BRAZIL - JANUARY 1993 - Dec, 1993 - 192/5

#588175

BRAZIL January 1993 - December 1993

Rm 1996-0055-0001
Box 900108378

REPORT OF MEMBERS, DEPOSITORIES & FISCAL AGENCIES

MEMBER	DEPOSITORY	FISCAL AGENCY
BRAZIL		
Mr. Pedro Sampaio MALAN President Banco Central do Brasil SBS - Edif. Sede Banco Central 70074 Brasilia, DF Brazil	Dept. for International Operations-DIORP Banco Central do Brasil Caixa Postal 1102/11 70074 Brasilia, DF Brazil	Dept. for International Operations-DIORP Banco Central do Brasil Caixa Postal 1102/11 70074 Brasilia, DF Brazil
cc: Department for International Organisations and Agreements (DEORI) Banco Central do Brasil Caixa Postal 08.670 70074 Brasilia, DF Brazil	cc: Department for International Organisations and Agreements (DEORI) Banco Central do Brasil Caixa Postal 08.670 70074 Brasilia, DF Brazil	cc: Department for International Organisations and Agreements (DEORI) Banco Central do Brasil Caixa Postal 08.670 70074 Brasilia, DF Brazil
BULGARIA		
Bulgarian National Bank 1, Alexander Battenberg Square 1000 Sofia Republic of Bulgaria	Bulgarian National Bank 1, Alexander Battenberg Square 1000 Sofia Republic of Bulgaria	Bulgarian National Bank 1, Alexander Battenberg Square 1000 Sofia Republic of Bulgaria
BURKINA FASO		
H.E. Ousmane OUEDRAOGO Minister of State, Minister of Finance and Planning Ministere des Finances et du Plan B.P. 7008 Ouagadougou Burkina Faso	Mr. Charles KONAN BANNY Governor Banque Centrale des Etats de l'Afrique de l'Ouest B.P. 3108 Avenue Abdoulaye Fadiga Dakar Senegal	Mr. Charles KONAN BANNY Governor Banque Centrale des Etats de l'Afrique de l'Ouest B.P. 3108 Avenue Abdoulaye Fadiga Dakar Senegal
cc: Banque Centrale des Etats de l'Afrique de l'Ouest B.P. 356 Ouagadougou Burkina Faso	cc: Banque Centrale des Etats de l'Afrique de l'Ouest B.P. 356 Ouagadougou Burkina Faso	cc: Banque Centrale des Etats de l'Afrique de l'Ouest B.P. 356 Ouagadougou Burkina Faso
cc: Mr. Charles KONAN BANNY Governor Banque Centrale des Etats de l'Afrique de l'Ouest B.P. 3108 Avenue Abdoulaye Fadiga Dakar Senegal		

STB
FVB
JF
IO
F

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

93 DEC 13 AM 9:21

To: The Managing Director
The Deputy Managing Director

December 10, 1993

From: S.T. Beza

Subject: Brazil--Meeting with Mr. Pedro Malan

Minister Cardoso's announcement of the economic program for 1994 was largely along the lines described in the back-to-office report of the recent mission (the cover note of which is attached). Initial reactions to the program are varied, but a general view seems to be that passage of the program will be quite difficult.

The Minister stressed repeatedly the need for a strong fiscal policy before other measures directed to the lowering of inertial inflation would be taken. These measures include the introduction of an index which would help induce contemporaneous and synchronized adjustment of most prices (removing backward-looking indexation) and the subsequent establishment of a new, strong currency. We were surprised by the detailed description of these two elements.

The Minister also set forth the constitutional reforms needed to strengthen the structure of the public finances and help sustain fiscal adjustment over the medium term. The proposed budget for the Federal Government showed an operational deficit of about 1 percent of GDP, but the Secretary of Economic Policy called this week to inform us that further revenue measures are being considered. This may be a response to the staff's emphasis on the need for an operational surplus.

Monetary policy was tightened significantly in late September 1993, and the annualized real interest rate in the overnight market of government securities has been kept at around 22 percent since then (it had averaged 4 percent in the first nine months of the year). The authorities indicated to the recent mission their intention to maintain the current level of real interest rates during 1994, with a further increase for a period of 2-3 months following the fixing of the exchange rate (say in June).

The mission had suggested that consideration be given to raising real interest rates considerably in the early months of the year (to perhaps around 30 percent) if a sure start was to be made in reducing inflation. It also suggested that higher real interest rates may be needed for a longer period than the authorities seem to have in mind after the fixing of the exchange rate.

mission mid January

Attachment

cc: Mr. van Houten
Ms. Saunders

F

Office Memorandum

To: The Managing Director
The Deputy Managing Director

December 10, 1993

From: S.T. Beza

Subject: Brazil--Meeting with Mr. Pedro Malan

Minister Cardoso's announcement of the economic program for 1994 was largely along the lines described in the back-to-office report of the recent mission (the cover note of which is attached). Initial reactions to the program are varied, but a general view seems to be that passage of the program will be quite difficult.

The Minister stressed repeatedly the need for a strong fiscal policy before other measures directed to the lowering of inertial inflation would be taken. These measures include the introduction of an index which would help induce contemporaneous and synchronized adjustment of most prices (removing backward-looking indexation) and the subsequent establishment of a new, strong currency. We were surprised by the detailed description of these two elements.

The Minister also set forth the constitutional reforms needed to strengthen the structure of the public finances and help sustain fiscal adjustment over the medium term. The proposed budget for the Federal Government showed an operational deficit of about 1 percent of GDP, but the Secretary of Economic Policy called this week to inform us that further revenue measures are being considered. This may be a response to the staff's emphasis on the need for an operational surplus.

Monetary policy was tightened significantly in late September 1993, and the annualized real interest rate in the overnight market of government securities has been kept at around 22 percent since then (it had averaged 4 percent in the first nine months of the year). The authorities indicated to the recent mission their intention to maintain the current level of real interest rates during 1994, with a further increase for a period of 2-3 months following the fixing of the exchange rate (say in June).

The mission had suggested that consideration be given to raising real interest rates considerably in the early months of the year (to perhaps around 30 percent) if a sure start was to be made in reducing inflation. It also suggested that higher real interest rates may be needed for a longer period than the authorities seem to have in mind after the fixing of the exchange rate.

Attachment

cc: Mr. van Houten
Ms. Saunders

Office Memorandum

PLEASE DO NOT COPY

To: The Managing Director
The Deputy Managing Director

December 1, 1993

From: S.T. Beza

Subject: Brazil--Back-to-Office Report

Attached is the back-to-office report of the mission headed by Mr. Fajgenbaum that returned last week from Brasilia. The mission discussed with the authorities the main elements of their economic program for 1994, but many aspects of the program and key policy measures still have to be defined. The authorities asked that the staff team return to Brasilia around mid-January 1994; in the meantime, the authorities said that they would maintain close contact with the staff. No action by management is required at this stage.

