vocational education and one in support of scientific and technological research (this last executed under the Ministry of Science and Technology). Projects now being prepared are designed to address fundamental political and institutional problems of basic education in the Northeast (FY90, FY91) and to assist in implementing new pedagogical approaches for poor urban populations in the Southeast (FY90), including utilizing non-governmental organizations (NGOs) to provide low-cost pre-school education to poor children. Our overall program in education is expected to be US$750 million over the next five years compared to about US$230 million since 1980 (see annex 3). The work program includes a substantial investment in sector work, which we are currently in the process of building up in order to provide a sound basis for the expanding program of lending. We plan comprehensive reports on secondary education (FY89) and higher education (FY90).

5. Adjustment lending in education is also possible. A recently completed gray cover report, "Brazil: Public Spending on Social Programs, Issues and Options," reviews the education sector as well as health, nutrition, and social security. On the basis of this report, we have initiated discussions with the Government on the possibility of a social sector adjustment loan covering these areas. We expect to discuss the report and the proposed sector adjustment loan in greater detail with the Minister and his team during their visit. The broad objective is to to advance the goal of redirecting public expenditures on education to the poor. Possible reforms include depoliticizing federal transfers to states and municipalities, encouraging private sector initiatives in education, municipalizing primary education, and taking steps to improve higher education efficiency.

6. In the past year we have found a surprising receptivity among Brazilian opinion-makers, including this Minister as well as state-level politicians, to considering fundamental reform in the education sector.

This is a result of the democratic government which took office in 1985 with a mandate to meet its "social debt", as well as a growing awareness that, in the education and health sectors, Government needs to serve the public with cost-effective programs rather than to continue the long-standing tradition of clientelism and political patronage.

7. The Minister's Priorities. First, as a Northeasterner, a sitting senator, and one of three representatives in the Government of the principal opposition party, Mr. Napoleão can be expected to request that preparation of the two Bank loans for the Northeast (totaling US$400 million) be speeded up and the amounts increased. He will be anxious to show progress since his term as Minister will end in 1990 when new elections will be held. The Minister may react to the most recent preparation mission which proposed that (a) the federal government should end its direct assistance to municipalities and provide block grants to states based on a combination of needs and performance, and (b) states should gradually end their direct provision of primary education, devolving responsibility to the municipalities, and should instead become responsible for norms and standards and for technical and financial assistance to the neediest municipalities. The Minister may not fully support these proposals since they reduce the political leverage of the Ministry vis-a-vis the municipalities.

8. Second, we understand the Minister may request assistance for analysis of higher education problems leading to possible future lending at that level. He may indicate that he is in agreement with recently stated Bank positions on cost recovery in higher education and on encouragement of private sector initiatives in higher education. It should be noted that the Minister has publicly stated his opposition to two politically popular education traditions in Brazil, free federal universities (he has said, "who is able to pay, should pay"), and government regulation of private school tuitions. His proposal to deregulate private school tuitions has been withdrawn after popular protest.

9. Suggestions for Your Response. First, regarding the proposed Northeast projects, you should emphasize that the infusion of funds (US$400 million or more) into the Northeast will not go very far towards solving the region's problems. The key is to replace the prevailing ethos of patronage with one of cost-effectiveness and investment in human development. This will require difficult political steps, including possibly ending direct federal support of municipal programs. Processing of the proposed projects will depend on the extent to which the Federal Government and the states can take these steps in a timely manner.

10. Second, you may wish to congratulate the Minister for his statements on cost-recovery and for encouraging the private sector. In this context, you may wish to support any proposal he may have for studying higher education issues with an objective of reducing inequity and improving management and cost-effectiveness. Finally, you should point out the urgent problems of general secondary education and the need to encourage private initiatives in the provision of pre-primary education, and indicate our willingness to support initiatives in these two areas.

11. You may wish to conclude by stating that Brazil urgently needs to improve cost-effectiveness and management of education, as well as to increase overall expenditures in the sector, if Brazil is to have the human capital necessary to compete with countries such as Korea and to assure its position as a major industrial economy in the next century. The greatest needs are in basic primary and secondary education. The Minister should be reminded that his example is important and that difficult decisions need to be taken now at all levels of government. The Bank is ready and willing to support efforts in the sector which will result in fundamental changes.

cc. Merssrs. Qureshi (o/r), Choksi, Wolff

Enc.

Annex 1

Visit of Senator Hugo Napoleão
Minister of Education, Brazil
June 21-23, 1988

Senator Hugo Napoleão was born 31 October 1943 in Portland, Oregon in the United States, where his father served as a diplomat, at the time a Brazilian Vice-Consul. He was educated primarily in Rio de Janeiro and graduated in 1967 with a law degree from the Pontifical Catholic University of Rio de Janeiro where he also later taught in the faculty of the Institute for Management and Administration. He is married and has two children.

Senator Napoleão entered elected public life at the age of 32 when in 1975 he was elected from his (parents') home state of Piaui to the federal congress. During this time he served as member and later vice-president of the foreign relations committee. In 1983 he was elected governor of Piaui where he served until 1986. He was a founder of the Liberal Front (PFL) in the state of Piaui and is president of the Regional Executive Committee of the PFL for the state. In 1987 he was elected Senator from Piaui and later that same year appointed Minister of Education, taking office in November.

Senator Napoleão's appointment as Minister of Education followed a career of 20 years in public service, including a wide range of elected offices (twice governor and congressman) from the northeastern state of Piaui. His term as senator began in 1985 and expires in 1995. The senator is the founder of the Liberal Front Party (PFL) in the state of Piaui, now the opposition party in every state save one (Sergipe) in the country. The position of Minister of Education has been held only by members of the PFL party since President Sarney's assumption of the presidency in 1985. Senator Napoleão has taken positions in two national controversies (cost recovery in higher education and eliminating pricing controls of private education) on which he has not prevailed. In many respects his administration has been traditional in that he has assembled a team of secretaries almost exclusively from his home state of Piaui and thus contributed to the now expected climate of continuous turnover of top educational administrators. As a PFL minister in a country presently dominated by PMDB governors, Senator Napoleão has used resources available to him to fund educational projects at the municipal level, in the process passing over the state educational apparatus.

Annex 2

Visit of Senator Hugo Napoleão
Minister of Education, Brazil
June 21-23, 1988

AGENDA

June 21, 1988

9:30 a.m. Meeting with Mr. Malan, Executive Director for Brazil

10:30 a.m. Meeting with Mr. Choksi

11:00 a.m. Operational meeting with Brazil Department Staff

1:00 p.m Luncheon hosted by Messrs. Malan and Choksi

3:00 p.m. Continuation of operational meetings

5:00 p.m. Meeting with Mr. Conable

June 22, 1988

Meetings with officials of the Interamerican Development Bank and the Organization of American States.

June 23, 1988

10:00 a.m. Continuation of operational meetings with Brazil Department

12:00 p.m. Round-up with Mr. Choksi

List of Bank-Financed Projects in Education since 1980

Signing Date	Name of the Project	Amount US$M
1980-88		
July 1980	Northeast Basic Education	32.0
December 1983	Technician Training	20.0
July 1984	Urban Basic Education in the North & Centerwest	40.0
February 1985	Science and Technology	72.0
July 1987	Skills Formation	74.5
1989-1993 (proposed)		
July 1989	Northeast Basic Education II	200.0
August 1989	Innovations in Basic Education	150.0
July 1990	Northeast Basic Education III	200.0
December 1991	Urban Education	200.0
Reserve Projects		
December 1990	Social Sector Adjustment	400.0
December 1990	Science and Technology II	200.0

June 1, 1988

Dear Mr. Minister:

Thank you for your letter of April 29, 1988, along with the document on the Government's proposals for modifications to the policy and regulatory framework affecting the implementation of the Northwest Program (POLONOROESTE) in the State of Rondonia.

Your proposals represent an important step toward the solution of problems encountered during the execution of the Northwest projects. The impressive scope and the relatively short implementation schedule are indications to us of the strong political commitment of the Federal and State Governments to these changes.

Over the coming months, the staff of the Bank's Brazil Department will be reviewing the proposals in detail. They will interact with you and your staff concerning implementation of the policy and regulatory changes with a view to making a recommendation for a possible follow-up project which would support economically and environmentally sound development of the Northwest Region.

I wish you every success in your effort.

Sincerely,

(Signed) Barber B. Conable

Barber B. Conable

Exmo. Sr.
Dr. Joao Alves Filho
Ministro de Estado do Interior
Esplanada dos Ministerios
CEP. 70.048 - Brasilia- DF
Brazil

cc: Messrs.: Malan (EDS), Qureshi (SVPOP), Husain (LACVP), Choksi (LA1DR)

LCoirolo:tgm

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 27, 1988

TO: Mr. Barber B. Conable

THROUGH: Mr. Attila Karaosmanoglu

FROM: S. Shahid Husain

EXTENSION: 69001

SUBJECT: **BRAZIL - Northwest Development Program**
Letter to You from the Minister of the Interior

1. The Minister of Interior of Brazil, Mr. João Alves Filho, requested a recent Bank mission to deliver to you the attached letter from him, transmitting a document signed by the State Governor of Rondonia, Secretary General of the Ministry of Interior, Secretary General of the Ministry of Agrarian Reform and Development, and President of the Brazilian Institute of Forestry Development. An unofficial English translation of the originals is also attached. The letter and document refer to a series of policy and regulatory reforms which the Brazilian Government is planning to make in an effort to reorient the development of environmentally fragile areas in Rondonia.

2. For your information, these proposed policy changes stem from a growing awareness on the part of the Brazilian Government of the problems and long-term consequences of environmental degradation in the Amazon basin. They are based on agro-ecological zoning techniques which make it possible to distinguish subareas with good potential for sustainable agriculture from those suitable only for selective extractive activities and those which need to be preserved without exploitation. The State of Rondonia has been the first to complete its agro-ecological zoning exercise and develop a land use planning proposal. Other States are expected to follow shortly.

3. The Federal and Rondonia State Governments are now proposing a series of reforms to the existing policy and incentives framework, as well as modifications to their respective investment programs, in order to implement the agro-ecological zoning. We are analyzing, in the Brazil Department, the extent to which these changes provide a sufficient basis for the Bank to support a follow-up Northwest Consolidation Project. Such a project would continue financing economic development activities in the Northwest region, while avoiding some of the environmental problems encountered during implementation of the first set of POLONOROESTE projects. The attached documents from the Government are quite ambitious in scope, and clearly much remains to be done to convert the stated intentions into specific, implementable actions. However, we do feel they are moving into the right direction and, given the sensitivity of the subject and the fact that this letter represents an important and constructive step in our long dialogue with Brazil over environmental issues, an encouraging reply (even though noncommittal at this stage with regard to the issue of Bank financing) would be very helpful.

4. Finally, Mr. Alves, who was your host when you and Mrs. Conable visited the Bank-financed rural development project in the Northeast State of Sergipe, of which he was then Governor, also asked that the mission transmit his personal regards.

Attachments

cc: Messrs.: Choksi (LA1DR); Weissman (LA1DR); Wijnand (o/r) (LA1AG); Nankani (LA1CO)

(UNOFFICIAL TRANSLATION)

April 29, 1988

Letter No. 178

Dr. Barber Conable
President of the International Bank
for Reconstruction and Development (IBRD)
Washington, D.C. (USA)

Dear Mr. President,

It is my pleasure to attach for your information a document which establishes the Responsibilities and Commitments assumed by Brazilian institutions with regard to the adoption of measures to consolidate the Agro-ecological Zoning of the State of Rondonia, as a basis for regional development policy, within the area of influence of the Northwest Development Program (POLONOROESTE).

I take this opportunity to extend to you my sincere and warm regards.

João Alves Filho
Minister of State for the Interior

(UNOFFICIAL TRANSLATION)

BRAZIL NORTHWEST DEVELOPMENT PROGRAM - POLONOROESTE

ASSIGNMENT OF RESPONSIBILITIES

BACKGROUND

The Brazilian experience with government intervention to promote the development of the Amazon Region (Amazonia Legal) has produced, in the case of most of the initiatives to date, results which have fallen short of those desired.

Among the multiple factors that have contributed, in isolation or combined, to this performance record, it is possible to highlight the following:

a) the still insufficient level of scientific and technical knowledge with respect to the region, the availability of specific productive resources, the potential of these resources and the best form for their management in order to transform their potential into effective development;

b) the need to improve the National Policy for Regional Development, which has resulted in the adoption of a series of economic policy measures of a spatial and partial nature, that require improved articulation--as in the case of the fiscal incentive policies, the large-scale Government investments and the more specific investment programs executed in the Region--in the majority of cases, without having ensured compatibility between global and sectoral actions;

c) the multiplicity of institutions having jurisdiction in the Amazon, with both advisory and executive responsibilities for development administration, which has created a complex institutional set-up characterized by dysfunctions and overlapping functions, which make the process of rational and integrated regional development more difficult and costly; and

d) the process of evolution of the Federative Republic of Brazil which has continuously and progressively reduced the autonomy of the Federal Units (the States), thereby distancing from the decision-making process precisely those units which have the greatest knowledge about the problems and possible solutions for their constituencies--a problem which, it is hoped, will be resolved under the next Constitution.

In this context, historical analysis of the economic policies implemented in the Amazon reveals that, although regional productive activity may have increased, some of the observed results cannot be considered satisfactory. In particular, in the absence of necessary complementary measures, the large Government infrastructure projects, especially the major road networks, have not promoted the desired integration of the regional economy and orderly occupation of the area, but have instead served only to advance the economic frontier and facilitate the penetration of capital to exploit regional resources, often on behalf of other regions and at times even other countries. Thus, the integration of the Amazon with the rest of the country has been obtained in a manner which has increased its dependency on the centers of capital, to the detriment of the desired path towards interdependence

Implementation of the large projects, both those designed to create infrastructure and the directly productive operations, has attracted large numbers of small producers to the furthest points of the frontier. They accomplish the pioneer function of taming and preparing the land for agricultural activities. They are followed by large business interests which appropriate the prepared land, frequently for partial use only, expelling the rural workers to more distant areas.

Similarly, many times enormous extensions of land are qcquired for speculative purposes only, whether as a form of savings or to safeguard the natural wealth for exploitation at a more appropriate time in the future.

The consequence of this process in the Amazon has been to accelerate the concentration of property, producing a distorted land tenure structure and imposing an environment of conflict between large organized enterprises and small rural producers, making it difficult to successfully implement policies designed to promote rural development throughout the region.

It can also be observed that the acceleration of demographic growth in the region has generally been an explosive factor in those remote areas receiving new investments which have, in turn, exercised an enormous power of attaction on people drawn by the hope of a better quality of life, and thereby expanded migratory flows.

Finally, it has been noted that the lack of coordination among actions has led to unsystematic and predatory exploitation of the region, aggravating the deterioration of renewable natural resources and degrading the environment. This fact, if not yet alarming, is at least extremely worrisome as far as the future is concerned, given the velocity with which the processes are occurring, unless the model of occupation is changed.

REORIENTATION OF POLONOROESTE

Although not all of the aforementioned observations refer to the States of Mato Grosso and Rondonia, the POLONOROESTE Program, initiated in 1981 by means of the Exposition of Motives No. 028/81 and Decree No. 86.029 of May 27, 1981, with assistance from the World Bank, has presented innumerable difficulties in execution. These difficulties do not need to be detailed here, since they are amply discussed in various supervision reports by the Brazilian Government and the World Bank.

Recently efforts have been intensified to correct this situation, and the conclusion of the Agroecological Zoning study, with a first version now available for Rondonia at a scale of 1:1.000.000, constitutes without doubt a great step forward in eliminating one of the major obstacles to success of the measures taken: the incipient level of scientific and technical knowledge of local conditions.

The Agroecological Zoning, which is already completed, makes it possible to identify areas with potential for sustainable agriculture--annual and perennial crops--areas which can be used only for extractive activities, those appropriate for grazing, those for agro-forestry, those for sustainable forest exploitation, and those which should be permanently preserved.

This study also identifies those soil management techniques which are most appropriate to the State's eco-systems and which provide the highest returns per area utilized, as well as those activities which are compatible with the maintenance of ecological equilibria and, consequently, with the interactive renovation of the development potential.

Thus, it will be possible to propose a coherent and integrated program which should, therefore, generate a productive base of support for the rural and urban development of the State, and which should contribute to identifying more realistic and objective solutions to the economic and social problems of the Region.

It is the intention of the Federal and Rondonia State Governments to ensure a process of orderly settlement, which obeys the principal criterion of utilizing the territory and its natural resources in a manner which is both socially just and adequate to guarantee the well being of the majority of the current and future populations. To this end it is essential to stop the destruction of the natural resources and to protect the environment, through a strategy of concentrating and intensifying activities in the more fertile soils, endeavoring to protect and conserve those forest eco-systems which are either fragile or which possess unique attributes and a diversity of animal and vegetative genetic resources essential for ecological equilibrium and the maintenance of the quality of life at desired levels.

The Federal and State Governments will contribute decisiely to guaranteeing the indigenous lands which have already been demarcated, and to demarcation of the remaining lands, at the same time that they reaffirm their political desire to defend the interests of the indigenous populations, in compliance with the Federal Constitution and complementary laws, such as the Indian Statute (Law No. 6.001/73).

CONCRETE ACTIONS

The Agroecological Zoning of Rondonia is a basic instrument for regional planning, which permits the establishment of balanced development strategies, in the direction of an Economic-ecological Zoning, defining criteria for public and private investment which lead towards harmonization of human activities with the maintenance of ecological equilibrium.

Consistent with the guiding principles of the Zoning, and conscious of the necessity of adopting measures which will guarantee that public and private investments are compatible with implementation of the Zoning, the Federal and State Governments propose to undertake the following:

WITHIN THE STATE'S SPHERE OF ACTION

1. Definition of the environmental policy for rural Rondonia, by means of a legal instrument (Diploma Legal) to be approved by May 31, 1988. This legal instrument will adopt the Agroecological Zoning of the State and will define the objectives of the Environmental Policy, harmonizing the use of the physical space with the capacity for sustained development of different areas of the State. It will promote the preservation of fragile eco-systems and the protection of indigenous communities; it will create the mechanisms to achieve these objectives, as well as guide public and private investments in a manner which is coherent with the implementation of the Zoning. The legal instrument will include provisions for future detailing and necessary adaptation, as a result of more intensive Zoning studies.

2. To facilitate widespread knowledge of the Agroecological Zoning and the State's policy for implementing it, materials will be developed by July 31, 1988 and disseminated beginning October 15, 1988, by means of the spoken, written and televised press (both within and outside of the State, in particular in those areas from which future migrants are likely to originate).

3. The State's Global Investment Program will be reviewed and revised by August 31, 1988, with a view to making it compatible with the Agroecological Zoning. Investments will be listed and the volume of resources indicated, by sector and location, in relatively greater detail for those official investments designed to facilitate implementation of the Zoning.

4. By August 31, 1988, the State Government will prepare a plan to ensure private sector compliance with the new legal instrument, as well as legislation for the protection of Indian reserves, land use and allocation, preservation of flora and utilization of energy, transport, water, mining and fisheries resources. This proposal will detail the available instruments which the State intends to use, such as: credit, taxation, positions vis-a-vis the Superintendency of the Amazon (SUDAM) and the Superintendency of the Free Zone of Manaus (SUFRAMA), as well as other forms of incentives, disincentives and supervision to ensure that private investments are coherent and supportive of the Economic-ecological Zoning.

5. The State will cooperate actively with the Ministry of Agrarian Reform and Development (MIRAD) in the implementation of the National Program of Agrarian Reform (PNRA). The State's land patrimony will be managed by a a State Land Institute, that will be created by September 30, 1988, and that will define the State's land policy in a manner which is consistent with the Agroecological Zoning.

6. By October 15, 1988, the means will be developed to transmit to migrants to Rondonia broad information concerning the Agroecological Zoning and the kinds of economic activity which are compatible with approved investment policies and plans, as well as the actions which the State will be taking to implement the Zoning.

WITHIN THE FEDERAL SPHERE OF ACTION

By September 30, 1988, the Minister of State for the Interior will submit to the President of the Republic a draft Presidential Decree which would institutionalize the Agroecological Zoning of Rondonia at the Federal level, would discipline Federal investments in the State in such a manner as to make them compatible with the Zoning, and would define a scheme for institutional articulation to guarantee the measures adopted in the Decree.

Based on the Agroecological Zoning of Rondonia, the Ministry of the Interior (MINTER) will support a proposal which the State will present to the Board of Directors of Superintendency for the Development of the Amazon (SUDAM) before August 31, 1988, to establish norms for the administration of incentives, so as not to provide fiscal or financial stimuli for activities which contradict the Zoning of the State. By July 31, 1988, MINTER will prepare a survey and analysis of all projects in Rondonia which have been approved or are under consideration for financing by either the SUDAM or SUFRAMA fiscal incentives This analysis will include an evaluation of the economic feasibility of the various investments, with a view to defining criteria/priorities to award or not such incentives.

By September 30, 1988, MINTER will propose to the National Monetary Council (CMN) regulations which will make all credit lines available in the State of Rondonia compatible with the Agroecological Zoning.

By September 15, 1988, MINTER will outline an Indigenous Policy for the State of Rondonia, with particular regard to activities of interdiction, definition, delimitation, demarcation, homologation and supervision of indigenous areas, as well as programs designed to meet educational and sanitary needs and to support productive activities.

By July 31, 1988 the Brazilian Institute for Forestry Development (IBDF) will prepare a proposal for assistance to the State Government of Rondonia in implementation of the Agroecological Zoning. This proposal will contain:

(a) a joint program for IBDF and the Federal Police to effectively manage the State forest and biological reserves, including a description of activities, timetable for implementation, and corresponding estimate of the needs for training and reinforcement of the capability to supervise and patrol the Reserves; and

(b) a joint action plan for IBDF and the State Government to ensure compliance with Brazilian forestry legislation, guarantee implementation of the Agroecological Zoning, and define respective responsibilities.

By July 31, 1988, based on Article 15 of Law No. 4.771 of September 15, 1965, IBDF will propose a Governmental Decree to regulate Article 44 of the same Law, so as to permit in those areas destined for agriculture (Areas 1 of the

Agroecological Zoning) a more intensive utilization of subareas of greater fertility and the creation of block reserves in less fertile subareas.

By August 31, 1988, in articulation with MIRAD, IBDF will establish, by means of a Portaria, that tree clearing will no longer be considered evidence of occupation and development, for the purpose of establishing claims for land titling and access to government benefits.

By June 30, 1988, IBDF and the State Government will prepare a proposal for forestry development and extension, so as to assure that proper forestry management practices are available to project beneficiaries.

By July 31, 1988, IBDF will define appropriate mechanisms to ensure reforestation.

The Special Secretariat for the Environment (SEMA) will present a separate document, which will form an integral part of this letter, concerning those activities which it will develop, directly or in articulation with the other signataries. This procedure is due to the fact that the chief executive officer of SEMA is currently abroad, to attend meetings which led to preparation of this letter of commitments.

With the objective of contributing to consolidation of the Agroecological Zoning of Rondonia, MIRAD proposes the following:

(a) By June 30, 1988, MIRAD will regulate its actions in the State of Rondonia so as not to initiate or expand any colonization project (especially at Machadinho and Cujubim), or to issue occupation licenses, titles or use rights which are not in accordance with the Agroecological Zoning;

(b) By August 31, 1988, MIRAD, in close cooperation with the State, will make its Regional Program for Agrarian Reform (PRRA) compatible with the Agroecological Zoning, defining priority action areas, types of activities and utilization of the Special Agrarian Reform Credit Program (PROCERA), with the respective timetables for execution;

(c) By August 31, 1988, in articulation with IBDF, MIRAD will reformulate the Portaria which currently accepts tree clearing as evidence of land improvement for the purposes of land regularization and titling;

(d) By August 31, 1988, MIRAD, in coordination with the State, will prepare a proposal for extractive settlements, including criteria and definition of responsibilities for implementation;

(e) By August 31, 1988, MIRAD will analize and propose ways in which the Rural Land Tax (ITR) could be used as an additional means to implement the Agroecological Zoning;

(f) By July 31, 1988, MIRAD will prepare statistical analyses of the land tenure situation in Rondonia, by Municipality; and

(g) In cases of existing forms of occupation which are inconsistent with the Agroecological Zoning, MIRAD will consider proposals by the State for expropriation on the grounds of social interest.

[Signed]

Jayme Costa Santiago
Secretary General, MINTER

Jeronimo Garcia de Santana
State Governor of Rondonia

Delile Guerra de Macedo
Secretary General, MIRAD

Antonio Jose Costa de Freitas Guimaraes
President, IBDF

ANNEX: Timetable for Execution

~~RAH~~

Chitra - everyone has copies

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDANCE DATE : 88/05/11 DUE DATE : 00/00/00
LOG NUMBER : 880511020 FROM : S.S.HUSAIN/MAQ
SUBJECT : MEMO - BRAZIL: UPDATE ON RECENT DEVELOPMENTS.

OFFICE ASSIGNED TO FOR ACTION : MR. B. CONABLE (E-1227)

ACTION:

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_____ RETURN TO _____

COMMENTS :

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 11, 1988

CONFIDENTIAL

TO: Mr. Barber B. Conable

THROUGH: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 69001

SUBJECT: BRAZIL: Update on Recent Developments

DECLASSIFIED

OCT 20 2023

WBG ARCHIVES

1. Further to the attached May 3 memorandum from Mr. Choksi to you, below is an update on recent economic developments in Brazil.

2. Since your last briefing, there have been no noteworthy developments on the domestic front. However, on the debt negotiation front, the commercial banks appear to have accepted the view that a Bank guarantee is unlikely to materialize. As such, discussions relating to the interest-capping scheme similar to that which we had put together for Paraguay in 1983/84, have been set aside for now. Furthermore, the candidates for parallel financing that we had put together with the Brazilians are now receiving greater scrutiny in the negotiations and are being fine-tuned to include more conditionality. The US Treasury has sought information on this process on a regular basis from us. It appears therefore, that we are headed for an Argentinian-type rather than a Mexico-type financial package. This implies that the exact nature of the exit mechanism, yet to be decided, will be crucial to ensuring critical mass, since small and regional banks are likely to want to use it, given the absence of a Bank guarantee. Alternatively, creditor governments may find themselves having to individually provide regulatory or other credit enhancement comfort to their respective banks.

Attachment

cc: Mr. Choksi, LA1DR (o/r)

THE WORLD BANK INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: May 3, 1988

CONFIDENTIAL

TO: Mr. Barber B. Conable

FROM: Armeane M. Choksi, Director, LAIDR

EXTENSION: 61811

DECLASSIFIED

OCT 20 2023

WBG ARCHIVES

SUBJECT: BRAZIL - Status of the Debt Negotiations and Our Program

1. The status of the current debt negotiations and our program with Brazil is described below.

Debt Negotiations

2. The debt negotiations continue to take place. Messrs. Qureshi, Husain and I met with Minister Mailson da Nobrega and his team on Friday, April 29. He indicated the shape of the overall program as follows: the financial package is for $5.2 billion, covering 1987, 1988 and the first-half of 1989; the amounts are to be disbursed in three tranches--$4.2 billion in mid-1988, $0.5 billion around end-December 1988, and $0.5 billion in mid-1989; there will be parallel financing links between these tranches and Bank loans, including at least two adjustment loans. There are three outstanding issues before there is agreement on a term sheet. These are:

(i) Links to the IMF. The banks want a formal linkage to the IMF program, the Brazilians are prepared to concede on informal links. This problem is likely to be solved through the use of creative "drafting". Minister Mailson indicated to us that he expected to reach an agreement with the IMF on the macroeconomic program. The IMF, in turn, expects to have a 20-month stand-by program in place by July. By that time, they expect to have reached agreement on the 1988 program. The details of the 1989 program will be worked out in a review in November 1988. The total program would be for about $1.5 billion.

(ii) Prejudgment Attachment. The banks want to retain the right to attach Brazilian funds held by them, in the event of any dispute, prior to any final judgments about the dispute. The Brazilians will not accept this. The banks are likely to concede if they get other concessions, including relaxed terms for relending and for debt-equity conversions.

(iii) World Bank Guarantee. This will be the last issue to be negotiated by the Brazilians and the banks. The commercial banks have approached us for a guarantee for the third tranche ($500 million). The Brazilians have as yet made no formal request. This we believe is a negotiating stance. The Brazilians would probably request us formally for such a guarantee on condition that they also got the prejudgment attachment waiver and an interest-capping arrangement with

World Bank support, similar to the Paraguay scheme (see Board Document R84-61, dated March 9, 1984, entitled "Paraguay - Private Cofinancing through the New Cofinancing Program for the Seventh Livestock Project"). When the Brazilians had earlier raised with us the issue of a guarantee, we had informed them that we would only consider a guarantee if so requested, on condition that: (a) there was a satisfactory macroeconomic program under implementation; (b) a structural reform program for key sectors is under implementation; (c) the parallel financing links between commercial bank tranches and Bank loans included at least two adjustment loans; (d) a satisfactory medium-term policy framework for structural reforms in four key sectors is presented to the Bank; and (e) that the proposed guarantee is linked only to the third tranche of the commercial banks' package. It is our view that the banks are not likely to conclude an agreement with the Brazilians without a guarantee. In the meanwhile, there continue to be strong reminders from the U.S. Treasury to the banks that guarantees are not warranted in the Brazil case.

Our Program

3. To date in FY88, new commitments to Brazil total $289.5 million for three investment projects. We expect our lending in FY88 to be at about $1.1 billion, consistent with the low case of our lending strategy, and implying about zero net disbursements. Our Brazil program, at the moment, remains essentially in a state of uncertainty, although there are many positive signs, including the gradual evolution of a macroeconomic program and continuing progress in our dialogue on the trade, power, agricultural and financial sector adjustment loans and on a medium-term policy framework. Once progress on an IMF program is made (i.e., there is an agreed Letter of Intent) the tempo of activity is likely to pick up on the external package, if an agreement is not yet in place. Given our strategy of graduated response, we would then be prepared to go forward with an expanded program providing we reached agreement with the Brazilians on sectoral reforms.

cc: Messrs. Qureshi, o/r
Husain, o/r
Steckhan, Acting LACVP

GTNankani:nev

WORLD BANK OTS SYSTEM
OFFICE OF THE PRESIDENT

CORRESPONDANCE DATE : 88/04/11 DUE DATE : 00/00/00
LOG NUMBER : 880412023 FROM : S.S.Husain/M.Qureshi
SUBJECT : BRAZIL: Briefing Note for Meeting with Mr. Mailson Ferreira da Nobrega, Minister of Finance, April 13/88 - 5:30 PM
OFFICE ASSIGNED TO FOR ACTION : Mr. B. Conable (E-1227)

file

ACTION:

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COMMENTS : cc: MH, JV (follow file)

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: April 11, 1988

STRICTLY CONFIDENTIAL

DECLASSIFIED

OCT 20 2023

WBG ARCHIVES

TO: Mr. Barber B. Conable

THROUGH: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 69001

SUBJECT: Visit of Mr. Mailson Ferreira da Nóbrega, Minister of Finance, Brazil

1. On Wednesday April 13 at 5:30 PM you will receive Mr. Mailson Ferreira da Nóbrega, Minister of Finance of Brazil, whom you met most recently on February 17, 1988. Biographical data on Mr. Ferreira da Nóbrega are summarized in Annex 1. Mr. Ferreira da Nobrega is expected to be accompanied by the Brazilian Ambassador to the United States, Mr. Márcio Moreira Alves; and the Ministry of Finance's Secretary for International Affairs, Mr. Sergio Amaral. Mr. Ferreira da Nóbrega will meet with Mr. Qureshi at 3:30 PM on April 13. Mr. Ferreira da Nóbrega will be meeting with private bankers in New York on Monday April 11, with Mr. Camdessus on April 12, and with key figures in the American Government.

A. Background

2. Mr. Ferreira da Nóbrega's Priorities. In his remarks to the country on assuming the post of Minister of Finance and in his conversations with the management of the Brazil Department last January, Mr. Ferreira da Nóbrega emphasized that his 25 years in public service had taught him that there were no miraculous solutions and that difficulties could only be overcome with serious and persistent efforts in the right direction. He also emphasized that all other problems in Brazil were secondary to two major issues which would need to be resolved if Brazil were to proceed with its economic and social development. These two problems were: (i) inflation; and, (ii) the external debt. With respect to the latter, he still proposes to have concluded negotiations with the commercial banks, IMF and Paris Club by September, and thus to have set the stage for new capital inflows from the Bank, IDB, other official sources and foreign investors.

3. Recent Domestic Economic Measures. Mr. Ferreira da Nóbrega proposes to combat inflation (currently projected by the Government at 600% for 1988) primarily by seeking to reduce the public sector deficit, which was being projected at some 7-8% of GDP for 1988, compared with an estimated 5.5% in 1987. The newly unified federal budget should assist him in this process. To date three major measures have been announced.

- o In March a resolution of the National Monetary Council froze lending to state governments, their agencies, and enterprises by official banks at the real level attained at the end of 1987. The Finance Ministry estimates that this measure will cut the potential deficit by 1% of GDP.

- o On April 7 President Sarney signed a Decree Law eliminating monthly wage adjustments for all federal public sector workers (including civil servants, the military, the legislature, and the judiciary as well as employees of state enterprises) for two months, during which time inflation is expected to run at about 20% per month. A bonus of about US$10 per month will be paid to all public employees earning less than about US$200 per month. The Finance Ministry estimates that these measures will cut the potential deficit by 1.6% of GDP.

- o On April 7 the corporate income tax rate paid by most financial institutions was raised from 45% to 50%. No estimate of the impact of this measure are available at this time.

There have been reports that additional measures under active consideration include cuts in subsidies and fiscal incentives. A reprogramming of both the federal fiscal budget and the budget for state enterprises is also under way. Additional cuts are being sought in this context. At this point there is no coherent economic program in place, and the kinds of measures being openly discussed by the Government at this time could at best stabilize the rate of inflation in the 15-20% a month range. The currently approved measures are therefore best seen as a positive move in the right direction, but no more. Longer-term deficit reduction is being sought by accelerating the slow-moving privatization effort and the liquidation of unviable public enterprises. Mr. Ferreira de Nóbrega also emphasizes using existing resources more efficiently, since the possibility of increasing revenues is limited. He hopes that if the Federal Government gives the example in these areas, the states and municipalities will follow suit.

4. Recent Political Developments and their Likely Implications. Mr. Ferreira da Nóbrega has a keen sense of priorities and good intentions, but it remains to be seen whether he will be able to mobilize the political support necessary to carry out his programs and achieve his goals. At present, he is largely dependent on President Sarney for support, though he has received some support from the business and academic communities. His chances of success therefore depend, in the short term, on whether the President thinks the Minister's programs will help or hurt his chances of getting a five-year term under the new Constitution. While the Constituent Assembly has now decided in favor of a presidential system with a five-year term for future presidents, President Sarney's term is still undetermined. Logic would suggest that positive results in controlling the public deficit would also help in controlling inflation, unemployment, and other economic

problems, and that this would bring the President political dividends. But in the short run cutting the deficit is likely to be unpopular, and could lead the Constituent Assembly to cut President Sarney's term to four years. The President has hesitated and continues to hesitate in approving deficit reduction measures, with an eye to his own mandate. Political experience suggests that, should presidential as well as municipal elections be held in November 1988, the pressures for increased public spending may prove irresistible. If early agreement is reached on a five-year term for President Sarney, then Mr. Ferreira da Nóbrega's chances of remaining in office and having a chance to carry through his programs would be considerably increased--although the pressures for undertaking selected popular but economically unjustified investments would also increase.

B. Likely issues for your meeting

5. With the participation of the Region, Mr. Ferreira da Nóbrega has been preparing a medium-term structural adjustment program for Brazil. He may wish to discuss this program with you. He is also likely to want to discuss:

(a) the prospects for the Bank's financial assistance to Brazil, particularly with sector adjustment loans, and;

(b) the Bank's role in Brazil's debt negotiations.

6. Bank Lending Prospects for 1988. Mr. Ferreira da Nóbrega has said that he would do everything needed on the Brazilian side to accelerate disbursements and facilitate the approval of new loans, and he is likely to ask whether the Bank is ready to undertake any new adjustment loans in the near future. In addition to proceeding as usual with the traditional investment loans, we are preparing sector adjustment loans in several different areas--electric power, agriculture, trade reform, financial reform, the social sectors, and public sector reform--and we can proceed as soon as: (i) a sound, defensible economic stabilization program is in place; (ii) satisfactory progress has been made towards concluding an external financial package, and; (iii) we have reached agreement with the Brazilians on the specifics of the sector reforms to be supported by the loan. It is doubtful that any adjustment loan could be ready to go to the Board before the end of this fiscal year, although the Power Sector adjustment loan is expected to be ready in the fall, and one other - possibly Trade Policy Reform I - may be ready before the end of the calendar year.