Financial policies have weakened significantly in 1993, and monthly inflation has risen to around 36 percent. A tightening of monetary policy since late September seems to have prevented a further acceleration of inflation. Real GDP is projected to grow by 4 percent in 1993, although economic activity has slowed down in the second half of the year. The balance of payments has remained strong, and gross reserves are expected to reach US$28 billion by end-1993 (up US$5 billion from end-1992).

As the authorities describe it, the economic program would achieve a very gradual reduction of inflation during the first five-six months of the year (the time needed for fiscal adjustment and the adoption of wage legislation to synchronize contracts), followed by a rapid decline once the exchange rate was fixed. A new indexation mechanism--based on the U.S. dollar--would be introduced to eliminate backward-looking indexation and induce a contemporaneous and synchronized adjustment of most prices. In the authorities view this would make feasible a quick reduction of inflation once the exchange rate is fixed. The program also contemplates a number of structural reforms in the fiscal, international trade, and privatization areas.

The mission warned the authorities that the fiscal plan they were about to present to Congress (operational deficit of 1 percent of GDP at the level of the Federal Government) was not good enough for the kind of program they envisaged; the mission indicated that a surplus was needed. The mission also suggested that interest rates may need to be quite high for some time. The authorities agreed to give consideration to these concerns.

The authorities expect congressional approval of the revised budget for the Federal Government (currently being prepared) and of a

Stabilization Fund (which requires an amendment to the Constitution) by mid-January 1994, and of a more comprehensive revision of the Constitution by mid-March. Although most congressional activities have stopped because of an investigation into corruption allegations affecting a number of members of Congress, the Minister of Finance feels that the fiscal proposals will receive early consideration. In the meantime, the authorities intend to introduce certain tax measures by administrative acts, but the validity of these measures for next year is not clear.

Attachment

cc: FAD, LEG, MAE, PDR, RES, SEC, TRE, WHD
Ms. Saunders

Office Memorandum

(F)

Brazil

To: The Managing Director
The Deputy Managing Director

December 3, 1993

From: S.T. Beza

Subject: Meeting With the Brazilian Ambassador

Attached is the curriculum vitae of the Brazilian Ambassador to the United States, Mr. Paulo Tarso Flecha de Lima.

We sent you the back-to-office report of the recent mission to Brazil last Wednesday, December 1.

Attachment

cc: Ms. Saunders

THE INTERNATIONAL MONETARY FUND ARCHIVES

RECORD CLOSURE NOTICE

The item identified below has been closed in accordance with the International Monetary Fund's IMF's Open Archives Policy (Decision No. 14498 – (09/126), adopted 2009-12-17 and effective 2010-03-17, as amended. This policy can be found on the International Monetary Fund website.

This record ☒ or file ☐ has been closed as it belongs to one of the following exemptions:

☐ **Legal records and other material that are protected by attorney client privilege**

☒ **Personnel files, medical information, or other records containing personal information**

☐ **Records and proceedings of the Grievance Committee**

☐ **Records acquired by the Fund by Third Parties, including Member Countries, with security classifications of 'CONFIDENTIAL' or above.** **(Declassification can be requested)**

☐ **Other sensitive nature:** N/A

Archival Ref No.:	588175
File Title & Dates:	Brazil January-December, 1993
Fonds:	Western Hemisphere Department Records, 1946-2003
Sous-fonds	Western Hemisphere Department Immediate Office Records, 1949-2000
Series:	WHDAI Country Files, 1971-1995
Box Number:	A588018-192
File Number:	5
Date Reviewed:	2024-24-25

DETAILS OF WITHDRAWN MATERIAL

DATE	1993
TYPE	Curriculum Vitae
TO	N/A
FROM	Paulo Tarso Flecha de Lima
SUBJECT/TITLE	Personal
NO. OF PAGES	1
AUTHORITY	N/A
LANGUAGE	English

(F)

INTERNATIONAL MONETARY FUND

Office Memorandum

PLEASE DO NOT COPY

To: The Managing Director
The Deputy Managing Director

December 1, 1993

From: S.T. Beza MB

Subject: Brazil--Back-to-Office Report

Attached is the back-to-office report of the mission headed by Mr. Fajgenbaum that returned last week from Brasilia. The mission discussed with the authorities the main elements of their economic program for 1994, but many aspects of the program and key policy measures still have to be defined. The authorities asked that the staff team return to Brasilia around mid-January 1994; in the meantime, the authorities said that they would maintain close contact with the staff. No action by management is required at this stage.

Financial policies have weakened significantly in 1993, and monthly inflation has risen to around 36 percent. A tightening of monetary policy since late September seems to have prevented a further acceleration of inflation. Real GDP is projected to grow by 4 percent in 1993, although economic activity has slowed down in the second half of the year. The balance of payments has remained strong, and gross reserves are expected to reach US$28 billion by end-1993 (up US$5 billion from end-1992).

As the authorities describe it, the economic program would achieve a very gradual reduction of inflation during the first five-six months of the year (the time needed for fiscal adjustment and the adoption of wage legislation to synchronize contracts), followed by a rapid decline once the exchange rate was fixed. A new indexation mechanism--based on the U.S. dollar--would be introduced to eliminate backward-looking indexation and induce a contemporaneous and synchronized adjustment of most prices. In the authorities view this would make feasible a quick reduction of inflation once the exchange rate is fixed. The program also contemplates a number of structural reforms in the fiscal, international trade, and privatization areas.

The mission warned the authorities that the fiscal plan they were about to present to Congress (operational deficit of 1 percent of GDP at the level of the Federal Government) was not good enough for the kind of program they envisaged; the mission indicated that a surplus was needed. The mission also suggested that interest rates may need to be quite high for some time. The authorities agreed to give consideration to these concerns.

The authorities expect congressional approval of the revised budget for the Federal Government (currently being prepared) and of a

Stabilization Fund (which requires an amendment to the Constitution) by mid-January 1994, and of a more comprehensive revision of the Constitution by mid-March. Although most congressional activities have stopped because of an investigation into corruption allegations affecting a number of members of Congress, the Minister of Finance feels that the fiscal proposals will receive early consideration. In the meantime, the authorities intend to introduce certain tax measures by administrative acts, but the validity of these measures for next year is not clear.