7. Debt negotiations. Resumption of Bank adjustment lending to Brazil is one way the Bank can assist Brazil in its debt negotiations, through helping to fill the external financial gap. Another is to continue assisting in defining a sound medium-term economic program and the related macroeconomic and sectoral policies--essential requirements for a successful conclusion of negotiations--and this assistance is currently being given. A third role the Bank can continue to play to assist the process is that of "honest broker" and cofinancing catalyst in Brazil's discussions with commercial banks and bilateral creditors, particularly the

Japanese. The Bank is currently assessing three proposals, each of which has been requested by the Advisory Committee and/or the Brazilian negotiators:

(a) parallel financing with optional cross default clauses;

(b) partial Bank guarantee on late maturities of a cofinancing facility (as in the Mexican case), and;

(c) a contingency take-out facility that would capitalize additional interest service payments whenever the interest rate (LIBOR + spread) exceeds some reference point, with the banks being able to exercise a put option at maturity to the Bank for the capitalized amount up to a pre-determined ceiling.

Different technical notes have been prepared on the above, and some of these have been shared with the Brazilians.

8. Moving beyond this technical analysis to provide some such comfort mechanism presupposes: (i) a credible economic policy scenario in place in Brazil; (ii) a conclusion that the Bank would have more to gain from providing comfort than from lending an equivalent amount directly to Brazil, and; (iii) a decision by Senior Management that playing such a role would have no adverse impact on the Bank as a financial institution. So far, our position has been that:

(a) we would be prepared to offer parallel cofinancing if so requested;

(b) we would be prepared to consider a guarantee on late maturities up to a fixed amount if four conditions are satisfied: (i) that there is a satisfactory macroeconomic program in place; (ii) that Brazil present the Bank with a satisfactory program of medium-term structural reforms in four key sectors: public sector reform, trade, finance and power; (iii) the parallel cofinancing facility includes links to at least two Bank-supported adjustment loans; and (iv) that the proposed guarantee is linked only to the third tranche of the commercial banks' current package; and

(c) we would be prepared to consider a contingent take-out facility if formally requested to do so by Brazil and the commercial banks, as long as there is a pre-determined ceiling on the Bank contingent take-out.

9. At present, our most likely expectation is that the Brazilians will seek to obtain the support of the commercial banks for the contingent take-out facility, and may in the process agree to support the commercial banks' request for a partial guarantee a la Mexico. They would then approach us with a formal request for both. Mr. Mailson may specifically

raise this possibility with you. If so, you may wish to respond that we would be prepared to consider such a proposal when it is presented. You may add that we would wish to see the present debt negotiations conclude successfully, and will try to respond as constructively as possible to their proposals.

10. Other Issues. You may also wish to ask the minister to bring us up to date on his plans for further deficit reduction, the development of a economic stabilization plan, and his conversations with the IMF, commercial banks, and the US Government.

cc: Messrs. Quijano (LACVP); Choksi (LA1DR, o/r); Nankani, Knight (LA1CO); Wijnand (LA1AG); Papageorgiou (LA1TF); Ms. Birdsall (LA1HR); Munasinghe (LA1IE); Weissman (LA1DR, o/r)

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Annex 1

Visit of Mr. Mailson Ferreira da Nobrega
Minister of Finance, Brazil
February 17, 1988

Mr. Ferreira da Nobrega was born in a small town in the interior of the small Northeastern state of Paraiba in 1942. He went to secondary school in the capital of Paraiba, Joao Pessoa, and then, in 1963, entered the Bank of Brazil, in which he spent the next 14 years (over half of his career to date). The Bank of Brazil gave him short courses in industrial credit and administration and also enabled him to gain a university diploma in economics in 1974 from the Faculty of Economics, Accounting, and Administration of the Federal District (Brasilia).

Mr. Ferreira da Nobrega began his career in the Bank of Brazil in a small rural agency in his home state. After seven years, he moved to the Regional Directorate for the Northeast in Recife, and some five years later (after gaining his diploma in economics), he became Chief of the Projects Analysis Division (in Brasilia). The following year, he became Chief of the Technical Advisory Group to the Bank of Brazil's President.

In 1977, Mr. Ferreira da Nobrega was invited to become Chief of the Economic Advisory Group to the Minister of Industry and Commerce, a post he held two years, following which he moved to the Ministry of Finance, where he spent about six years (a quarter of his career).

In the Ministry of Finance, he was Coordinator for Economic Affairs for four years and then, in 1983, became Secretary General for two years, the highest post in the Ministry after the Minister. He was concurrently the chairman of several Ministerial and inter-Ministerial committees, notably one on informatics and one which studied the National Treasury, the Central Bank, and the Bank of Brazil with a view to redefining and clarifying their roles and functions. He also served on various committees in areas as varied as rural credit, capital markets, aeronautics, data processing, steel manufacturing, and pension funds. He also attended all the World Bank's Annual Meetings in the years 1978-82 and 1985-86 as well as several of the Annual Meetings of the Inter-American Development Bank. He was part of the Brazilian delegation which negotiated a program with the IMF in 1983-84 and led the Brazilian delegation which renegotiated a bilateral agreement with Japan in the context of the Paris Club. In 1985, Mr. Ferreira da Nobrega became Executive Director of the European Brazilian Bank in London, representing the Bank of Brazil, a post he held until he became Minister of Finance in late December 1987.

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MR. YUSUKE KASHIWAGI, CHAIRMAN, BANK OF TOKYO, LTD.

TOKYO, JAPAN

THANK YOU FOR YOUR TELEX MESSAGE OF MARCH 17. I RECOGNIZE THE DIFFICULT NATURE OF THE NEGOTIATIONS BETWEEN THE COMMERCIAL BANKS AND BRAZIL. PLEASE BE ASSURED THAT THE WORLD BANK CONTINUES TO BE VERY SUPPORTIVE OF THE EFFORTS OF THE COMMERCIAL BANKS AND BRAZIL TO REACH AGREEMENT. IT IS FOR THIS REASON THAT WE HAVE INDICATED THAT, DESPITE THE ABSENCE OF AN AGREED MEDIUM-TERM DEVELOPMENT PROGRAM TO BE UNDERTAKEN BY BRAZIL, WE WOULD BE PREPARED TO UNDERTAKE PARALLEL COFINANCING LINKED WITH OUR EXISTING LENDING PROGRAM. AS YOU KNOW, IN THE CASE OF MEXICO, THE AGREED STRUCTURAL ADJUSTMENT AND DEVELOPMENT PROGRAM PROVIDED THE ESSENTIAL JUSTIFICATION FOR THE BANK TO EXPRESS ITS SUPPORT THROUGH APPROPRIATE GUARANTEE ARRANGEMENTS. SUCH AN AGREED PROGRAM DOES NOT YET EXIST IN THE CASE OF BRAZIL.

I SHOULD ALSO NOTE THAT THE ATTITUDE OF THE BANK'S SHAREHOLDERS TOWARD PROVIDING CREDIT ENHANCEMENT IS UNCERTAIN. HOWEVER, MY STAFF AND I ARE FOLLOWING CLOSELY THE PROGRESS OF THE NEGOTIATIONS BETWEEN BRAZIL AND THE BANKS AND I WANT TO ASSURE YOU THAT IN OUR INTERNAL DELIBERATIONS WE SHALL CAREFULLY TAKE INTO ACCOUNT THE

END OF TEXT

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PAGE 2 OF 2

OFFICIAL DEPT DIV ABBREVIATION: SVPOP

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START HERE

VIEWS AND CONSIDERATIONS YOU HAVE CONVEYED TO ME. WITH BEST

REGARDS, BARBER CONABLE, WORLD BANK

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CLASS OF SERVICE: TELEX

TELEX NO: TOBANKA J22220

DATE: MARCH 18, 1988

SUBJECT

DRAFTED BY: MAQureshi:gmb

EXTENSION: 73665

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cc: Mr. Qureshi
Mr. Husain
Mr. Bock

AUTHORIZED BY (Name and Signature): Barber B. Conable Barber B Conable

DEPARTMENT: President

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(2–83)

THE WORLD BANK

1.

ROUTING SLIP	Date March 18, 1988

OFFICE OF THE PRESIDENT

Name	Room No.
Mr. Qureshi	E-1241

	To Handle		Note and File
	Appropriate Disposition		Prepare Reply
	Approval		Per Our Conversation
XX	Information		Recommendation

Remarks

Marianne Haug

From

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EXC
REF : TCP FCA
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* EXC - EXECUTIVE OFFICES *
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248423 WORLDBANK
TOHBANKA J22220

GAD-241 (LET)
FROM BANK OF TOKYO LTD TOKYO DATE MARCH 17, 1988
TO WORLD BANK WASHINGTON

MR. BARBER B CONABLE
PRESIDENT
THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

SORRY TO DISTURB YOU BEFORE YOU GO TO CHINA AS I UNDERSTAND I HAVE A SPECIAL MESSAGE TO BE PUT BEFORE YOU WITH REGARD TO IBRD'S GUARANTEE FOR BRAZILIAN PACKAGE

1) ACCORDING TO THE STATEMENT BY MR. HUSAIN, V.P. OF IBRD AT THE BAC MEETING ON 10TH MARCH, WE UNDERSTAND IBRD IS NEGATIVE TOWARDS PROVIDING GUARANTEE TO SUPPORT THE BRAZILIAN PACKAGE. IT IS ONLY PREPARED TO PROVIDE A PARALLEL FINANCING.
THE REASONS FOR NOT PROVIDING A GUARANTEE ARE SAID TO BE AS FOLLOWS:
  I) IF A GUARANTEE IS ONCE PROVIDED FOR BRAZIL, IBRD WILL BE REQUESTED TO DO THE SAME FOR OTHER COUNTRIES IN THE FUTURE.
 II) THE AMOUNT OF NEW MONEY FOR BRAZIL IS SUBSTANTIALLY SMALLER THAN THAT FOR MEXICO. (IN MEXICAN CASE, IBRD PROVIDEDA GUARANTEE.)
III) THERE IS NO GOOD REASON WHY IBRD SHOULD DO FOR BRAZIL WHAT IT DID NOT DO FOR ARGENTINA.

2) WE TRUST THAT IBRD SHOULD NOT CONFINE ITS ACTIVITIES TO ITS TRADITIONAL/BUREAUCRATIC BOUNDARY IN FACE OF TODAY'S WORLD ECONOMIC PROBLEMS.
WE UNDERSTAND, YOUR VIEW ON THE ISSUE INDICATED AT THE TELEPHONE CONVERSION WITH MR. W. RHODES OF CITIBANK ON 15TH MARCH IS THAT YOU ARE NOT NECESSARILY NEGATIVE ON THE GUARANTEE ISSUE, BUT OPEN FOR DISCUSSION.

3) IF I MAY PUT BEFORE YOU OUR POSITION, OR THE JAPANESE POSITION IN GENERAL, AT THIS CRITICAL TIMING OF ARRANGEMENT FOR BRAZILIAN PACKAGE,
  I) THERE HAS BEEN NO SUCH TIME LIKE NOW IN THE PAST THAT A STRONG LEADERSHIP OF IBRD IS EARNESTLY REQUESTED IN ORGANIZING OVERALL FINANCIAL PACKAGES FOR HEAVILY-INDEBTED COUNTRIES.
 II) IN ADDITION TO A PARALLEL CO-FINANCING, A GUARANTEE BY IBRD FOR AT LEAST SUBSTANTIAL PORTION OF POLICY LOAN OR SECTOR LOAN IS INDISPENSABLE FOR THE SUCCESSFUL CONSUMMATION OF THE NEW MONEY EXERCISE FOR BRAZIL. WITHOUT IT, AT LEAST YOU COULD NOT EXPECT A FULL PARTICIPATION OF JAPANESE BANKS.
III) COMMERCIAL BANKS HAVE HAD BITTER EXPERIENCE VIS-A-VIS BRAZIL FOR THE PAST YEAR SINCE FEB.20, 1987 AND THEY ARE ALMOST LOSING CONFIDENCE IN THE COUNTRY. OUR LOAN PORTFOLIO IS EFFECTIVELY VALUE-IMPAIRED, IN VIEW OF THE PAST PERFORMANCE OF PAYMENT SUSPENSION. UNDER SUCH CIRCUMSTANCES, CREDIT ENHANCEMENT BY IBRD ON BRAZILIAN PACKAGE IN THE FORM OF EFFECTIVE GUARANTEE IS DEFINITELY NEEDED TO ATTRACT COMMERCIAL BANKS' COMMITMENTS AS BIG AS USDLS 5.8 BILLION.
      WITHOUT AN EFFECTIVE CO-FINANCING ARRANGEMENT WITH IBRD, WE AT BOT WOULD BE UNABLE TO CONVINCE THE JAPANESE GROUP TO POSITIVELY PARTICIPATE IN THE NEW PACKAGE.
      YOUR PROMPT AND DECISIVE ACTION WOULD KINDLY BE REQUESTED.

BEST REGARDS

YUSUKE KASHIWAGI
CHAIRMAN
THE BANK OF TOKYO, LTD.

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Chron X

March 18, 1988

Dear Mr. President:

It is indeed good to know that you have been appointed Alternate Governor for Brazil on the Board of Governors of The World Bank.

Congratulations!

The Executive Directors, Officers and Staff join me in extending to you a warm welcome. We look forward to your participation in the affairs of the Bank.

On a personal note, I hope to have the opportunity of greeting you here in Washington in the near future.

Sincerely,

(Signed) Barber B. Conable

Barber B. Conable

Senhor Elmo de Araujo Camoes
Presidente
Banco Central do Brasil
Caixa Postal 04.0170
70074 Brasilia (DF), Brazil

cc: Mr. Malan
Mr. Choksi
Mr. Schultz

ETSanidad:jlk

WORLDBANK MSS

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AND SECRETARY

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TO: WORLD BANK - WASHINGTON

15.03.88
PT: 2435

ATTN: MR. T. T. THAHANE - SECRETARY
DEORI-GABIN-88/122 - 03.11.88

I AM PLEASED TO INFORM YOU THAT HIS EXCELLENCY THE PRESIDENT OF THE REPUBLIC HAS DESIGNATED MR. ELMO DE ARAUJO CAMOES, PRESIDENT OF CENTRAL BANK OF BRAZIL TO ACT AS ALTERNATE GOVERNOR FOR BRAZIL BEFORE THE INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT, INTERNATIONAL FINANCE CORPORATION AND INTERNATIONAL DEVELOPMENT ASSOCIATION.

SINCERELY YOURS

CARLOS ALBERTO AMORIM JR.
HEAD OF THE DEPARTMENT FOR INTERNATIONAL ORGANIZATIONS AND AGREEMENTS
BANCENTRAL

OP:CFC
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SECRETARY'S DEPARTMENT

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THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

OFFICE MEMORANDUM

DATE: February 10, 1988

TO: Mr. Barber B. Conable

THROUGH: Mr. Moeen A. Qureshi

FROM: S. Shahid Husain

EXTENSION: 69001

SUBJECT: Visit of Mr. Mailson Ferreira da Nobrega, Minister of Finance, Brazil

1. On Wednesday, February 17, 1988, at 11:45 a.m., you will receive Mr. Mailson Ferreira da Nobrega, Minister of Finance of Brazil, whom you may have met briefly at the Bank's Annual Meeting in September-October 1986. Biographical data on Mr. Ferreira da Nobrega are summarized in Annex 1. Mr. Ferreira da Nobrega will be accompanied by H.E. Mr. Marcilio Marques Moreira, Ambassador of Brazil in the United States; Mr. Pedro Malan, Executive Director for Brazil in the Bank; Mr. Sergio Amaral, Secretary, and Mr. Daniel de Oliveira, Deputy Secretary of International Affairs in the Ministry of Finance; and a press secretary. Mr. Ferreira da Nobrega will visit the Bank for about a half- day; his program (Annex 2) also includes a meeting with the managers of the Bank's Brazil Department and a luncheon hosted by Mr. Qureshi. Mr. Ferreira da Nobrega also expects to meet with key figures in the American Government and in the commercial banks during his stay in the United States.

2 Background. Mr. Ferreira da Nobrega came to the position of Minister of Finance after a career of 25 years in public service, over half of it in the Bank of Brazil, and about a quarter of it in the Ministry of Finance, where his highest position before becoming Minister was Secretary General (second in command). Having attended several of the Bank's Annual Meetings, negotiated a program with the IMF, and renegotiated a bilateral agreement with Japan in the context of the Paris Club, Mr. Ferreira da Nobrega has personal knowledge of the major agencies from which Brazil obtains financial assistance. He was absent from Brazil during the period 1985-87 and therefore is not associated in the public mind with the various programs his predecessors tried without success. Mr. Ferreira da Nobrega is basically a technocrat, a term he dislikes, since in Brazil it is associated with the military regime's technical experts; he prefers "bureaucrat," a term which in Brazil does not necessarily have the negative connotations it has in the U.S. Mr. Ferreira da Nobrega is known not as a brilliant, imaginative economist but rather as a solid, intelligent civil servant who can be counted on to get results. He also has the reputation of being an optimist-realist: someone who believes in the future of Brazil but believes that Brazil will not achieve its potential without sacrifices and hard work. In Brazil's present situation, he may be exactly what is needed.

3. His priorities. In his remarks to the country upon assuming the post of Minister of Finance and in his conversations with the management of the Brazil Department last month, Mr. Ferreira da Nobrega emphasized that his 25 years in public service had taught him that there were no miraculous

solutions and that difficulties were only overcome with serious and persistent efforts in the right direction. He also emphasized that all other problems in Brazil were secondary to two major issues which would need to be resolved if Brazil were to proceed with its economic and social development. These two problems were (1) inflation and (2) the external debt. These are discussed briefly below and at greater length in Annex 3.

4. Inflation. Mr. Ferreira da Nobrega proposes to combat inflation primarily by seeking to reduce the public deficit. The newly unified Federal budget should assist him in this process. At the Federal level, he will seek to cut expenditures by holding fast on public-sector wages, introducing annual ceilings for budgetary transfers to public enterprises, and liquidating non-functioning public enterprises. He also emphasizes using existing resources more efficiently, since the possibility of increasing revenues is limited. He hopes that if the Federal Government gives the example in these areas, the States and municipalities will follow suit.

5. External debt. Mr. Ferreira da Nobrega has said that this issue should be viewed objectively and pragmatically, therefore explicitly distancing himself from those who seek a confrontation with the external creditors. He sees his major task as restoring Brazil's credibility with external creditors in order to re-activate voluntary flows of capital, both official and private, to Brazil. Specifically, he hopes, by September at the latest, to have reached agreement with the commercial banks, the IMF, and the Paris Club, and thereby to have set the stage for new flows of capital from foreign investors, the World Bank, the IDB, and official sources.

6. Chances of success. Mr. Ferreira da Nobrega has a keen sense of priorities and good intentions, but it remains to be seen whether he will be able to mobilize the political support necessary to carry out his programs and achieve his goals. At present, he is entirely dependent on President Sarney for support. His chances of success therefore depend, in the short term, on whether the President thinks the Minister's programs will help or hurt his chances of getting a five-year term under the new Constitution. Logic would suggest that positive results in controlling the public deficit would also help in controlling inflation, unemployment, and other economic problems. But political experience suggests that, with elections toward the end of 1988, the pressures for increased public spending may prove irresistible. If early agreement is reached on a five-year term for the President, then Mr. Ferreira da Nobrega's chances of remaining in office and having a chance to carry through his programs would be considerably increased--although the pressures for undertaking selected popular but economically unjustified investments would also increase.

7. Likely Issues for Your Meeting. In his meetings with the Bank's Brazil Management Team, Mr. Ferreira da Nobrega will discuss a medium-term structural adjustment program for Brazil; our sector adjustment operations; periodic macroeconomic assessments; our economic work program; and specific recently completed economic assessments and proposals. With you, he is likely to want to discuss (a) the possibility of rapidly increasing the Bank's financial assistance to Brazil, particularly with quick-disbursing sector adjustment loans, and (b) the Bank's role in Brazil's debt negotiations.

8. The Bank's Role in Lending. Mr. Ferreira da Nobrega has said that he would do everything needed on the Brazilian side to accelerate disbursements and facilitate the approval of new loans, and he is likely to ask whether the Bank is ready to undertake any new adjustment loans in the near future. In addition to proceeding as usual with traditional investment loans, we are in fact poised to undertake sector adjustment loans in several different areas--electric power, agriculture, trade reform, financial reform, the social sectors, and public sector reform--and we can proceed as soon as (i) a sound, defensible economic stabilization program is in place, (ii) satisfactory progress has been made towards concluding an external financial package, and (iii) we have reached agreement with the Brazilians on the specifics of the sector reforms to be supported by the loan. It is doubtful that any adjustment loan could be ready to go to the Board before the end of this fiscal year, although one or more (Power Sector II, Trade Policy Reform I) may be ready before the end of the calendar year. You can assure Mr. Ferreira da Nobrega that the Bank is eager and ready to help, but that our response at this point depends mainly on what happens in Brazil. You can also tell him, however, that we think his proposals are exactly what Brazil needs, and that we will support them as much as we can.

9. Debt Negotiations. Resumption of Bank adjustment lending to Brazil is also one way the Bank can assist Brazil in its debt negotiations, through helping to fill the external financial gap. Another is to continue assisting in defining a sound medium-term economic program and the related macroeconomic and sector policies--an essential requirement for a successful conclusion of the negotiations. A third role the Bank can continue to play to assist the process is that of "honest broker" and cofinancing catalyst in Brazil's discussions with commercial banks and bilateral creditors, particularly the Japanese. Finally, it is possible, under certain circumstances, that the Bank would consider playing a catalytic role in consummating an agreement between Brazil and the commercial banks through some comfort mechanism. Taking on such a role presupposes (i) a credible economic policy scenario in place in Brazil, (ii) a conclusion that the Bank would have more to gain from providing comfort than from lending an equivalent amount directly to Brazil, and (iii) a decision by Senior Management that playing such a role would have no adverse impact on the Bank as a financial institution. We need to discuss this final possibility within the Bank, however, before we are ready to give any positive signals to Mr. Ferreira da Nobrega.

10. You may also wish to ask the Minister to bring us up to date on any further thoughts he may have had since his discussions with the Brazil Department's Management on domestic economic policy actions and on his approach to external financial creditors.

Annexes (3)

cc. Messrs. Quijano (LACVP); Choksi (LA1DR); Nankani, Knight (LA1CO); Wijnand (LA1AG); Papageorgiou (LA1TF); Munasinghe (LA1IE); Ms. Birdsall (LA1HR)

DAK

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Annex 1

Visit of Mr. Mailson Ferreira da Nobrega
Minister of Finance, Brazil
February 17, 1988

Mr. Ferreira da Nobrega was born in a small town in the interior of the small Northeastern state of Paraiba in 1942. He went to secondary school in the capital of Paraiba, Joao Pessoa, and then, in 1963, entered the Bank of Brazil, in which he spent the next 14 years (over half of his career to date). The Bank of Brazil gave him short courses in industrial credit and administration and also enabled him to gain a university diploma in economics in 1974 from the Faculty of Economics, Accounting, and Administration of the Federal District (Brasilia).

Mr. Ferreira da Nobrega began his career in the Bank of Brazil in a small rural agency in his home state. After seven years, he moved to the Regional Directorate for the Northeast in Recife, and some five years later (after gaining his diploma in economics), he became Chief of the Projects Analysis Division (in Brasilia). The following year, he became Chief of the Technical Advisory Group to the Bank of Brazil's President.

In 1977, Mr. Ferreira da Nobrega was invited to become Chief of the Economic Advisory Group to the Minister of Industry and Commerce, a post he held two years, following which he moved to the Ministry of Finance, where he spent about six years (a quarter of his career).

In the Ministry of Finance, he was Coordinator for Economic Affairs for four years and then, in 1983, became Secretary General for two years, the highest post in the Ministry after the Minister. He was concurrently the chairman of several Ministerial and inter-Ministerial committees, notably one on informatics and one which studied the National Treasury, the Central Bank, and the Bank of Brazil with a view to redefining and clarifying their roles and functions. He also served on various committees in areas as varied as rural credit, capital markets, aeronautics, data processing, steel manufacturing, and pension funds. He also attended all the World Bank's Annual Meetings in the years 1978-82 and 1985-86 as well as several of the Annual Meetings of the Inter-American Development Bank. He was part of the Brazilian delegation which negotiated a program with the IMF in 1983-84 and led the Brazilian delegation which renegotiated a bilateral agreement with Japan in the context of the Paris Club. In 1985, Mr. Ferreira da Nobrega became Executive Director of the European Brazilian Bank in London, representing the Bank of Brazil, a post he held until he became Minister of Finance in late December 1987.

Annex 2

Visit of Mr. Mailson Ferreira da Nobrega
Minister of Finance, Brazil
February 17, 1988

AGENDA

10:00 a.m.	Meeting with Mr. Choksi and the Division Chiefs of the Brazil Department
11:45 a.m.	Meeting with Mr. Conable
12:30 p.m.	Luncheon hosted by Mr. Qureshi

Annex 3

Visit of Mr. Mailson Ferreira da Nobrega
Minister of Finance, Brazil
February 17, 1988

1. Domestic Economic Policy. Mr. Ferreira da Nobrega stressed that he does have an economic plan which includes bold economic measures, although he intends to avoid packages similar to those which lost credibility. His emphasis will be on orthodox approaches. He intends to work at controlling inflation by giving priority to reducing the fiscal deficit. Although the newly introduced unified budgetary system will strengthen his hand, its implementation will be difficult, and the operational deficit for 1988 will likely exceed the 2% target he had earlier sought to achieve. He also stresses the need to calm expectations which, in the past, have been "mismanaged" and have therefore affected inflation through the indexation mechanism. He intends to concentrate on three areas: (i) wage policy, which needs to be rapidly modified to prevent an unsustainable increase in the public sector's wage bill; (ii) guidelines for budgetary transfers to public enterprises, for which he hopes it will prove possible to agree on annual ceilings; and (iii) expenditure cuts, where he hopes that the wage bill and other administrative costs can held down and that selected non-functioning public enterprises can be liquidated. None of these will be easy, but he expects to give them all a good try.

2. Strategy Towards External Creditors. Mr. Ferreira da Nobrega sees his major task as restoring Brazil's credibility with external creditors in order to re-activate voluntary flows of capital to Brazil. He stressed that he expects to reach an early agreement with the commercial banks, one which would involve an interim agreement, a lifting of the moratorium, and a medium-term agreement. He expects, between now and September or sooner, to have achieved the following:

- o normalized relations with external private creditors;
- o an IMF-standby program;
- o an increase in the flow of funds from the World Bank, the IDB, and the Paris Club; and
- o the renewed confidence of foreign investors, and new flows eventually reaching $2-3 billion a year.

3. The Role of the World Bank. In this overall framework, Mr. Ferreira da Nobrega hopes the Bank do three things: (1) accelerate disbursements, and he would do everything that was needed on the Brazilian side; (2) undertake new lending--sectoral adjustment loans--in agriculture, trade, finance, etc.; and (3) assist with the debt negotiation process through a role in securitization and cofinancing. Although there have been some references to a Structural Adjustment Loan or Program, Mr. Ferreira da Nobrega feels that given the complexity of the Brazilian economy and experience with such operations in other countries, he would have to consider this very carefully. He was open-minded on it, and would be willing to discuss it later. Mr. Ferreira da Nobrega has said that his overall objective was to establish credibility in economic policies, restore public confidence in the economy and to make possible a major recovery of private sector investment in the economy.

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Correspondents / Participants
To: [President Barber Conable]
From: Pedro Sampaio Malan, Executive Director

Subject / Title
Draft of Letter to the Editor regarding Mr. Eberstadt's op-ed article (How Creditworthy is the World Bank, March 1)

Exception(s)

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PAGE 1 OF 1

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-DRAFTED BY: DAKLAUS/MM EXTENSION: 61895

-AUTHORIZED BY: BARBER B. CONABLE

-CC: MESSRS. QURESHI, HUSAIN, CHOKSI, LA1 (O/R), NANKANI, LA1CO

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391 612083 =

-SUA EXCELENCIA

-MAILSON FERREIRA DA NOBREGA

-MINISTRO DA FAZENDA

-BRASILIA, BRASIL

BT

WASHINGTON D.C., MARCH 3, 1988

THANK YOU VERY MUCH FOR YOUR KIND TELEX. IT WAS ALSO A PLEASURE FOR ME TO MEET YOU PERSONALLY, AND MY COLLEAGUES AND I ALSO LOOK FORWARD TO STRENGTHENING THE ALREADY CLOSE COOPERATION BETWEEN THE GOVERNMENT OF BRAZIL AND THE WORLD BANK. SINCERELY, BARBER B. CONABLE, PRESIDENT, WORLD BANK, INTBAFRAD

END OF TEXT

SIGNATURES:

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AUTHORIZED BY: Barber B. Conable

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THE WORLD BANK
Washington, D.C. 20433
U.S.A.

BARBER B. CONABLE
President

January 20, 1988

Dear Mr. Minister:

It is indeed good to know that you have been appointed Governor for Brazil on the Board of Governors of The World Bank. Congratulations!

The Executive Directors, Officers and Staff join me in extending to you a warm welcome. We look forward to your participation in the affairs of the Bank.

On a personal note, I hope to have the opportunity of greeting you here in Washington in the near future.

Sincerely,

Barber Conable

A Sua Excelencia
Senhor Mailson Ferreira da Nobrega
Ministro da Fazenda
Ministerio da Fazenda
Esplanada dos Ministerios
Bloco P, 6o andar
70048 Brasilia, DF, Brazil

Brazil Financing Plan 1988 - 89

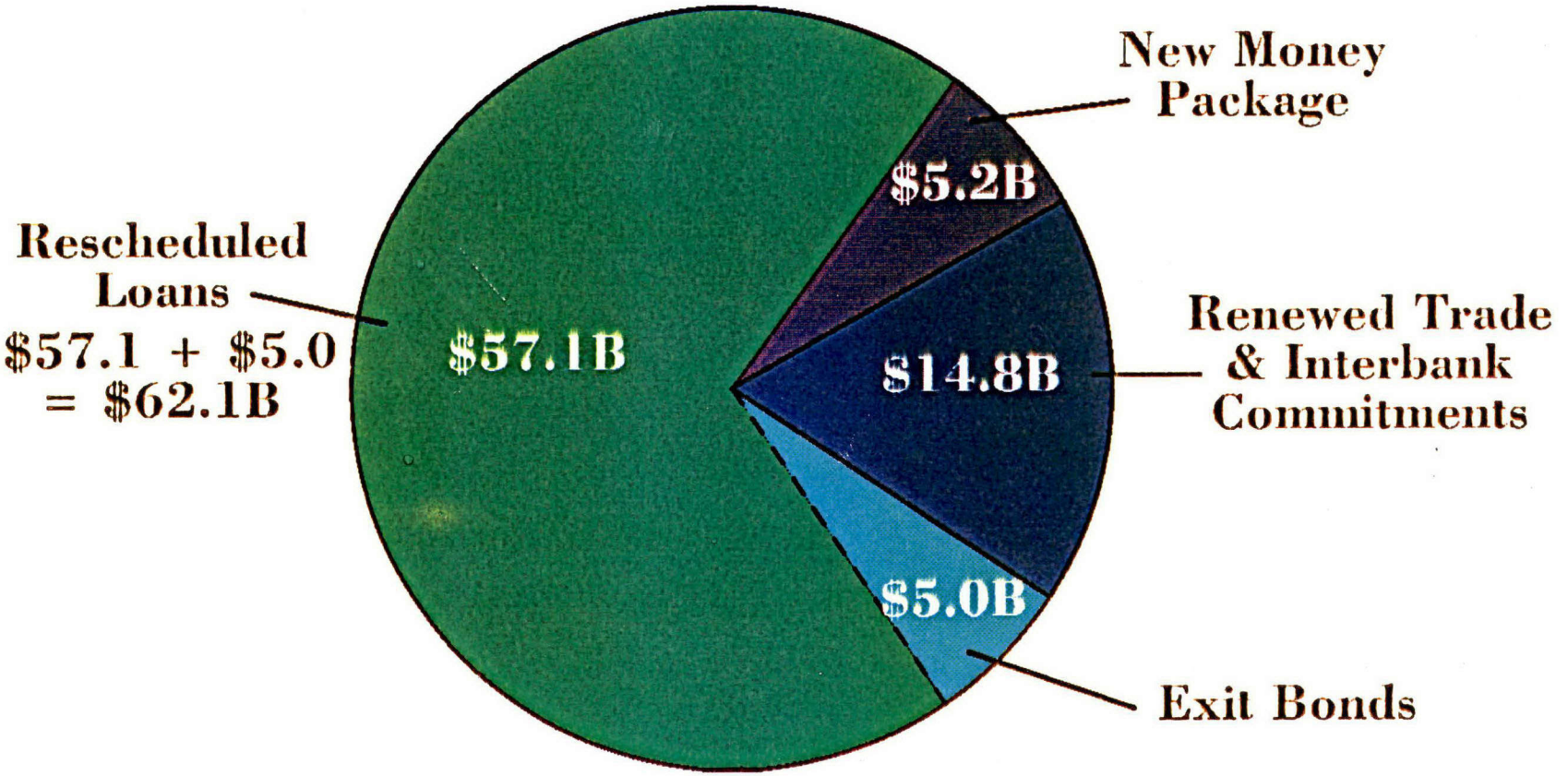
Commercial Bank Portion

This pamphlet is provided for your convenience only. It is not intended to vary, and is subject to, the terms of the term sheet dated June 22, 1988.

The Brazil Financing Plan 1988-89 Is Intended To Help Brazil Strengthen Its Economy. It Is A Cooperative Effort Among:

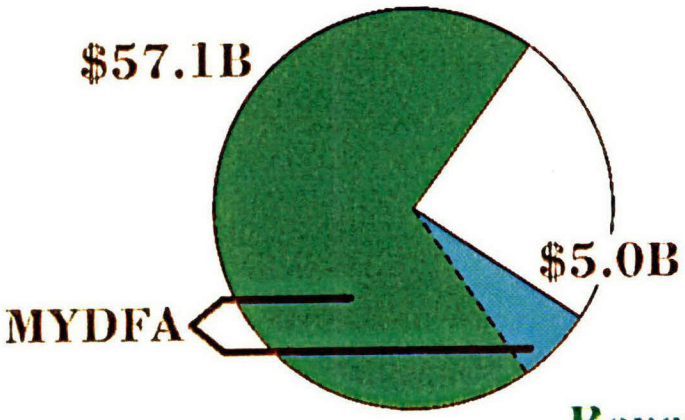
- Brazil
- Multilateral Institutions
- The Paris Club
- Commercial Banks

The Commercial Bank Participation Consists Of Four Major Pieces...



$82.1B

95% Of All External Medium-Term Debt Is Consolidated Into A Multi-Year Deposit Facility Agreement (MYDFA)



Combines:
- 1983-5 DFAs
- 1986-7 Maturities
- Window: 1988-93 Maturities

Repayment Schedule

Down Payment: $1.7B
Paid 1991-3 from original maturities

Principal: $62.1B
Tenor 20 years, Grace 7 years
Scaled repayments 1995-2007

Debt Beyond Window: $3.3B
Paid 1994-on

The MYDFA And The Interest Rate Adjustment Agreement Implement The 13/16% Margin

13/16% Pricing Effective On	For Maturities
January 1, 1988	• All previous DFAs • 1986 - 1988 maturities
January 1, 1989	• All public-sector unmatured debt
As falls into MYDFA	• All other debt

Retiming:

- Shift from 3 to 6 months payment begins from 1st MYDFA Interest Date after effectiveness
- Shift is only for DFA

The MYDFA Has Several Attractive Features...

RELENDING PROGRAM

Private Sector:	**For each month in 1988 after effectiveness**	**≥ $100M**
	1989	**≥ $1.50B**
	1990	**≥ $1.55B**
	1991 - on	**≥ Principal maturities**
Public Sector:	**In each year**	**= Principal maturities + interest**

The MYDFA Has Several Attractive Features...

Debt-To-Equity Under Resolution 1460

Status Of Debt	Amount Eligible	Procedure	Amount Of Cruzados Received	Amount Registered
Liability of Banco Central	$150 Million per month	• Two Auctions: - Northeast $75M - Rest of Brazil $75M • Investors bid for right to swap • Discount set by auction • Projects approved by Banco Central	(Amount of debt) x (Current exchange rate) less discount Northeast auction generally has lower discount	Amount of debt converted, less discount
Unmatured	No limit	Negotiated with each borrower: Private to Private Public to Public	(100% of amount of debt) x (Current exchange rate) Comes from payment of matured debt	(Amount of debt converted) x (Discount of most recent auction)

Each Bank May Choose Either US Dollars Or Its Relevant "Home Currency" For Accounting For Its MYDFA Deposits, And May Switch Between These At Certain Times.