Attachment

cc: FAD, LEG, MAE, PDR, RES, SEC, TRE, WHD
Ms. Saunders

Office Memorandum

To: The Managing Director
The Deputy Managing Director

December 1, 1993

From: J. Fajgenbaum JF

Subject: Brazil--Back to Office Report

The mission that returned last week from Brasilia held discussions with the Minister of Finance, the President of the Central Bank, and other senior officials. 1/ The authorities described the main elements of their economic program for 1994, although it became clear in the discussions that several aspects of the program and the timing of key measures still have to be defined. Furthermore, there are a number of legal issues regarding the implementation of certain fiscal measures which the authorities are trying to clarify. The authorities asked that a staff team return to Brasilia around mid-January 1994 to negotiate a possible stand-by arrangement. In the meantime, they would maintain close contact with the staff.

Since mid-October the political situation has been dominated by corruption allegations involving a number of members of Congress. This has all but halted most congressional activities, including the revision of the Constitution that started in early October. The Minister of Finance, however, feels confident that the crisis affecting Congress would facilitate a speedy approval of the revised budget for the Federal Government and other fiscal measures.

1. Recent economic developments

Financial policies have weakened significantly in 1993. The surplus in the primary balance of the public sector is projected to decline from 2.2 percent of GDP in 1992 to virtually zero in 1993; over the same period, however, the deficit in the operational balance is estimated to fall from 2.3 percent of GDP to 2 percent of GDP, reflecting a sharp drop in real interest payments on domestic debt facilitated by a lax monetary policy during most of 1993. Real interest rates in the overnight market of government securities declined from an average of 30 percent in 1992 to 4 percent (on an annual basis) during the first nine months of 1993.

Monthly inflation rose from 24 percent in December 1992 to around 36 percent in September-October 1993, but a recent tightening of

---

1/ The mission comprised Messrs. Lizondo, Medeiros and Traa, Ms. Heysen and myself.

monetary policy seems to have halted a widely expected further acceleration. Annual inflation (from December to December) is expected to reach more than 2,700 percent in 1993 compared with 1,160 percent in 1992. Despite a slowdown in economic activity in the second half of the year, real GDP is projected to grow by about 4 percent in 1993, mainly on account of a strong expansion of the automotive sector which has benefitted from tax and credit incentives.

The trade balance is estimated to decline from US$15.5 billion in 1992 to US$13.5 billion in 1993, notwithstanding continued export strength. The sharp expansion of imports has reflected increased domestic demand, the further reduction of import duties in early July, and some real appreciation of the cruzeiro. Net capital inflows have remained high, and gross international reserves are projected to increase by US$5 billion to US$28 billion by end-1993, the equivalent of 10 months of imports of goods and nonfactor services.

2. Report on the discussions

The key objective of the economic program being prepared by the authorities is to reduce inflation substantially in 1994. During the first 5-6 months of the year (the time needed to demonstrate fiscal adjustment and introduce new wage legislation), inflation would decline gradually on the strength of the financial policies being planned, and then it would drop to close to international levels following the fixing of the exchange rate. The program also contemplates a number of important reforms, including modifications to the Constitution that would result in structural improvements in the public finances and the social security system, as well as in the removal of restrictions on private sector activity in certain sectors of the economy.

The authorities are revising the draft federal government budget for 1994 presented to Congress last August with the aim of limiting the operational deficit to nearly 1 percent of GDP (to be externally financed); they expect this to be consistent with a primary surplus of just over one percent of GDP. The revised budget would avoid the unintended increases in real wages and social security benefits included in the original draft budget and would envisage a reduction in other current expenditure. The revised budget also would count on congressional approval of a Stabilization Fund that would introduce a tax surcharge (currently envisaged at 5 percent and yielding nearly one percent of GDP) and would allow for a reduction of one percent of GDP in mandatory expenditure and transfers to the state and municipal governments. Because the authorities expect Congress to approve the Stabilization Fund (which involves an amendment to the Constitution) and the revised budget only by mid-January 1994, they intend to introduce the tax surcharge by an administrative measure before year-end so that it can become effective in 1994.

The mission emphasized the need to aim at a surplus in the public sector operational balance in 1994 if the key objective of the program was to be achieved, while providing a margin to deal with slippages or unexpected developments during the transition to low inflation. The mission also noted that a larger primary surplus than envisaged would be needed even to achieve the authorities' target for the operational balance because real interest rates may have to be higher than contemplated (see below), and thus result in an interest bill that is higher than currently projected.

The authorities emphasized that targeting an operational surplus was politically difficult. Moreover, they stressed that a surplus was not necessary because, in a major departure from previous practice, the fiscal program would not rely on inflation as a mechanism to reduce in real terms expenditures which are not fully indexed in order to lower the deficit ex-post. Nevertheless, as inflation would remain high in the first part of 1994 the resulting inflation tax would help reduce domestic public debt.

The authorities agreed, however, on the need to build some margins into the fiscal program, and stated that this could be done at the time of the discussions with the staff in January. The mission suggested that the margin be built through additional revenue measures, perhaps by raising the rate of the tax surcharge, because a further compression of expenditure might not be sustainable. Moreover, the mission noted that the assumed 4 percent growth in real GDP built in the revenue projections for 1994 was optimistic, and that a more realistic assumption may lower those projections significantly. Also, the mission encouraged the authorities to prepare revenue measures that could replace the tax on bank debits (expected to yield about one percent of GDP in 1994) should the Supreme Court rule against the tax, when it reviews it on December 19, 1993. The authorities agreed to give consideration to these concerns.

The authorities assumed that the public enterprises and the state and municipal governments would show an operational balance of zero in 1994, although preliminary projections prepared by the staff show a deficit of one percent of GDP. The authorities intend to maintain public prices (in real terms) at the level projected for end-1993 (i.e., 5 percent higher than the average for 1993) until the exchange rate is fixed (see below), and to monitor closely the expenditure of public enterprises. The mission suggested that public prices could be raised faster than planned for December 1993 to provide some room to cover a possible decline in real terms following the fixing of the exchange rate in mid-1994 (see below).

The authorities indicated that recent measures to limit the state and municipal governments' access to the domestic financial markets would be strictly enforced to help achieve an operational balance of zero. They recognized, however, that these governments may need to adopt adjustment measures if they are to absorb effectively new expenditure responsibilities transferred from the Federal Government, particularly in the health and education sectors.

The authorities stated that monetary policy would be tight. Real interest rates would be maintained at current levels (around 22 percent a year in the overnight market of government securities) during 1994, with a temporary increase during the 2-3 months following the fixing of the exchange rate. They agreed to consider the mission's suggestions to increase real interest rates in the early months of 1994 if a start was to be made in reducing inflation, and to keep them higher for a longer period than currently envisaged after fixing the exchange rate in order to bring inflation down faster to international levels and thus limit the extent of the likely real appreciation of the currency. The authorities were working on the possible path of the real interest rates during 1994.