Home Currencies:

- Belgian (Financial) Francs
- Canadian Dollars
- Deutsche Marks
- Dutch Guilders
- European Currency Units
- French Francs
- Italian Lire
- Japanese Yen
- Portugese Escudos
- Pounds Sterling
- Spanish Pesetas
- Swiss Francs
- US Dollars

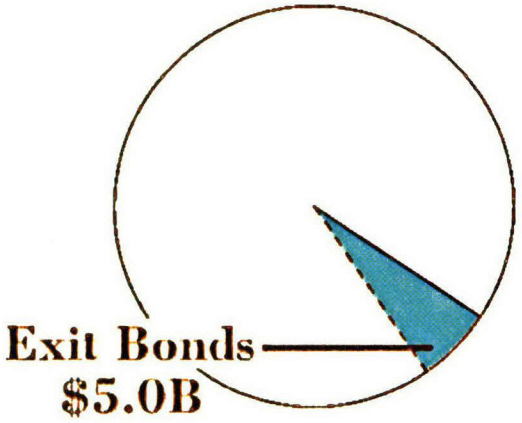
Determination of Home Currency: Currency of country under which laws the bank or its parent is organized

Date of Initial Choice: Before 1st interest date

Option to Switch:

- Upon relending
- On last interest date before grace ends
- Upon merger or other such change in bank structure

In Addition, Each Bank May Reduce Its MYDFA Exposure By Exchanging Debt For Brazil Investment Bonds...



Amount

- $5 billion total in public-sector debt
- Each bank up to $15 million

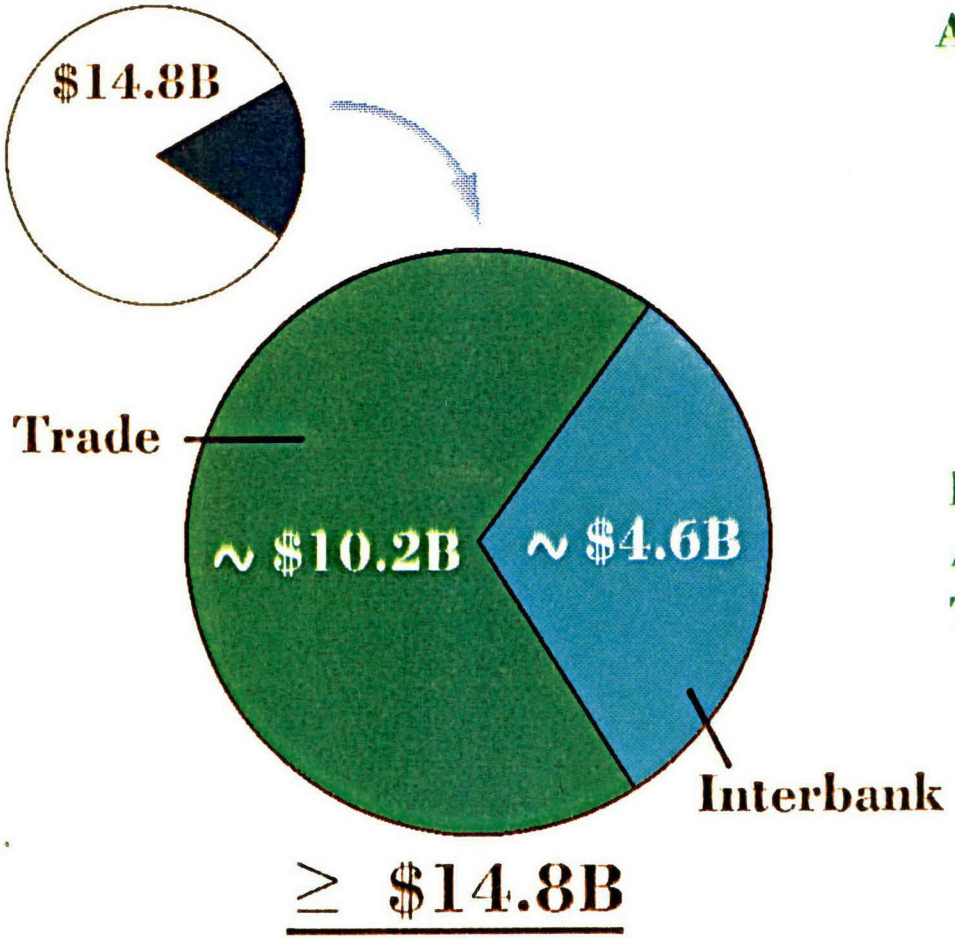
Terms

- 6% Fixed Interest
- Tenor 25 years, Grace 10 years

Benefits

- Reduces bank's base for calculating new money
- Bearer Bonds
- Exchangeable for:
  - OTNs ~ Hedging mechanism
  - Debt-to-Equity under Res. 1460
  - Swap operations of non-traditional exports
- Exempt from Brazilian taxes

Banks Must Also Resume The Level Of Their Commitments In The 1986 Trade & Interbank Letters...



≥ $14.8B

Amount

- Level must be aggregate level of 1986 Letters
- Allocation may incorporate switches done since 1986 Letters

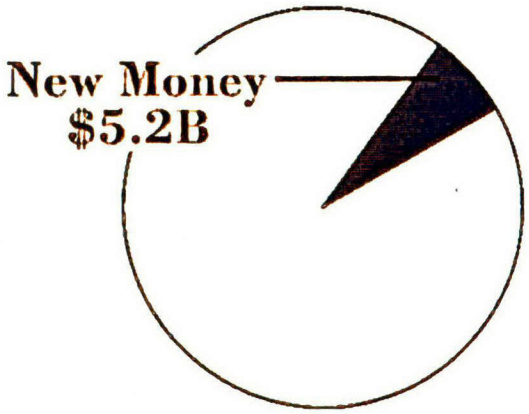
Banks Must Resume Their Aggregate Level In Order To Be Eligible For:

- Equity Investment Feature of Parallel Facility

In 1988-90, Banks Are Allowed To Switch A Portion Of Their Interbank To Their Trade Commitment. The Commitment Terms Remain Roughly As In 1986.

	Terms		Optional Switch
	Interbank	Trade	
Interest	• 5/8% + LIBOR for deposits with Banco Central • Negotiable for other deposits	• 5/8% + LIBOR for deposits with Banco Central • Negotiable for trade credits	• $600M available in each of 1988, 1989 & 1990
Tenor	Up to 360 days	• Short-term: up to 360 days • Medium-term: negotiable for switch amount and other as approved by Banco Central	• Allocated on pro-rata basis among all applications
Availability	2.5 years	2.5 years	
Facility Fee	1/8% of Commitment	1/8% of Commitment	

The Plan Also Includes $5.2 Billion Of New Money...



Disbursements	Not Before	Condition Precedent
1st Tranche - $4B	Oct 1, 1988	IMF Standby approved
2nd Tranche - $600M	Dec 1, 1988	IMF MD Letter IBRD Projects
3rd Tranche - $600M	April 1, 1989	Purchases 2 & 3 under Standby made

Interest Margin

13/16%

Principal Repaid

Tenor 12 years, Grace 5 years

Except New Trade facility - 9 year bullet

Brazil Financing Plan: Multilateral Participation

Tranche	IMF	World Bank (excluding Cofinancings)	Paris Club
I	Board Approval of Standby Arrangement	**Disbursements** • At least US $100 Million under Agricultural Sector II Loan • At least US $80 Million under at least 3 ongoing Non-adjustment Loans covering at least 3 distinct sectors **Approval** • US $195 Million Irrigation Subsector Loan • US $270 Million Fourth Agro-Industries Loan • US $270 Million 1st Agricultural Credit Loan • US $109 Million Endemic Disease Control Loan	

Brazil Financing Plan: Multilateral Participation

Tranche	IMF	World Bank (excluding Cofinancings)	Paris Club
II	Status Report from Managing Director Confirming Brazil's progress under Brazil Economic Program	Disbursements • At least US $90 Million under Agricultural Sector II • At least US $70 Million under 3 Ongoing Non-adjustment Loans covering at least 3 distinct sectors	Execution of Paris Club Agreed Minute

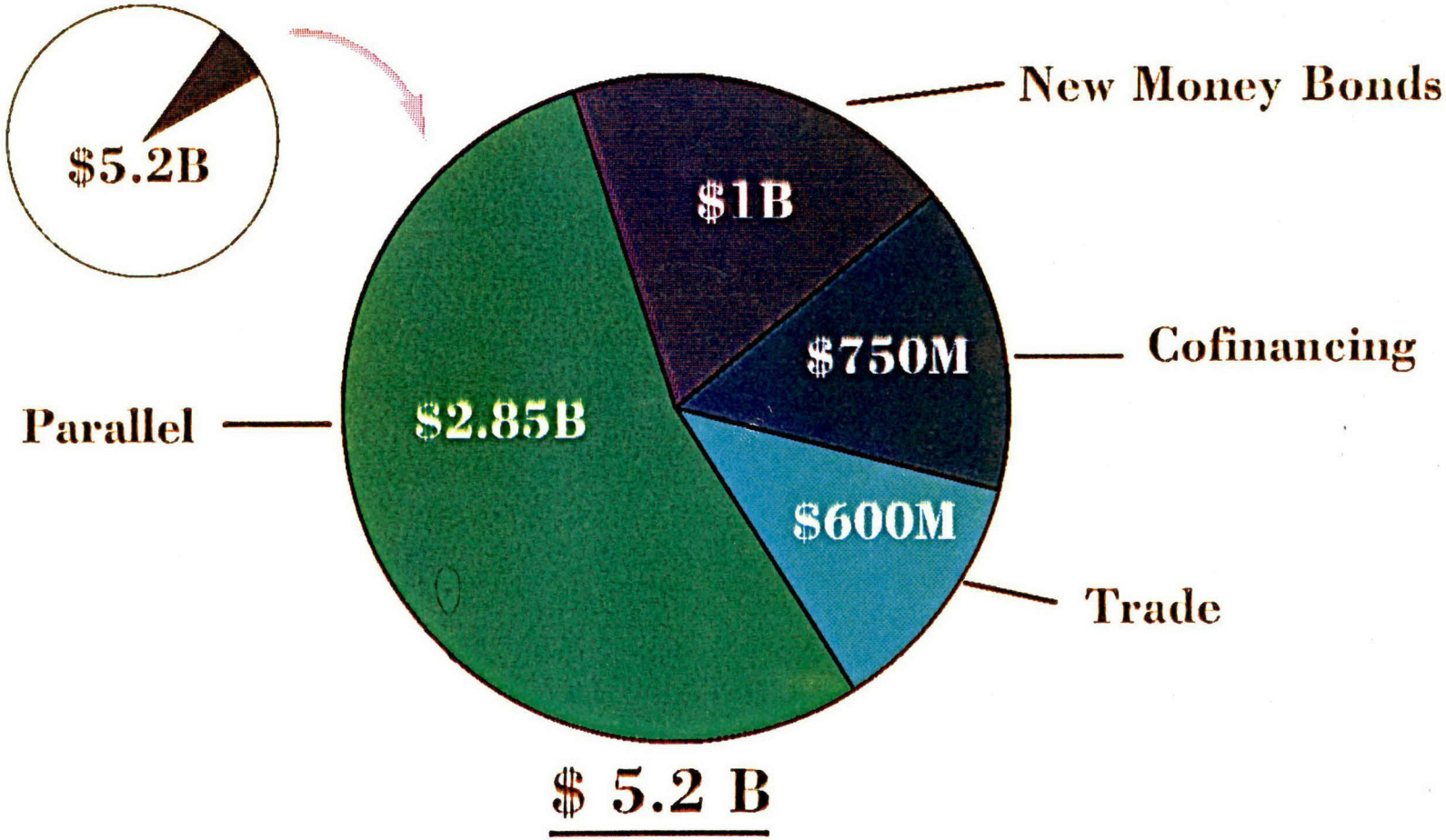
Brazil Financing Plan: Multilateral Participation

Tranche	IMF	World Bank (excluding cofinancing)	Paris Club
III	Status Report from Managing Director confirming purchase of First and Second Conditional Tranches under the Standby Arrangement or Purchase of First Conditional Tranche and authorization to purchase Second Conditional Tranche	Disbursements • At least US $90 Million under at least 2 Ongoing Non-adjustment loans covering at least 2 distinct Sectors Approval • At least US $60 Million under New Non-adjustment loan	Certificate from Banco Central confirming bilateral discussions with governments or appropriate institutions holding at least 66-2/3% of Brazil Indebtedness covered by Agreed Minute

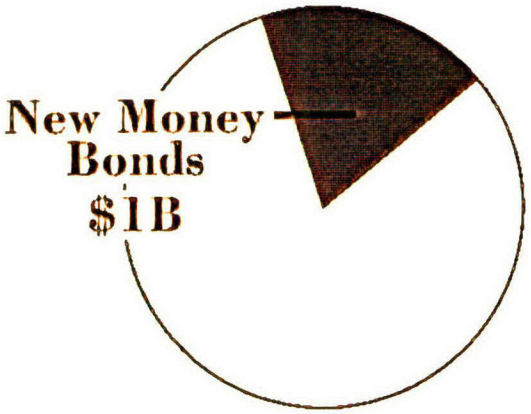
Brazil US $ 5.2 Billion New Money: Potential Disbursement Schedule

	Parallel New Money	New Money Bonds	New Money Trade	Commercial Bank Power Sector Cofinancing	Commercial Bank Sector Cofinancing	Total
Tranches for Parallel New Money	**US $ 2.85 Billion**	**US $ 1 Billion**	**US $ 600 Million**	**US $ 500 Million**	**US $ 250 Million**	**US $ 5.2 Billion**
1st Tranche Available from the Effectiveness of the Parallel New Money Facility	**US $ 2.4 Billion**	**US $ 1 Billion**	**US $ 600 Million**			**US $ 4 Billion**
2nd Tranche Available on or after Dec. 1, 1988	**US $ 350 Million**			**US $ 250 MM**		**US $ 600 Million**
3rd Tranche Available on or after April 1, 1989	**US $ 100 Million**			**US $ 250 MM**	**US $ 250 MM**	**US $ 600 Million**

The New Money Package Offers An Extensive And Attractive Menu Of Options...



The New Money Bonds Comprise $1 Billion In Bearer Bonds



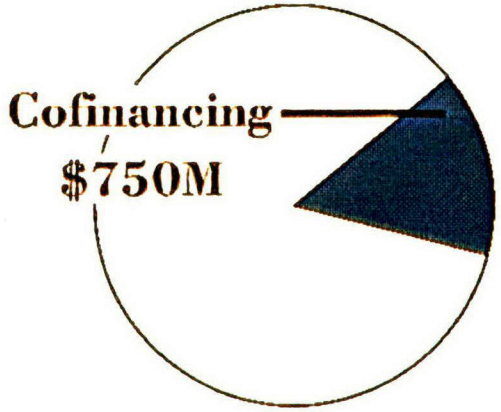
Terms

- Interest 13/16% + LIBOR
- Denominated in $250,000
- Tenor 12 years, Grace 5 years
- Obligor: Banco Central

Benefits

- Bearer Bonds
- Eligible for Debt-to-Equity under Res. 1460
- Exempt from Brazilian taxes

The Cofinancing Facility Is Coordinated With Specific World Bank Projects Totaling $1 Billion



Cofinancing

World Bank: $1 billion

Comm. Banks: $500 million for Power Sector Rehabilitation Plan

$250 million for Trade Policy Loan

And/or one or more new policy base loans

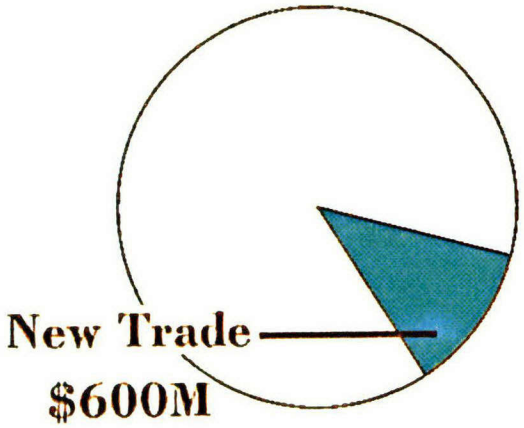
Terms

- 13/16% + LIBOR or 13/16% + CD or comparable rate
- Tenor 12 years, Grace 5 years

Benefits

- Optional cross-default with World Bank
- Eligible for Debt-to-Equity under Res. 1460
- Eligible for Debt-to-Debt exchange

The New Money Trade Facility Provides $600 Million Of Medium-Term Trade Financing, Scarce Until Now



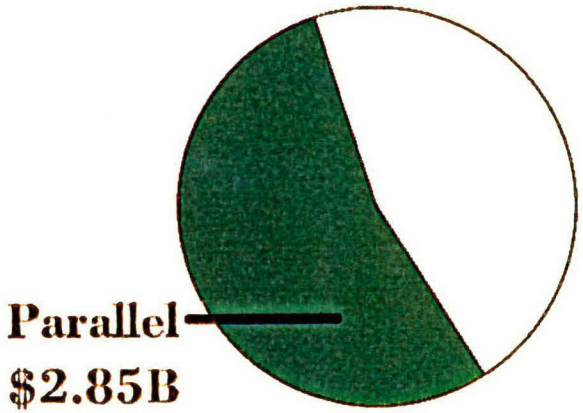
Terms

- Interest negotiable (13/16% + LIBOR when on deposit at Banco Central)
- Tenor of at least 1 year, up to remaining tenor of facility
- Bullet maturity of 9 years
- Import financings no greater than $300 million

Benefits

- Medium term trade financing
- Negotiable terms
- Eligible for Debt-to-Equity under Res 1460
- Eligible for Debt-to-Debt exchange

All Remaining New Money Commitments Comprise The Parallel Facility Of $2.85 Billion, Which Features Equity Investment At 100% Face Value



Terms

- 13/16% + LIBOR or 13/16% + CD or comparable rate
- Tenor 12 years, Grace 5 years

Benefits

- Equity Investment Feature at 100% face value
- Eligible for Debt-to-Equity under Res 1460
- Available for relending to private and public sectors
- Eligible for Debt-to-Debt exchange
- Disbursal linked to World Bank approval of adjustment and sectoral loans

The Equity Investment Feature Is An Attractive And Unprecedented Option...

Amount	$600 million in each of three years, beginning 12 months after "Critical Mass" date
Investment Value	100% face value
Procedure	Allocated on a pro-rata basis among eligible applicants
Eligibility	Participants must have • Committed full share of new money • Resumed full Trade & Interbank lines

The Terms And Benefits Of The Commercial Bank Facilities Are Summarized Here...

	Interest Rate (Over Six-Month LIBOR or CD or Comparable rate)	Tenor (Years)	Grace (Years)	Debt-To-Equity (Res. 1460)	Re-lending	Bearer Bonds	Other Benefits
New Money Bonds	13/16%	12	5	✓		✓	• Exempt from Brazilian taxes • Debt-to-Debt
Cofinancing	13/16%	12	5	✓			• Debt-to-Debt
New Trade	- 13/16% at Banco Central - Other Negot.	Bullet Maturity of 9	N/A (9)	✓			• Debt-to-Debt • Medium term trade financing
Parallel	13/16%	12	5	✓	✓		• Equity Investment at 100% value • Debt-to-Debt
Exit Bonds	6% Fixed	25	10	✓		✓	• Reduces bank's base • Exchangeable for - OTNs - Export operations • Exempt from Brazilian taxes
MYDFA	13/16%	20	7	✓	✓		• Debt-to-Debt
Interbank	- 5/8% at Banco Central - Other Negot.	Up to 1, for 2.5	N/A				• Switch from Interbank to Trade Facility
Trade	- 5/8% at Banco Central - Other Negot.	Short: up to 1 Med: 1-2.5	N/A				• Fee of 1/8% of Commitment

Each Bank Must Commit 11.4% Of Its Base...

Base For Each Bank Equals:

- Total of Medium-term debt as of March 31, 1987, as verified by Banco Central, plus Trade and Interbank commitments.

Less

- Past New Money participations
- Exit Bonds
- Other exclusions to July 15, 1988
  - Local redemption/Debt forgiveness
  - Debt-for-Equity
  - Non-performing loans
  - Net of Debt assigned/acquired

Banks Must Commit Their Full 11.4% Share In Order To Be Eligible For Equity Investment Feature Of Parallel Facility

Each Bank May Allocate To:

- **New Money Bonds** — Up to lesser of 19.2% or $5 million
- **Cofinancing** — Up to 14.4%
- **Trade** — Up to 11.5%
- **Parallel** — At least 54.9%

Any Undersubscribed Facility Except Parallel

will be filled from Parallel based on banks' "second dip" preferences, as expressed in commitment telex.

Banks Committing Early Will Receive An Early Participation Fee

Commitment Date	Fee
On or before August 5, 1988	3/8% of aggregate commitment
After August 5, 1988, and on or before September 2, 1988	1/8% of aggregate commitment

BRAZIL ECONOMIC BRIEFING

June 1988

THE ECONOMIC DATA AND OTHER INFORMATION INCLUDED IN THIS PAMPHLET HAS BEEN FURNISHED BY OR IS BASED UPON CONSULTATIONS WITH REPRESENTATIVES OF THE CENTRAL BANK OF BRAZIL.

EACH BANK SHOULD MAKE ITS OWN INVESTIGATION AS THE BASIS OF ANY CREDIT DECISION AND NO REPRESENTATION OR WARRANTY, EXPRESS OR IMPLIED, AS TO THE COMPLETENESS, ACCURACY OR ADEQUACY OF SUCH DATA OR INFORMATION IS MADE OR INTENDED BY THE PRESENTATION THEREOF IN THIS PAMPHLET.

BRAZIL ECONOMIC BRIEFING

I. Background Economic Trends

CHART 1. Real GDP Growth, 1978-1988

CHART 2. Industrial Output, 1984-1988

CHART 3. Inflation and the Exchange Rate, 1986-1988

CHART 4. Trade Balance, 1978-1988

CHART 5. Trade Balance: Accumulated Surplus in Last 12 Months

CHART 6. Exports of Primary and Industrialized Products

CHART 7. Oil and Non-oil Imports

CHART 8. Capital Goods Imports, 1978-1988

CHART 9. International Reserves, 1985-1988

CHART 10. Total External Debt by Creditor, 1983-1987

CHART 11. Key Debt Ratios, 1981-1987

II. Foreign Exchange Cashflow Projections

TABLE 1. Foreign Exchange Cashflow, 1987-1989

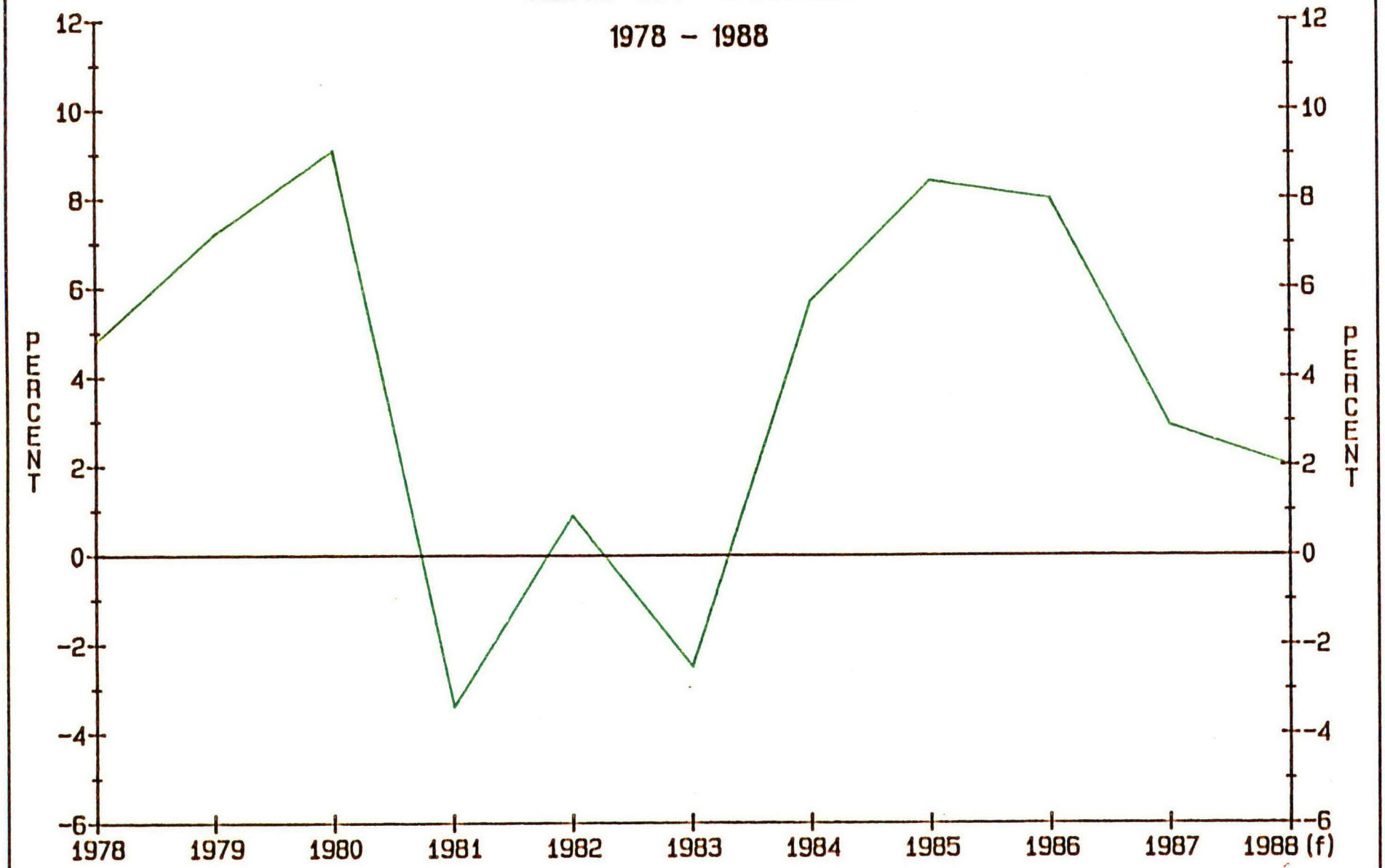
TABLE 2. Foreign Exchange Cashflow: Explanatory Details