To facilitate the conduct of monetary policy, and given their intention not to accumulate additional international reserves, the authorities introduced last week an interest rate equalization tax of 3-5 percent to slow down the inflow of private capital that would be attracted by the high domestic real interest rates. Furthermore, they were considering the possibility of inducing a reversal of such flows by raising the tax rate should the public sector decide to access the international capital markets. They recognized, however, the potential risks of this policy and stated that they would manage ("fine tune") the tax rate in the light of developments.

The authorities have established a commission to look into the likely effects of a sharp decline of inflation on the public financial institutions, and to make recommendations on how to deal with these effects. The mission noted that there may be a need to extend this review to the private financial system, and suggested that consideration be given to possible technical assistance from the Fund.

In an attempt to eliminate inflationary inertia caused by indexation based on past inflation, the authorities have just announced their intention to introduce an indexation mechanism linked to the rate of devaluation of the currency. As this index would help adjust prices (including public prices) and contracts by virtually contemporaneous inflation, its widespread adoption would imply a comprehensive synchronization of price adjustments that, in turn, would allow a sharp decline of inflation upon fixing the exchange rate. The authorities expect this index to be used (voluntarily) in most private sector contracts because de facto would permit indexation to the U.S. dollar, which is now prohibited.

The authorities intend to introduce new wage legislation that would establish full monthly adjustments (based on the new index) of public wages and the minimum wage. 1/ To avoid an increase in real wages caused by the shortening of the indexation period and declining inflation, the new legislation also would establish (just before the new indexation mechanism is applied) that public wages and the minimum wage would be converted to their average real levels of the last 4-12 months. The authorities were considering various options regarding the timing and modalities of this legislation because the current law requires that a full cycle of wage indexation be completed before new legislation can become effective; this cycle would be completed around mid-year. Private sector wages will continue to be freely determined.

Once wage and other contracts are based on the new index, and following several months of strong financial policies, the authorities intend to fix the exchange rate in the context of an exchange rate regime that involves full backing of the currency, perhaps along the lines of a currency board. (The specifics and timing of this process still have to be defined.) The authorities indicated that a real appreciation of the currency of around 12 percent could be expected if inflation does not decline immediately to international levels, but stated that such an appreciation should not cause major problems given the present strength of the external current account and the likely large inflows of private capital that could be attracted by the stabilization of the Brazilian economy. Nevertheless, they expressed concern about the possibility of political pressures to fix the exchange rate before having demonstrated fiscal policy strength and before the new wage legislation has been put in place.

Simultaneously with the fixing of the exchange rate, public prices and perhaps the indicator used to index tax liabilities (UFIR) would be frozen. The authorities recognized that the fiscal program would need to include an additional margin to cover a possible erosion of public revenue in real terms caused by this freeze.

The proposed constitutional reforms include modifications in public employment and social security provisions, reallocation of expenditure responsibilities among the various levels of government, reduction of revenue earmarking, and taxation of energy and telecommunications. These reforms are expected to be approved by Congress by mid-March 1994. As several fiscal measures envisaged for 1994 (including the Stabilization Fund) are of a temporary nature, the authorities agreed to quantify the potential yield over the medium

---

1/ Currently only partial adjustments are made on a monthly basis, while full indexation takes place every four months for the minimum wage and once a year for public wages.

term of the proposed constitutional reforms on the public finances to ensure that the planned fiscal adjustment can be sustained.

The economic program also includes a further reduction of import duties in the process of moving towards a uniform external tariff structure among members of MERCOSUL, and a broader scope of the privatization program, which would include the electricity sector and the sale of minority holdings in private companies. To this end, the authorities were working on the necessary legal framework, which in their view could take 4-6 months to be in place. The authorities are considering paying off debts resulting from mortgage subsidies (amounting to US$9 billion) and from compulsory loans obtained by the Federal Government in 1986 (amounting to US$4 billion) by issuing special bonds that could be used as means of payment in the privatization program. The mission urged the authorities to prepare and announce a timetable of the planned privatizations in order to re-establish confidence in this program, which has been affected by slow progress since October 1992.

cc: FAD, LEG, MAE, PDR, RES, SEC, TRE, WHD
Ms. Saunders

F

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

Brazil

FACSIMILE NUMBER
(202) 623-4661

FACSIMILE INQUIRIES
(202) 623-6262

Facsimile Cover Sheet

MSG. NO. (Fax Center use only)	DATE November 29, 1993	PAGE 1 OF 2

TO

NAME Minister Fernando Henrique Cardoso

AGENCY Four Seasons Hotel

CITY/COUNTRY Toronto, Canada

FACSIMILE TELEPHONE NO. 416-964-2301
(Country Code) (City Code) (Number)

TEXT

INTERNAL DISTRIBUTION

FROM

NAME Michel Camdessus, Managing Director

DEPT./DIV. IMF

ROOM NO.	EXTENSION	ACCOUNT CODE

AUTHORIZED BY (TYPE)	SIGNATURE

IMF-42 (PREVIOUSLY SEC-56)
6-24-92

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

November 29, 1993

Dear Minister Cardoso:

Thank you for inviting me to attend the opening signing of the documents pertaining to the financial agreement with Brazil's creditor commercial banks.

Unfortunately, I have just returned from an overseas trip and have had to turn immediately to the new ESAF arrangements, and thus I am not able to attend the ceremony.

I hope all goes well as this signing constitutes another step towards completing the agreement.

Sincerely yours, warmly

Michel Camdessus

Minister Fernando Henrique Cardoso
Minister of Finance
Four Seasons Hotel
Toronto, Canada

+55-61-225-0822 GAB.MIN.DA FAZENDA 645 P01 NOV 23 '93 12:08

STB
FvB
JF
IO
F

FERNANDO HENRIQUE CARDOSO
Ministro de Estado da Fazenda

Action

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

93 NOV 23 PM 12:24

ORIG: WHD
CC: MD
DMD
MR. KAFKA
MS.R. SAUNDERS
EXR

Brazil

RECEIVED
IMF FAX CENTER
054134

His Excellency
Michel Camdessus
Managing Director
International Monetary Fund
Fax # (001202) 623.4661

1993 NOV 23 AM 10:44

November 23, 1993.

Dear Mr.Camdessus

I am writing to you to confirm that negotiations have been successfully concluded between the Brazilian Government and the creditor banks and that the documents pertaining to this financial agreement will be signed in Toronto, Canada, on November 29, 1993.

I have the pleasure to invite you to attend the opening signing ceremony to be held at the Four Seasons Hotel, at 11:00 a.m. on Monday, November 29. A luncheon will follow on the top floor restaurant at the same hotel. I look forward to meeting you on both occasions.

Sincerely yours,

FERNANDO HENRIQUE CARDOSO
Minister of Finance of Brazil

Brazil. STB CL FVB (ACTION) JF IO

12/10

ORIG: WHD
CC: ~~MD~~
MR. FISCHER
MR. OUATTARA
MR. NARVEKAR
MR. KAFKA
MS. R. SAUNDERS

BRAZILIAN EMBASSY
WASHINGTON, D.C. (F)

THE AMBASSADOR

November 21, 1994

Nº 561

The Honorable Michel Camdessus
Managing Director
International Monetary Fund
700 19th Street, NW - Room 10-100
Washington, D.C. 20431

my dear Managing Director.

I have the honor to inform you that Mr. Fernando Henrique Cardoso will be inaugurated as the President of Brazil on January 1st, 1995.The Brazilian Government will be most pleased if the International Monetary Fund (IMF) would be represented at the inaugural ceremonies by a specially designated delegation.

Some data are provided in the document "Presidential Inauguration - Basic Information", attached herewith. The final program for the occasion is the following:

January 1st, 1995 - Sunday

3:00 pm- The special missions greet His Excellency Itamar Franco, President of the Republic, and present their Letters of Credence
Location: Palácio do Planalto
Dress: Dark suit
Corresponding uniform
National attire

4:30 pm - Inauguration of His Excellency Fernando Henrique Cardoso and His Excellency Marco Antonio de Oliveira Maciel as President and Vice President of the Republic, before the National Congress
Location: Chamber of Deputies
Dress: Dark suit
Corresponding uniform
National attire

5:30 pm - Handing over of the sash of office by His Excellency Itamar Franco to His Excellency Fernando Henrique Cardoso
Location: Palácio do Planalto
Dress: Dark suit
Corresponding uniform
National attire

9:00 pm - The special missions greet His Excellency the President of the Republic and Mrs. Fernando Henrique Cardoso.
Location: Palácio Itamaraty
Dress: Black Tie with decorations (miniatures)
Corresponding uniform
National attire
Long dress

9:30 pm - Reception in honor of the foreign special missions and Brazilian senior officials, hosted by His Excellency the President of the Republic and Mrs. Fernando Henrique Cardoso
Location: Palácio Itamaraty
Dress: Black Tie with decorations (miniatures)
Corresponding uniform
National attire
Long dress

Three members of the special missions will be invited to all the above-mentioned events, and their spouses will be invited to join them in greeting His Excellency the President of the Republic and Mrs. Fernando Henrique Cardoso, as well as to the reception.

There will be no special program for spouses.

Sincerely,

Paulo-Tarso Flecha de Lima

(F)

Office Memorandum

To: The Managing Director
The Deputy Managing Director

November 12, 1993

From: S. T. Beza

Subject: Brazil--Staff Visit

1. During the Annual Meetings the Brazilian authorities said that their economic program for 1994 would seek a reduction of inflation on the basis of a strengthening of fiscal policy and a de-indexation of the economy, based on the fixing of the exchange rate in the context of a currency board. They promised to send us material on these matters to assist us in preparation of a staff visit.

2. Material has been sent to us in the past few days which clarifies some aspects of fiscal plans but still leaves many questions; our tentative view is that they are not planning enough fiscal improvement. Also, the authorities have dropped the idea of an exchange rate anchor (for fear of a real appreciation of the currency). They refer to other means for dealing with inertial inflation and expectations, but have not specified how this might be done (their latest views on monetary and exchange rate policies have not been communicated to us and they apparently are concerned about doing this by fax).

3. The authorities are now anxious to have the staff travel to Brasilia to discuss their plans before the Minister's announcement to the public in late November (the visit would be about two weeks later than originally contemplated by the authorities because of delays in their schedule).

4. I do not think it advisable to deny the mission at this stage, and our plan is to have the staff travel on Monday night (November 15). The visit will have to be a brief one in view of the Minister's schedule for making his announcement. Moreover, the staff will not be in a position to endorse the program of the authorities as it emerges, given the recent changes in plans and the numerous elements of policies that still need to be investigated by the mission in just days.

5. I have discussed with Mr. Kafka the difficulty of the mission giving definitive views on the 1994 program in the light of the circumstances described above. He was of the same view.

cc: FAD, LEG, MAE, PDR, RES, SEC, STA, TRE
Ms. R. Saunders

MINISTÉRIO DA FAZENDA
SECRETARIA DE POLÍTICA ECONÔMICA
ESPLANADA DOS MINISTÉRIOS BL. P, 3° andar
CEP.: 70.048-900 - BRASÍLIA - BRASIL

Dr. Beza

FAX N° : /SPE
Brasília, 08/11/93

Folha de rosto para Facsímile

To: Dr. Sterie Beza
c/o Prof. Alexander Kafka
Fax: 623 4994

From: Prof. Winston Fritsch
Phone: (061) 226.3732/225.0723
Fax: (061) 225.0113/223.5731
N° of pages: 10 (including this)

Dear Prof. Kafka,

Please find enclosed the material we promised to forward to Dr. Beza today.

Best regards,

p/ Winston Fritsch

Any problem with this transmission, please call (61) 226 3732.

Brasília
8 November 1993

Dear Dr. Beza,

As agreed last week, I am forwarding you:

(i) the latest estimates of the Central Government Borrowing Requirements for 1993. Estimates of Total Public Sector Borrowing Requirements for 1993 will be sent next Wednesday;

(ii) an outline of the proposed fiscal measures to achieve an operational balance next year which could be fully financed by already budgeted loans from the multilateral banks. This outline includes an estimate of the fiscal impact of each individual measure and an indication of the legislative strategy for their approval.

I look forward to being of help in answering any doubt you may have regarding this and further material to be sent to you.