CHART 12. New Lending to Brazil

TABLE 3. New Lending to Brazil - Official Sector and Commercial Banks

TABLE 4. Brazil's Interest Payments to Banks

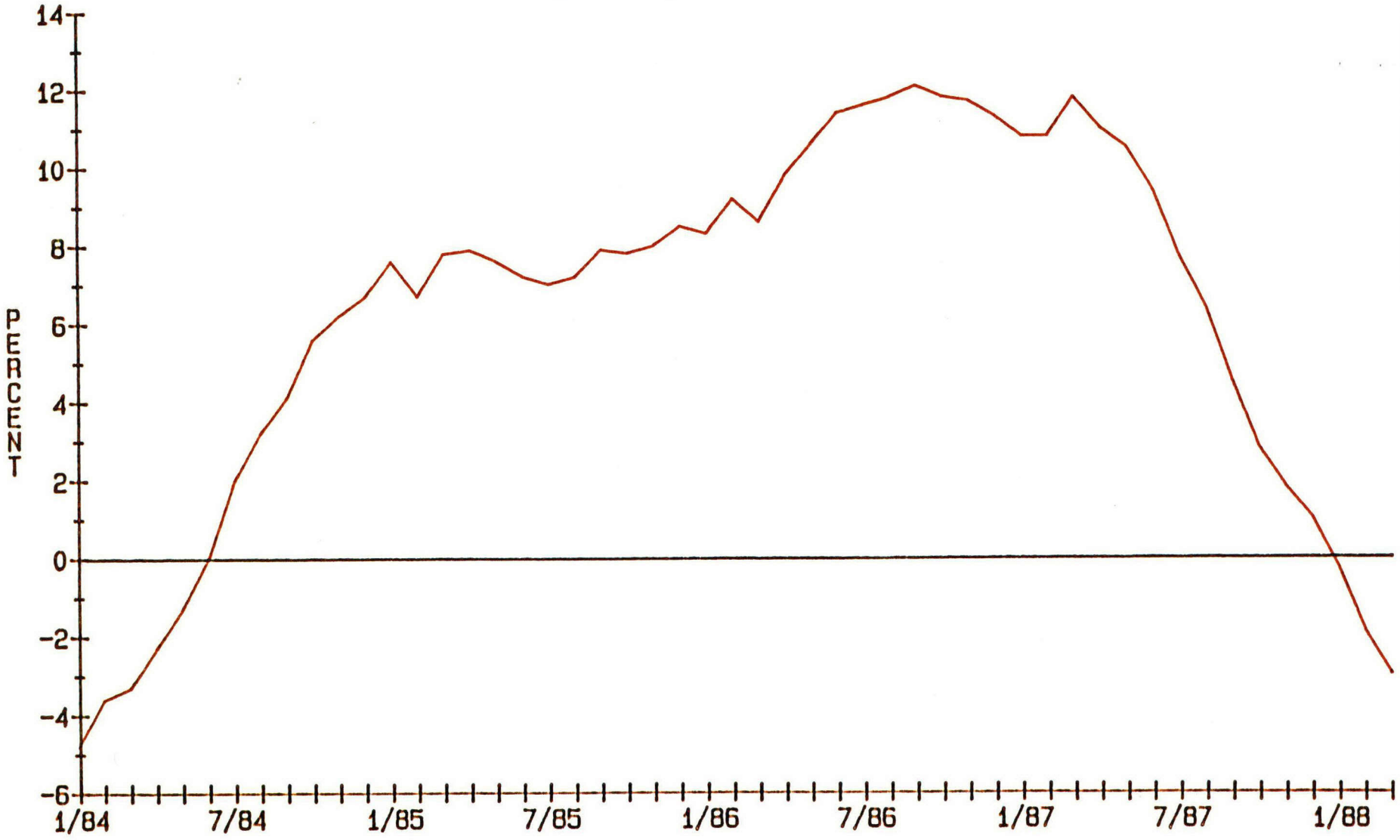
CHART 1
REAL GDP GROWTH
1978 - 1988



Source: Central Bank

CHART 2
INDUSTRIAL OUTPUT: 1984 – 1988

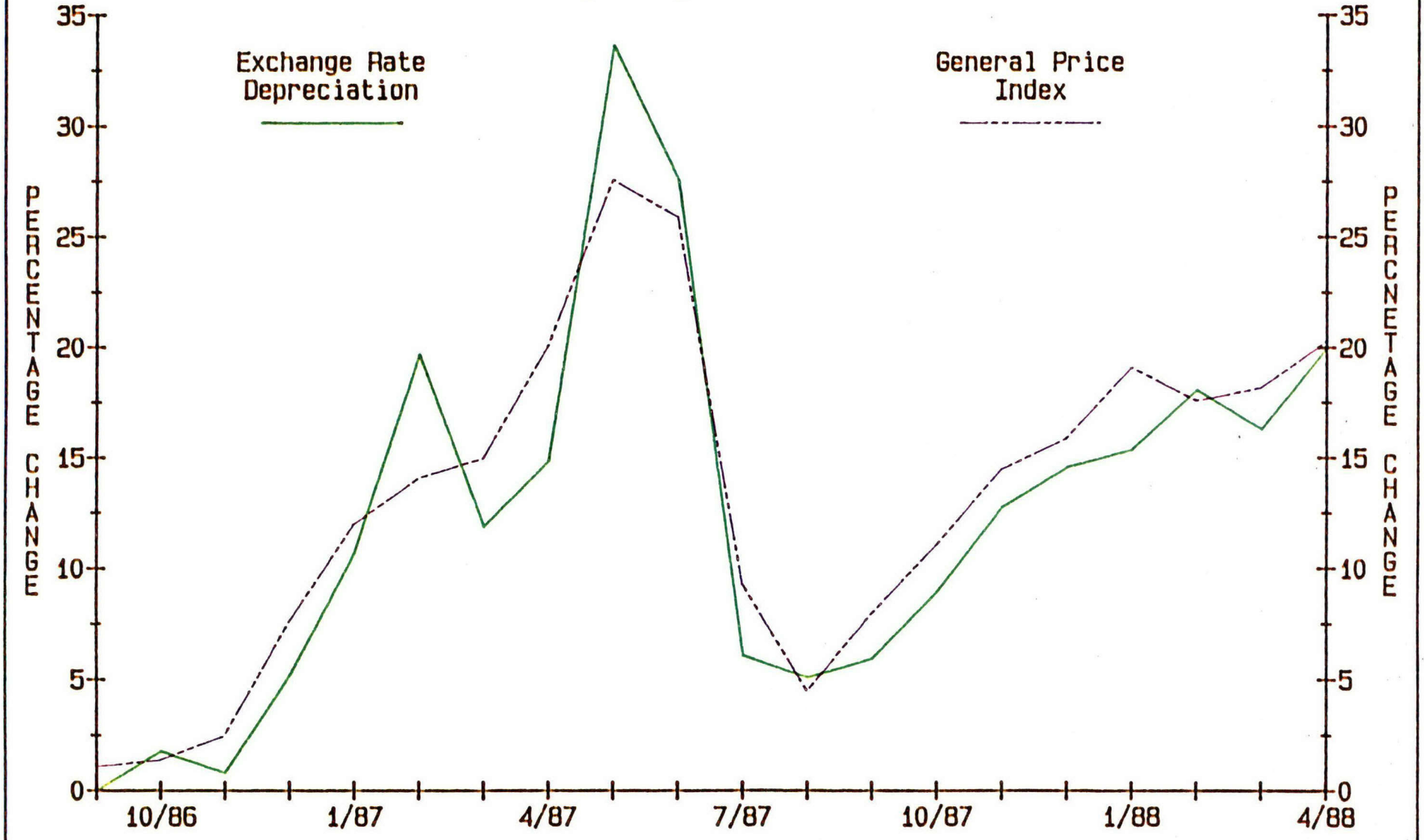
Percentage Change in Last 12 Months



Source: IBGE and Central Bank

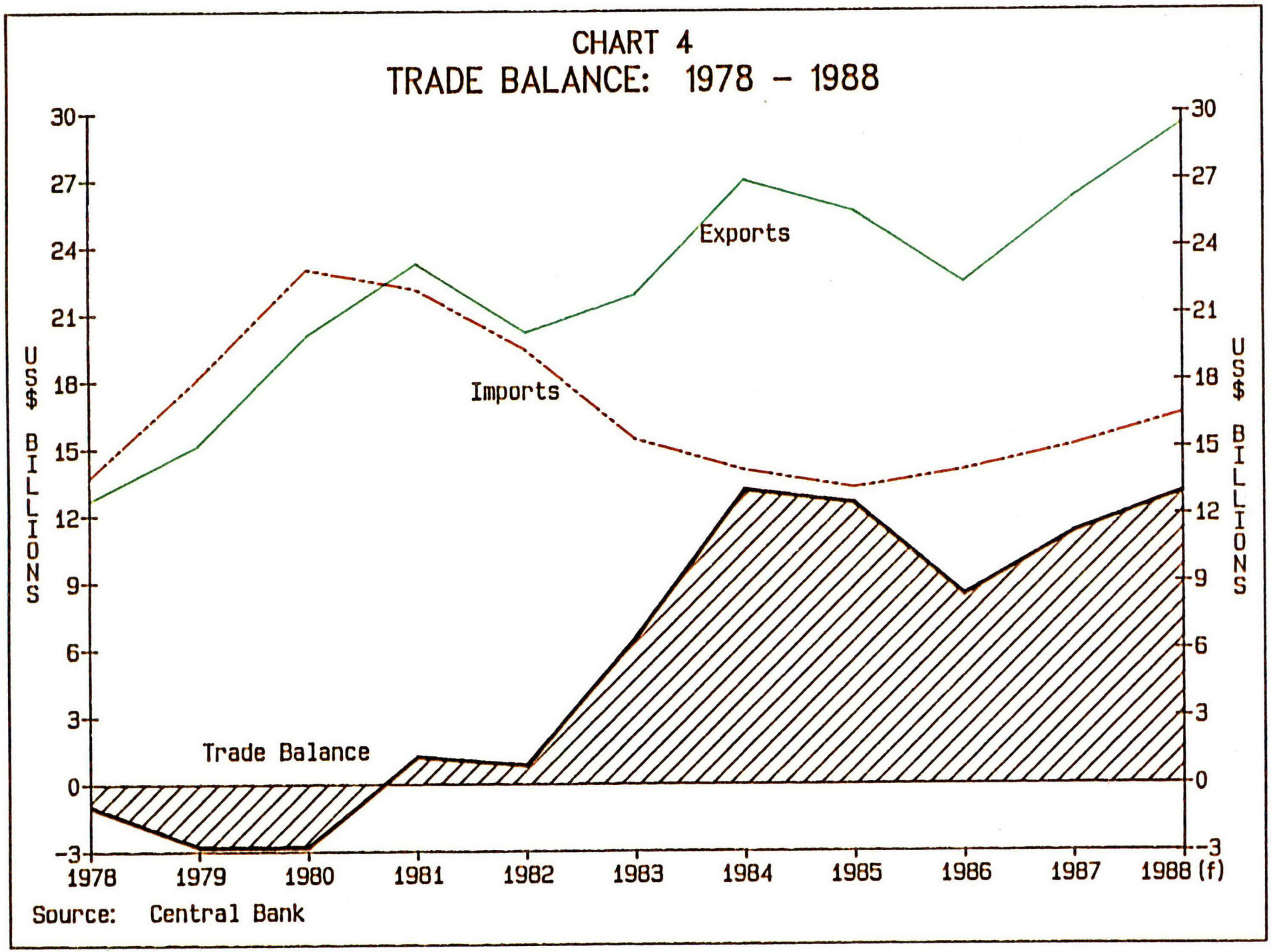
CHART 3
INFLATION AND THE EXCHANGE RATE

Monthly Changes, 1986 - 1988



Source: Central Bank

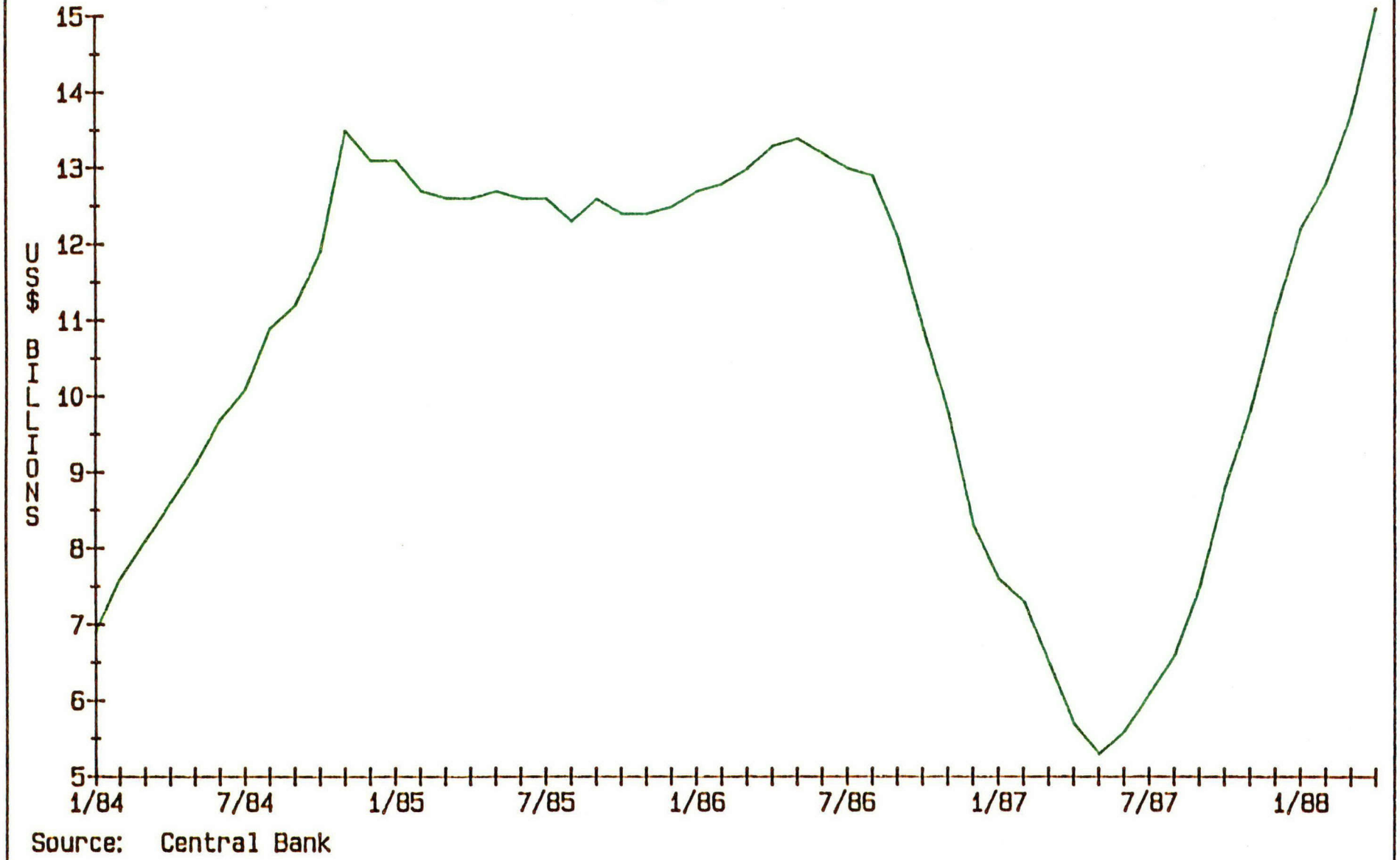
CHART 4
TRADE BALANCE: 1978 - 1988



Source: Central Bank

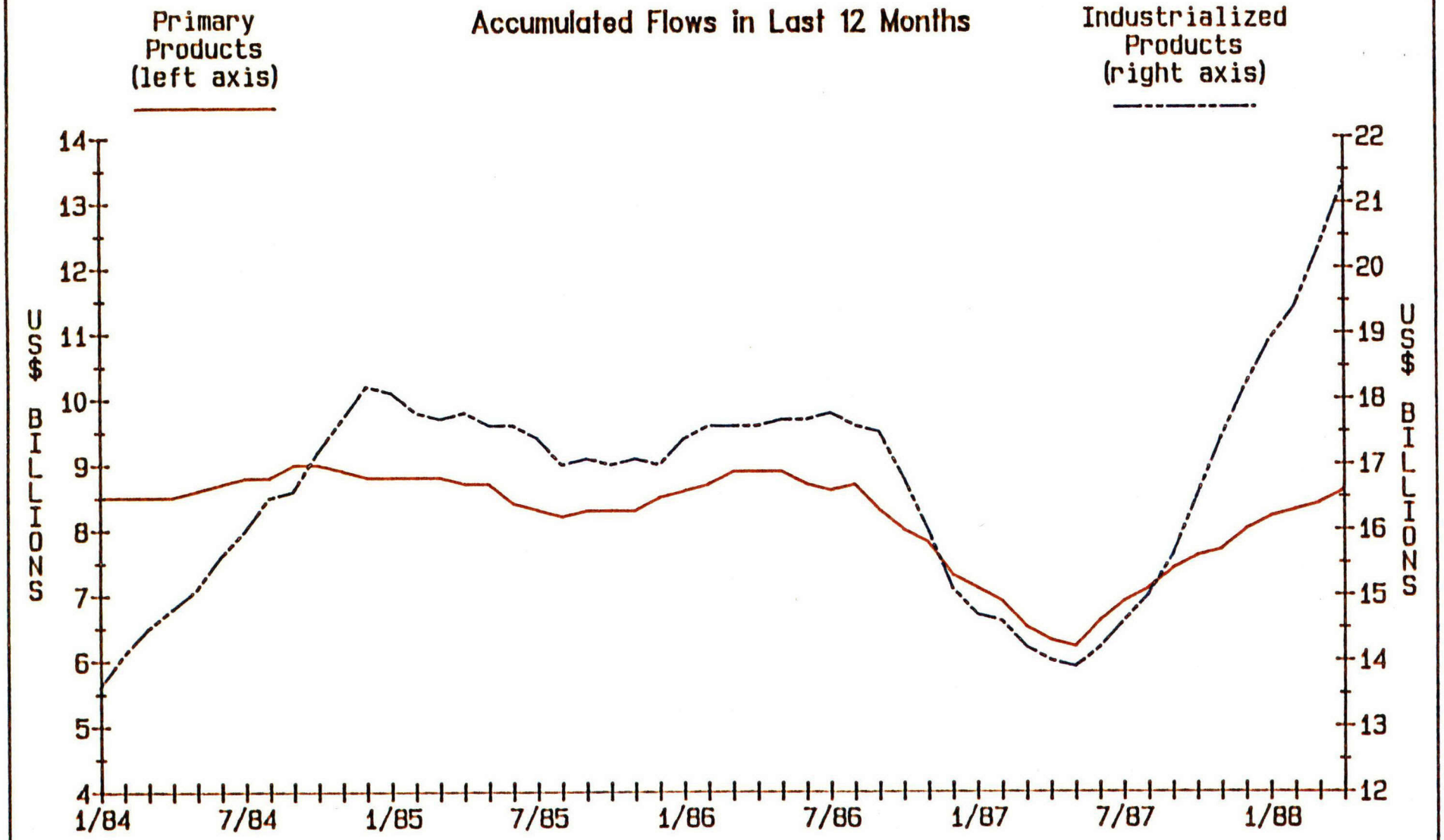
CHART 5
TRADE BALANCE: 1984 - 1988

Accumulated Surplus in Last 12 Months



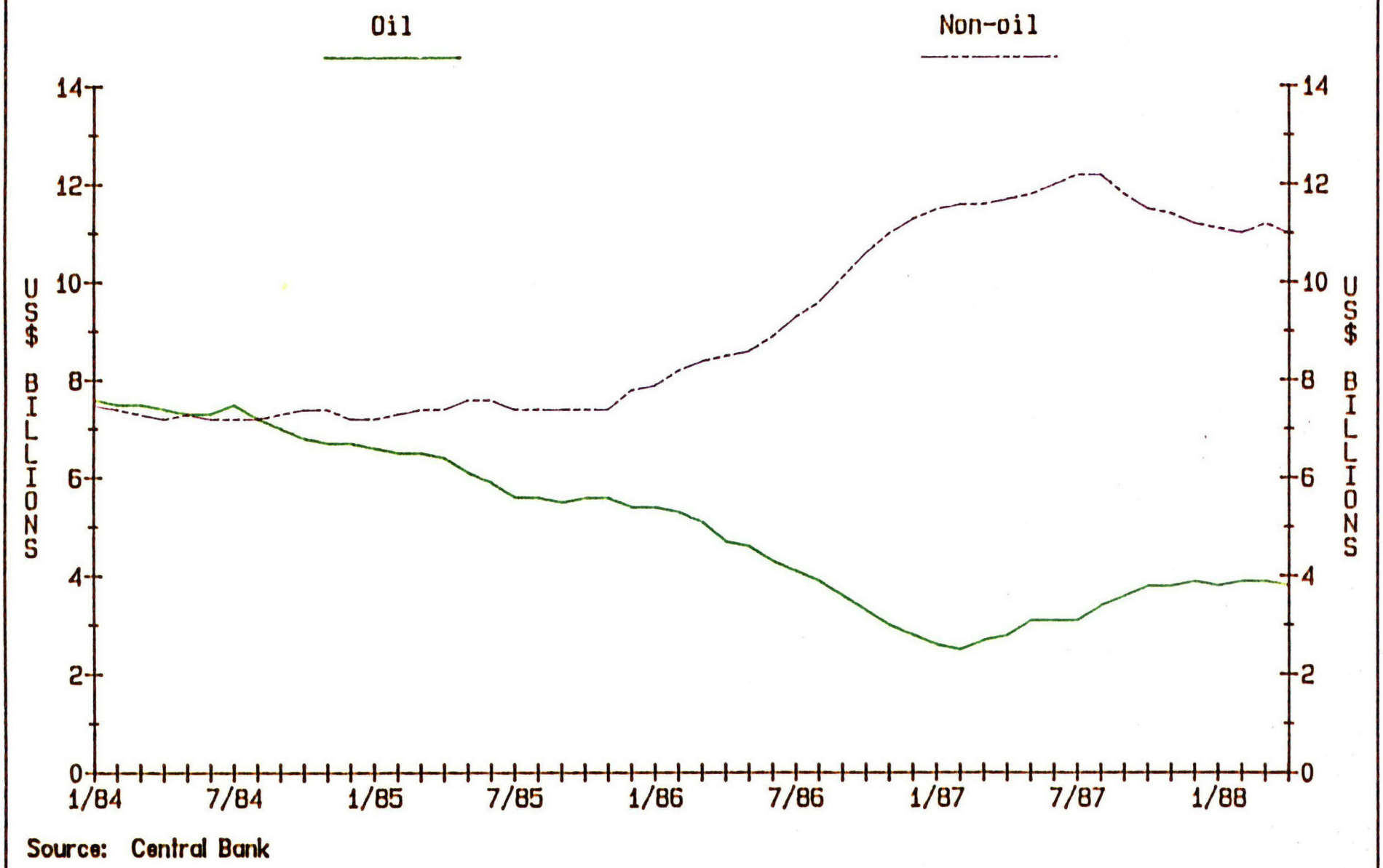
Source: Central Bank

CHART 6
EXPORTS OF PRIMARY AND INDUSTRIALIZED PRODUCTS
1984 - 1988



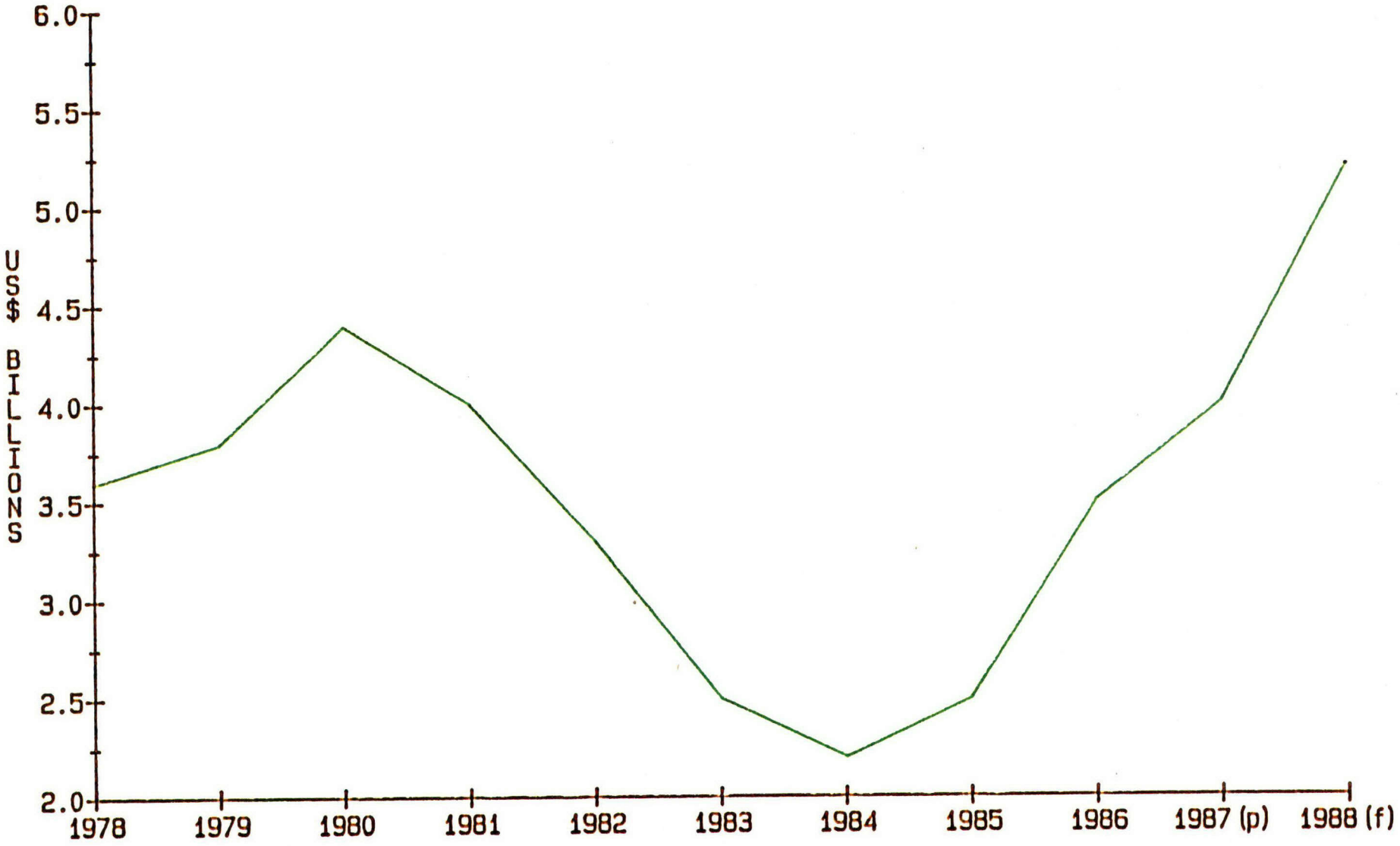
Source: Central Bank

CHART 7
OIL AND NON-OIL IMPORTS: 1984 - 1988
Accumulated Flows in Last 12 Months



Source: Central Bank

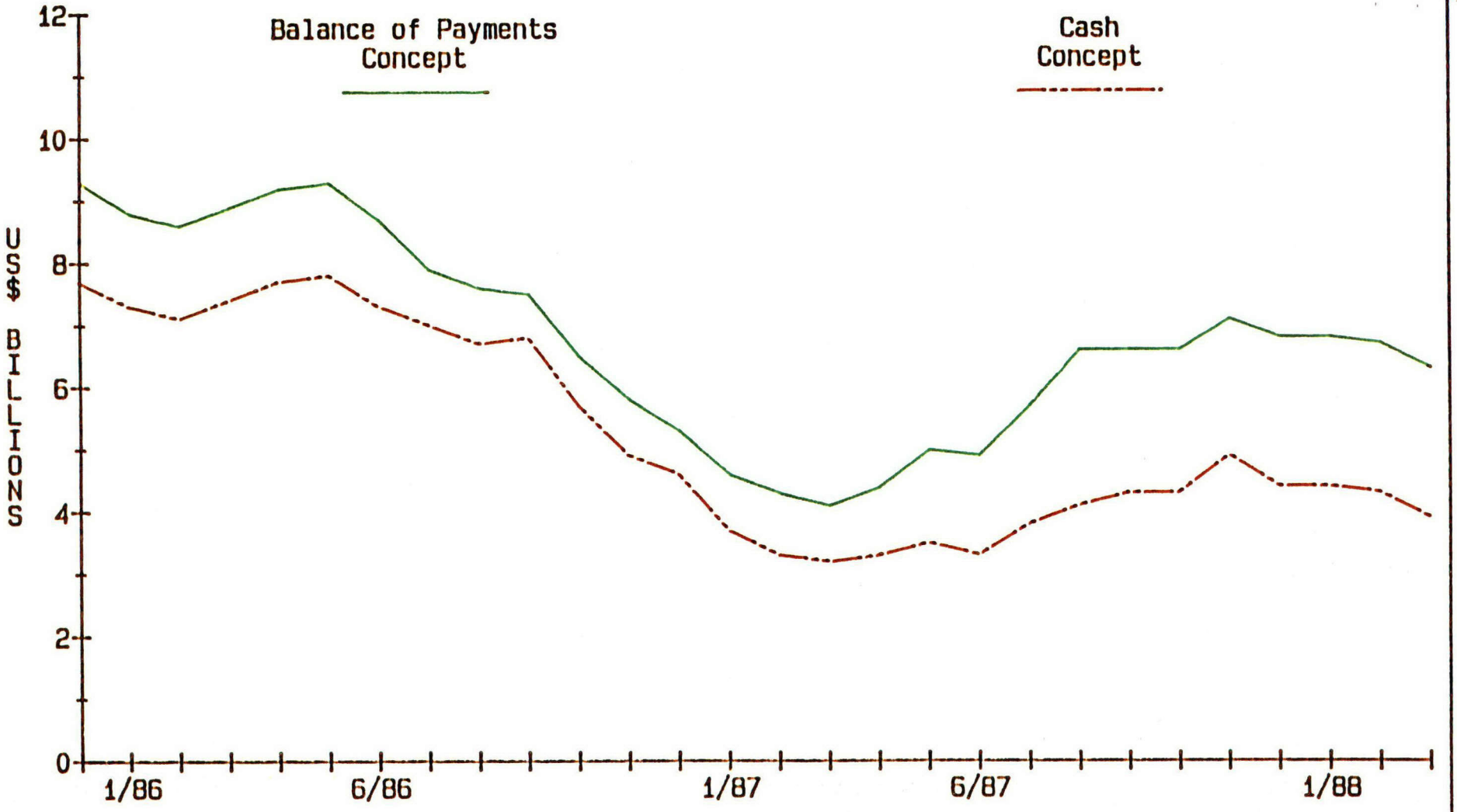
CHART 8
CAPITAL GOODS IMPORTS
1978 - 1988