Sincerely yours,

p/ Winston Fritsch

(i) Últimas estimativas para as Necessidades de Financiamento do Governo Central em 1993: ver Quadro I e "Observações sobre a Projeção do OGU/93"

ORCAMENTO GERAL DA UNIAO (Consolidado OGU Tradicional + BNPAS)
1988 - 1994 (Conceito de Competencia)

QUADRO 1

08-Nov-93
05:49 PM

EM CR$MIL

DISCRIMINACAO	1990		1991 REALIZADO		1992 REALIZACAO PROVAVEL		1993 PROJECAO	
	VALOR	% PIB	VALOR	% PIB	VALOR	% PIB	VALOR	% PIB
I - RECEITA TOTAL	5.776	17,65%	24.857	14,76%	266.794	14,97%	6.246.371	15,25%
- Receita Orcamentaria	5.648	17,25%	24.825	14,74%	266.660	14,96%	6.246.261	15,25%
- Receita Extra-Orcamentaria	128	0,39%	33	0,02%	134	0,01%	110	0,00%
II - TRANSFERENCIAS CORRENTES DO TESOURO	1.350	4,12%	6.036	3,65%	69.172	3,88%	1.550.110	3,70%
- Ao Setor Publico	1.318	4,03%	5.859	3,55%	58.883	3,86%	1.458.837	3,53%
Estados e Municipios	1.180	3,61%	4.903	2,97%	58.082	3,26%	1.254.913	3,06%
Empresas Estatais	8	0,02%	15	0,01%	61	0,00%	1.205	0,00%
. Fundos Regionais e BNDES	131	0,40%	941	0,67%	10.745	0,60%	222.219	0,57%
- Ao Setor Privado	32	0,10%	166	0,10%	284	0,02%	61.774	0,15%
. Subsidios e Subvencoes	32	0,10%	166	0,10%	281	0,02%	61.774	0,15%
III - RECEITA LIQUIDA DE TRANSFERENCIAS (I-II)	4.425	13,52%	18.832	11,11%	197.623	11,09%	4.695.260	11,47%
IV - DESPESAS	4.790	14,63%	21.440	13,00%	226.251	12,69%	6.377.476	15,57%
- Pessoal e Encargos Sociais	1.823	5,58%	7.169	4,34%	78.517	4,40%	1.910.481	4,67%
- Despesa Liquida com Produtos Agropec.	11	0,03%	27	0,02%	539	0,03%	8.214	0,02%
- Outras Despesas Correntes e de Capital	2.952	9,02%	14.254	8,64%	117.230	6,36%	4.460.200	10,39%
-Beneficios Previdenciarios	1.165	3,57%	5.721	3,47%	75.312	4,36%	2.018.270	4,93%
-Despesas Correntes	1.007	3,08%	5.403	3,27%	33.391	2,47%	1.653.504	4,04%
-Despesas de Capital	777	2,37%	3.130	1,90%	27.327	1,53%	786.126	1,92%
V - AJUSTE FAT	.	.	(1.097)	-0,67%	(7.031)	0,39%	(139.625)	-0,34%
VI - AJUSTE CRITERIO FINANCIAMENTO,INC "FLOAT"	(901)	-2,76%	(4.659)	-2,82%	(48.344)	-2,73%	(943.476)	-2,30%
VI.1 FLOAT	..	...	-4507	-2,73%	-40941	-2,30%	-940476	-2,30%
VI.2 DISCREPANCIA ESTATISTICA	..	...	-152	-0,09%	(7.706)	0,43%	0	0,00%
VII - NECESSIDADES DE FINANCIAMENTO LIQUIDO, EXC. TRANSFERENCIAS CAPITAL A ESTATAIS(IV - III)	(537)	-1,64%	(2.638)	-1,60%	(27.011)	-1,52%	601.814	1,47%
VIII - TRANSFERENCIAS DE CAPITAL A ESTATAIS	62	0,19%	713	0,43%	1.904	0,11%	67.741	0,17%
IX - NECESSIDADES DE FINANCIAMENTO LIQUIDO								
IX.1 - RESULTADO PRIMARIO	(475)	-1,45%	(1.925)	-1,17%	(25.107)	-1,41%	669.254	1,63%
IX.2 - DESPESA LIQUIDA DE JUROS	(284)	-0,87%	1.746	1,06%	31.650	1,78%	807.230	1,97%
IX.3 - RESULTADO OPERACIONAL	(759)	-2,32%	-179	-0,11%	6.543	0,37%	1.473.485	3,61%

Elaboracao: CPF/SEPE/MINECON

OBSERVAÇÕES SOBRE A PROJEÇÃO DO
OGU/93

1. A previsão para as necessidades de financiamento do OGU em 1993 foram elaboradas pela SOF/SEPLAN considerando, do lado da receita, uma projeção da SRF/MF com base nos dados realizados até setembro e 35% de inflação até o fim do ano.

2. Do lado da despesa, a previsão corresponde às dotações aprovadas no Orçamento, mais os créditos adicionais concedidos até o momento, não se esperando novos créditos até dezembro, seja para pessoal, benefícios previdenciários ou outros custeios, sendo, por isso, uma posição de 1993 praticamente fechada.

3. Para o float, haveria a necessidade de efetuar-se uma nova programação das despesas do tesouro, com base na última posição das despesas enviada pela SOF/SEPLAN. Na falta de melhor informação, repetiu-se o percentual do PIB de 1992 (2,3% do PIB) sendo que tal procedimento não parece corresponder a superestimativa, considerando-se que no que se refere às despesas previstas para pessoal e encargos sociais o float esperado situa-se em torno de 1% do PIB.

4. No que se refere às transferências a estados e municípios não foi considerado o valor enviado pela SOF, até o momento, por não estar compatível com a receita incluída nas projeções. Para efeito da previsão ora enviada foi feita uma estimativa das transferências, a partir dos impostos incluídos no cálculo, acrescida do valor das transferências para pagamento de pessoal do DF e territórios e das transferências de capital fornecidada pela SOF.

5. Das demais despesas correntes foi deduzido o valor da fonte 150 correspondente aos juros do FAT, tendo em vista que as despesas porventura geradas com essa fonte já estariam sendo captadas no chamado "ajuste FAT", que nada mais é do que o superávit primário daquele fundo.

6. Saliente-se que os dados ora enviados correspondem ainda a uma estimativa preliminar, estando sujeitos a aprimoramento posterior, especialmente no que se refere às despesas líquidas com juros da dívida pública.

(ii) Proposta de ajuste fiscal para 1994

A sequência proposta para o ajuste fiscal em 1994 está sintetizada no quadro "Projeções das Necessidades de Financiamento do Governo Central de 1994". Os dados estão todos em porcentagens do PIB a preços constantes, no conceito de competência. O quadro comporta cinco colunas, que se descrevem a seguir:

Coluna (1) - Inicial, Agosto de 1993 - Sumaria os dados da proposta orçamentária de 1994, conforme submetida ao Congresso Nacional em agosto de 1993. Prevê um déficit operacional de 6,1% do PIB. A conta de juros, nesta coluna como nas demais, supõe uma taxa de 15% a.a. para a dívida interna e 6% a.a. para a dívida externa.

Coluna (2) - Corrigida, Outubro de 1993 - Comporta duas alterações técnicas em relação à coluna (1). Em primeiro lugar, substitui as projeções de inflação declinante ao longo de 1994, contidas na proposta orçamentária, pelo suposto da manutenção de uma inflação constante ao nível anual de 35% ao mês. O propósito desse exercício é mostrar o exagero contido nas previsões para pessoal, benefícios e contribuições previdenciárias, devido ao fato que esses items estão legalmente indexados à inflação passada e, portanto, seu valor real sobe quando a inflação cai. Esta correção implica uma queda do déficit operacional para o ano que vem, de 6,1% para 4,9% do PIB. A Coluna (2) também inclui outra correção, a saber, a exclusão, tanto das receitas (no item principais contribuições) como da despesa (no item pessoal), da parcela paga pela União para o plano de seguridade de seus servidores.

Coluna (3) - Com ajustes, Novembro de 1993 - Introduz novas estimativas da receita para o ano que vem, que envolvem fundamentalmente a eliminação do item de "esforço de arrecadação", equivalente a 0,5% do PIB, introduzido na proposta orçamentária original. As novas estimativas supõem a manutenção do IPMF, mas com uma arrecadação mais modesta de US$ 400 milhões por mês. Elas, entretanto, excluem o pacote de medidas tributárias infraconstitucionais que estão em processo de aprovação no Executivo, assim como o impacto de novos impostos sobre grandes fortunas, sobre os ativos das empresas, e sobre os lucros dos bancos, que dependem de decisão do Legislativo.

As estimativas da coluna (3) - no que se refere aos items de pessoal, benefícios e contribuições previdenciárias - também supõem que, em dezembro, os salários, tanto dos servidores, como da iniciativa privada (incluindo o salário mínimo), serão convertidos pela média real observada (seja ao longo do ano de 1993, seja no último quadrimestre de 1993), passando em seguida a serem corrigidos mensalmente pela última UFIR disponível. O resultado desta conversão é que os valores para pessoal e benefícios ficam muito próximos da coluna (2), mas agora (dada a política de mensalização dos ajustes salariais) se tornam praticamente imunes à inflação. A receita já é ufirizada e o governo pretende dispender em outros custeios e capital os valores que efetivamente aparecerão na nova proposta orçamentária a ser submetida ao Congresso. Em consequência, a partir da coluna (3), torna-se irrelevante conhecer a taxa de inflação implícita nas projeções. Isto, no suposto adicional que os ganhos de receita com o efeito Tanzi serão suficientemente fortes para compensar a perda de receita do IOF e do IPMF, no caso de uma queda acentuada da inflação em 1994. Note-se ainda que o suposto de 'ufirização' do orçamento implica adotar uma hipótese de 'float' igual a zero em 1994, o que dá uma margem adicional de segurança para os dados apresentados.

Finalmente, a coluna (3) introduz a hipótese de que na nova proposta orçamentária serão cortados cerca de 40% dos gastos com outros custeio e capital financiados com recursos livres (i.e., não vinculados), contidos na proposta de agosto de 1993. A SOF já está trabalhando nesses cortes.

Sem ajustes constitucionais, a previsão para o déficit operacional no próximo ano é igual a 3,1% do PIB.

Coluna (4) - Com revisão constitucional - Contém as principais variações de receitas e despesas caso sejam a tempo aprovadas as propostas de revisão constitucional a serem apresentadas no final de novembro e que estão sumariadas nas notas ao quadro. A aprovação dessas propostas implica aproximadamente zerar o déficit operacional para o ano que vem.

Coluna (5) - Com Fundo de Estabilização - Na falta da revisão constitucional, propor-se-á no final de novembro a aprovação de uma única emenda constitucional criando um Fundo de Estabilização por dois anos. Este fundo - no valor de 3,6% do PIB - permitirá em primeiro lugar uma ampla desvinculação da receita, logrando uma redução de gastos (nas transferências para Estados e Municípios e em outros custeios e capital financiados com recursos vinculados) de 1,1% do PIB. Em segundo lugar, criará uma sobretaxa sobre todas as receitas do governo federal, gerando recursos adicionais equivalentes a 0,9% do PIB. Haverá, adicionalmente, um ganho considerável, da ordem de 1,6% do PIB, na flexibilização da alocação de recursos no orçamento.

Os recursos desse Fundo permitirão zerar as necessidades internas de financiamento do governo federal, que apresentará então, em 1994, um déficit operacional de apenas 0,9% do PIB, equivalente aos recursos internacionais (fundamentalmente do BID e do BIRD) já inscritos na proposta orçamentária. Travada assim integralmente a necessidade de emissão de quase-moeda (títulos mobiliários do Governo Federal), poderá então o governo partir para um efetivo programa de estabilização a partir do próximo mês de janeiro.

Quadro 2 (anexo)

Notas relativas ao Quadro 2:

(1) Conforme orçamento enviado ao Congresso em agosto de 1993.

(2) Substitui as projeções de inflação declinante do orçamento pela hipótese de inflação constante a 35% ao mês. Em consequência, caem a folha de pessoal, as contribuições e os benefícios previdenciários. Retira, tanto da receita quanto da despesa, a parcela da União para o plano de seguridade de seus servidores.

(3) Inflação: 35% a.m. Conversão "pela média" de salários e benefícios, em janeiro de 1994, seguida de urvização. Corte equivalente a 1,3 % do PIB em Outros Custeios e Capital (OCK). Novas estimativas da receita, de novembro 1993.

Memo: As novas estimativas da receita não incluem o impacto das seguintes medidas fiscais infraconstitucionais que devem ser enviadas ao Congresso em novembro de 1993:

* imposto s/grandes fortunas:	0,04	% PIB
* imposto s/ativos:	0,50	% PIB
* contribuição s/ lucros bancos:	0,09	% PIB
TOTAL:	0,63	% PIB

(4) Inclui, além da conversão pela média de salários e benefícios e corte de 1,3% do PIB no OCK, o impacto das seguintes mudanças constitucionais a serem enviadas ao Congresso em novembro 93:

* Criação de imposto especial sobre energia, combustíveis e telecomunicações	0,8% PIB

* Exclusão do IR-fonte pago pela União dos Fundos de Participação de Estados e Municipios	0,2% PIB
* Suspensão, por dois anos, dos incentivos fiscais constitucionais	0,4% PIB
* Suspensão, por dois anos, das transferências aos Estados exportadores (10% IPI) e aos fundos regionais	0,4% PIB
* Estabelecimento, por dois anos, de um teto, igual ao valor de 1993, para os Fundos de Participação de Estados e Municípios	0,3% PIB
* Pagamento reduzido de servidores postos em disponibilidade	0,3% PIB
TOTAL	2,4% PIB

(5) Inclui, além da conversão pela média de salários e benefícios e corte de 1,3% do PIB no OCK, o impacto da criação de um Fundo Constitucional de Estabilização, no valor de 3,6% do PIB, constituído a partir de:

* Sobretaxa de 5% à receita total, sobre a qual não incidirá qualquer vinculação constitucional ou legal (0,9% do PIB);

* Retirada de 15% da receita total, antes da aplicação de qualquer vinculação constitucional ou legal (2,7% do PIB). Desses 2,7%, 1,1% do PIB constitui efetiva economia de despesas, por redução das transferências constitucionais para Estados e Municípios (0,5% do PIB) e de outras despesas de custeio e de capital feitas com recursos vinculados (0,6% do PIB). Os restantes 1,6% do PIB aumentam a margem de flexibilidade de alocação de recursos no orçamento.