Source: Central Bank

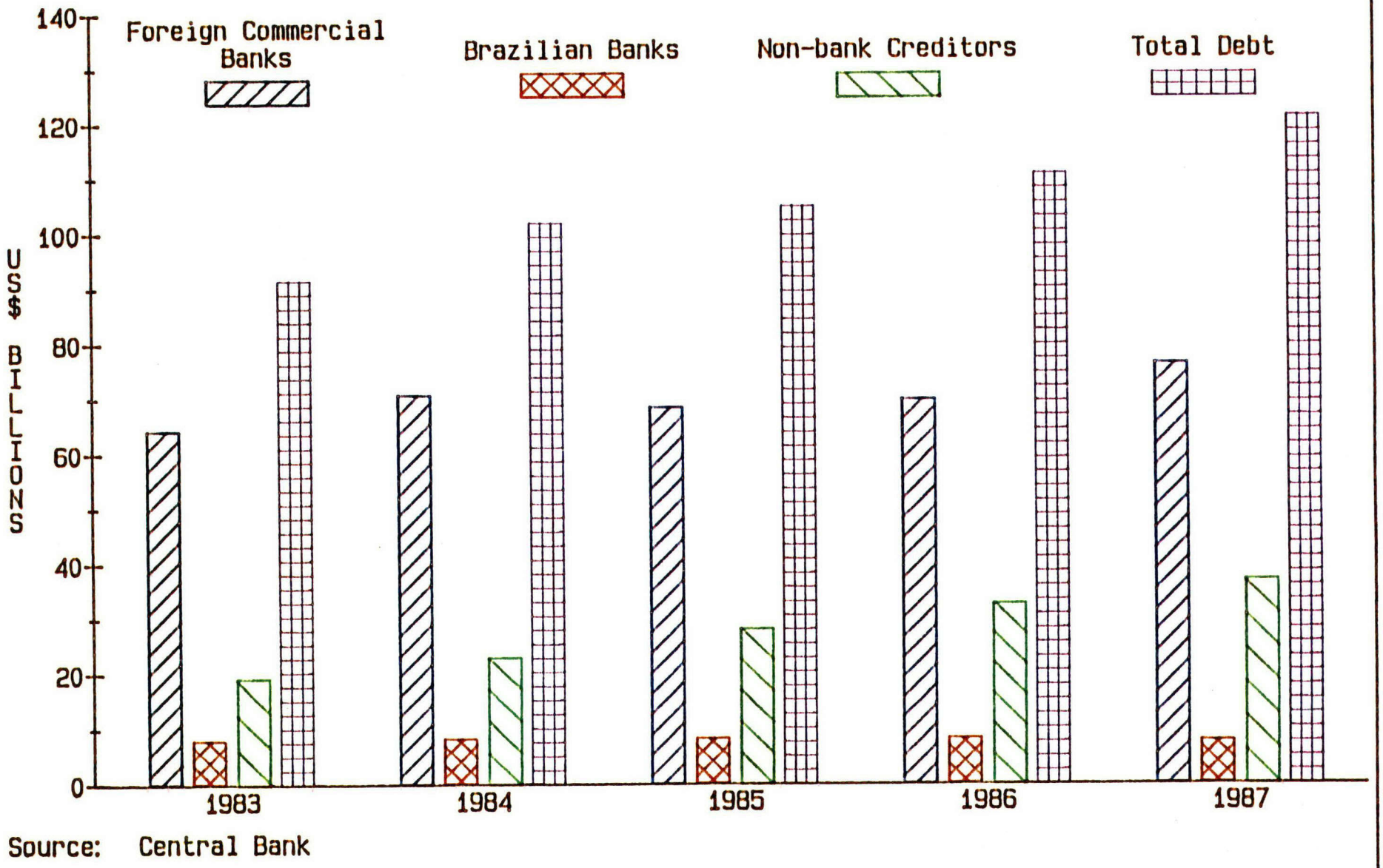
CHART 9
INTERNATIONAL RESERVES
IN THE CENTRAL BANK OF BRAZIL

1985 - 1988



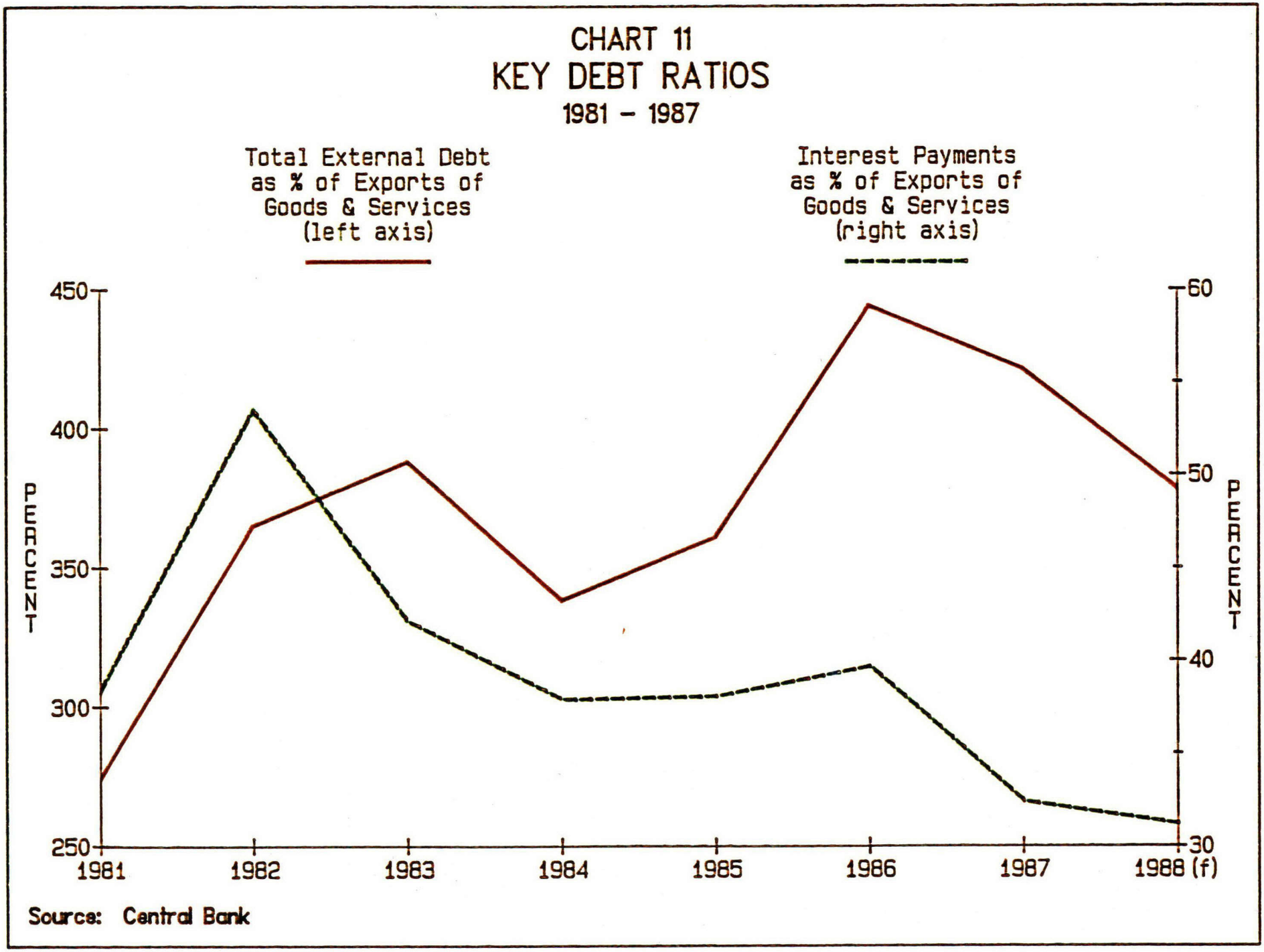
Source: Central Bank

CHART 10
TOTAL EXTERNAL DEBT BY CREDITOR
1983 - 1987



Source: Central Bank

CHART 11
KEY DEBT RATIOS
1981 - 1987



Source: Central Bank

Table 1.

Brazil: Foreign Exchange Cashflow, 1987 - 1989

$ billions

	1987	1988	1st Half 1989
Trade balance	11.2	13.0	6.0
Interest payments	-9.3	-10.8	-5.4
of which interest on arrears		-0.4	
Other services & transfers, net	-2.7	-3.3	-1.7
1. Current Account Balance	-0.8	-1.1	-1.1
Foreign investment in cash, net	0.1	0.2	0.1
IMF disbursements, net of repayments	-1.1	-0.4	0.0
World Bank & IFC loans, net of repayments	0.1	0.4	0.3
Inter-American Development Bank loans, net	0.1	0.1	0.0
Official export credit agencies and non-guaranteed suppliers credits, net	0.4	0.3	0.2
Eurobond and other excluded debt repayments	-0.7	-0.9	-0.3
2. Balance on Current and Long-term Capital	-1.9	-1.4	-0.8
Short-term capital, net	-0.6	0.6	0.3
of which:			
trade-related financing	-0.6	0.0	0.3
restoration of trade facility		0.6	
Errors and omissions	-0.5	0.0	0.0
3. Balance on Current and Capital Accounts	-3.0	-0.8	-0.5
4. Banco Central, Changes in Assets/Liabilities	3.0	-3.8	-0.1
1987 interest arrears	3.4	-3.4	
other short-term liabilities, net	0.5	-0.7	0.0
of which: bank interim financing	0.7	-0.7	
change in short-term assets (increase = -)	-1.0	0.3	-0.1
5. Balance Before Bank Financing (3 + 4)	0.0	-4.6	-0.6
6. Bank Financing	0.0	4.6	0.6
of which:			
agreed bank financing for 1987		3.0	
addl. borrowing requirements from banks		1.6	0.6
Memorandum item			
Change in official reserves (BOP definition, increase = -)	-1.5	0.0	-0.2
of which:			
change in short-term assets	-1.0	0.3	-0.1
monetization of gold	-0.3	-0.3	-0.1
valuation adjustments	-0.2	0.0	0.0

NOTE: These projections of the Economic Subcommittee are based on discussions with representatives of the official sector and Brazilian authorities.

6/29/88

Table 2.

Foreign Exchange Cashflow -- Explanatory Details

A. Key Forecast Assumptions

	1988	1989 1st Half
Brazilian real GDP growth	2.0%	6.0%
LIBOR	7.6%	8.25%
World trade growth (real)	3.0%	3.0%
World output growth (real)	2.0%	2.0%
Petroleum prices ($/bbl.)	$16.30	$17.50
Commodity price change	6.0%	5.5%
U.S. dollar inflation	5.5%	5.5%

B. 1987 Interest Arrears and Interim Financing Agreement

($ Million)

	Dec. 1987	Dec. 31 1987	Jan. 1988	Jan. 31 1988	Oct. 1988
Interim Payments					
banks	715		240		
Brazil	357		205		
Liabilities of Banco Central					
outstanding 1987 arrears		3429		2984	
interim owed to banks		715		955	
Total		4144		3939	
Interest owed on*					
1987 arrears					333
interim financing					82
Total					415
Arrears cleanup					
principal					3939
interest					415
Total					4354

*projected

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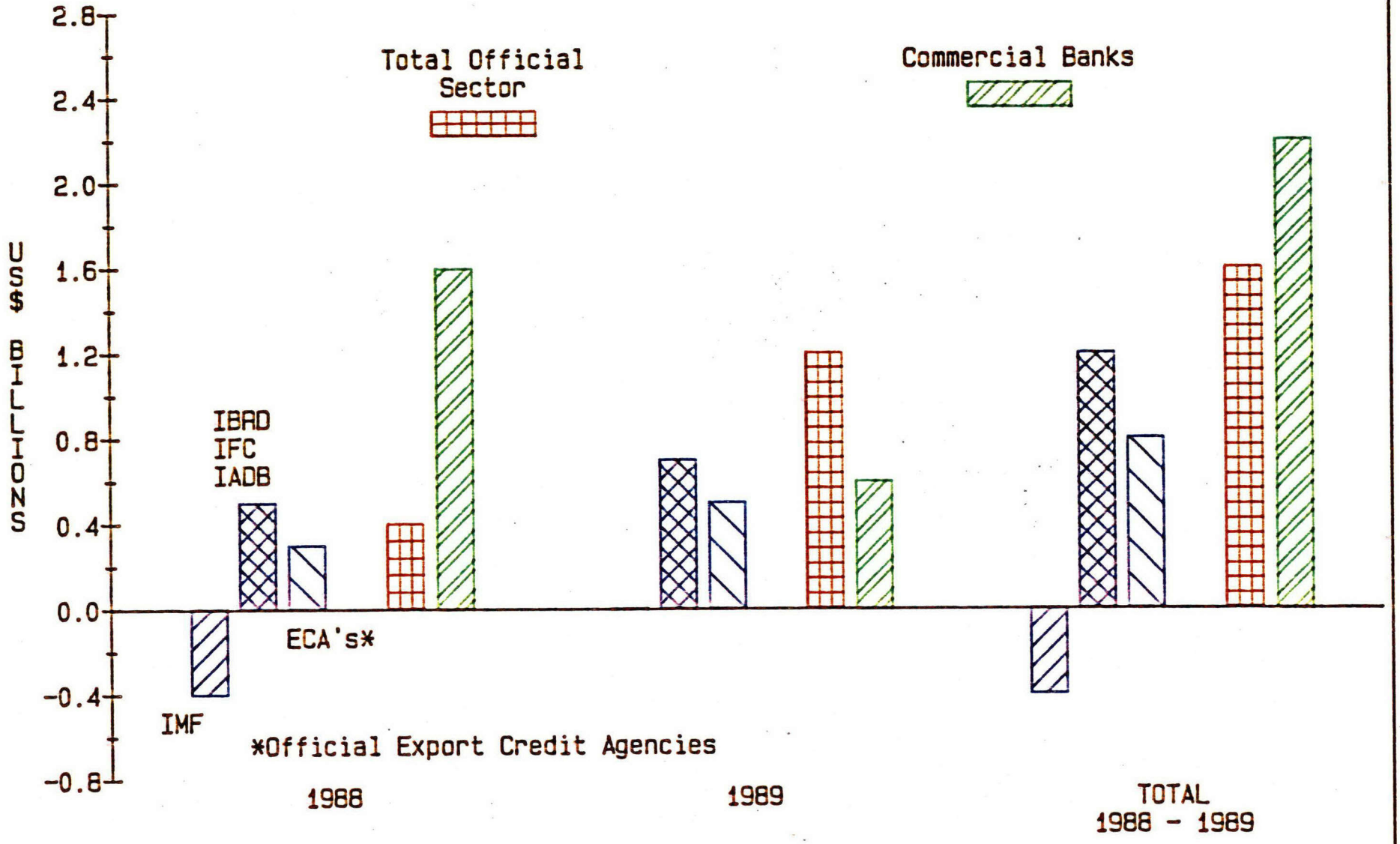
CHART 12
NEW LENDING TO BRAZIL: 1988 - 1989
Loans Net of Principal Repayments



Source: Table 3

Table 3.

New Lending to Brazil - Official Sector and Commercial Banks

Medium- and long-term loans net of principal repayments, in billions of dollars.

	1988	1989	Total
IMF	-0.4	0.0	-0.4
IBRD, IFC, & IADB	0.5	0.7	1.2
Official export credit agencies	0.3	0.5	0.8
Subtotal official sector	0.4	1.2	1.6
Commercial banks	1.6	0.6	2.2
TOTAL	2.0	1.8	3.8

Note: These projections of the Economic Subcommittee are based upon discussions with representatives of the official sector and Brazilian authorities. New money projections for commercial banks in 1988-89 exclude Brazilian savings due to interest rate reductions and the retiming of interest payments.

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Table 4.

Brazil's Interest Payments to Banks

Estimated interest on medium- and short-term debt to foreign commercial banks, in billions of dollars.

	1987	1988	1989*	Totals
Interest on Medium-term debt	5.3	6.0	6.0	17.3
Interest on Short-term debt				
Project 3 (Trade)	0.7	0.8	1.0	2.5
Project 4 (Interbank)	0.4	0.4	0.3	1.1
Total interest payments to foreign banks	6.4	7.2	7.3	20.9

---

*Full-year basis.

NOTE: These data take into account reductions due to interest rate adjustments (repricing and carve-out), which are estimated to total $480 million in 1988-89.

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