QUADRO 2

PROJECOES DAS NECESSIDADES DE FINANCIAMENTO DO GOVERNO CENTRAL EM 1994
(% PIB A PRECOS CONSTANTES)

(Dados preliminares em 8/11/1993)

DISCRIMINACAO	INICIAL AGO/93 (1)	CORRIGIDA OUT/93 (2)	C/ AJUSTES INFRA CONSTITUCIONAIS (3)	C/ REVISAO CONSTITUCIONAL (4)	C/ FUNDO ESTABILIZACAO (5)
I. RECEITA TOTAL	18,9%	17,8%	17,7%	18,6%	183%
Impostos	9,6%	8,6%	8,3%	9,6%	87%
Principais Contribuicoes	9,0%	7,9%	8,1%	8,1%	85%
Outras Receitas	1,3%	1,3%	1,3%	1,3%	14%
II. DESPESA TOTAL	22,7%	20,6%	18,6%	17,4%	175%
IIA. TRANSFERENCIAS MANDATORIAS PARA EST. E MUNIC.	3,4%	3,4%	3,1%	2,2%	26%
IIB. DESPESAS DO GOVERNO CENTRAL	19,3%	17,1%	15,6%	15,2%	149%
Pessoal	6,2%	4,7%	4,7%	4,4%	47%
Beneficios	5,6%	4,9%	4,6%	4,6%	46%
Programa das Operacoes Oficiais de Credito	0,3%	0,3%	0,3%	0,3%	03%
Outros Custeios e Capital	7,2%	7,2%	6,9%	6,9%	62%
III. DEFICIT PRIMARIO	3,8%	2,7%	0,9%	-1,6%	-11%
IV. JUROS	2,3%	2,2%	2,2%	1,9%	20%
V. DEFICIT OPERACIONAL	6,1%	4,9%	3,1%	0,4%	09%
VI. FINANCIAMENTO EXTERNO	-0,9%	-0,9%	-0,9%	-0,9%	-09%

STB
FUB
IO
F

Office Memorandum

To: Mr. Fajgenbaum November 8, 1993

From: Jan F. van Houten JvH

Subject: Brazil--Briefing for Staff Visit

Thank you for sending us a revised version of the brief. From the redraft it would appear that the state of policy and program preparation by the authorities has taken a step backwards since the Annual Meetings. It now appears that there is considerable uncertainty about the role of the exchange rate in the anti-inflation program. Hence the design of monetary policy is also uncertain. In the absence of a specification of these elements, the program could in principle fall anywhere in the range of shock versus gradualism. The fiscal adjustment required would most likely not be the same over this range. Nonetheless, the brief seems to preempt any further discussion by stating that "targeting an operational balance of zero may be all that is feasible". It is not clear at this stage how the mission is to reconcile this observation with the Country Strategy Brief for Brazil and the most recent summing up of the Article IV consultations (see opening paragraph).

The brief rightly stresses that the fiscal package be based on sustainable measures. But it also appears to leave the door open for a package based on other measures by asking the mission to discuss the authorities' plans in the event Congress fails to approve a constitutional revision and related fiscal measures before year-end. There is a presumption that replacement measures would not be equally durable or sustainable, and hence are unlikely to form the basis for a credible fiscal adjustment--and Fund support. In view of these major uncertainties in fiscal program design it would appear premature for the mission to discuss contingency fiscal measures in the event of slippages (top of page 5).

The discussion on monetary policy leaves the reader with little to hold on to, except that it must be "tight". In the absence of a specification of the role for exchange rate policy, this may indeed be all that can be said at this highly preliminary stage. Still, the brief could indicate the staff's view on the role of the exchange rate, and hence of monetary policy, in bringing down inflation. As a minimum it should indicate that a real exchange rate rule (see page 3) in unlikely to be compatible with a credible disinflation program.

We would reiterate our view that a briefing memorandum on this important case be formally cleared by PDR.

cc: FAD, LEG, MAE, RES, SEC, STA, TRE, WHD

STB
FVB
IO
F

Office Memorandum

To: Mr. Fajgenbaum October 29, 1993

From: J. B. Zulu JZ.

Subject: Brazil--Briefing for Staff Visit

While I understand that the discussions at this stage are likely to be of an exploratory nature, the briefing could usefully include greater specificity with respect to monetary policy, especially the likely impact of de-indexation on financial instruments and institutions. Adoption of a currency board arrangement alone (assuming that adequate fiscal adjustment can be secured) does not obviate the need for active short-term liquidity management, especially when capital flows potentially can be destabilizing. Further, Brazil's financial system is subjected to numerous regulatory and portfolio requirements that distort the efficient intermediation of resources, and the mission will wish to review with the authorities their current plans for liberalization.

Finally, in light of the important relaxation of macroeconomic policy combined with the recent policy initiatives (as outlined in the "Immediate Action Program" of June 1993 as well as the stated intention of eventually adopting a currency board arrangement), it is not clear that the November 1992 Country Strategy Brief can continue to guide policy discussions. Following your visit, and as the political scene clarifies, you should probably consider revising the CSP.

I have the following specific observations.

- You will want to investigate the factors underlying the sustained decline in real interest rates during 1993. In this context, the impact of capital inflows on banks' liquidity should be reviewed.

- The status of financial sector reforms should be reviewed, particularly progress in restructuring the Federal Savings Bank and the state banks, and in developing an appropriate legal framework. To what extent have credit subsidies been passed to the budget?

- You will want to discuss with the authorities the potential for elimination of existing exchange restrictions and the multiple currency practice. You could also advise on the benefits of eliminating capital account restrictions, including the credibility that this would lend to the new currency board arrangement.

- It would be appreciated if the mission could ascertain whether the authorities remain interested in MAE technical assistance and, if so, what is the likely timing. This would help us plan our resources.

cc: FAD, LEG, PDR, RES, STA, TRE, WHD

Contributors: D. Dueñas, A. Kovanen, E. Milne

Brazil

STB
FVB
JF
IO
F

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

93 NOV -1 PM 2:27

To: Mr. Fajgenbaum

October 29, 1993

From: Jan F. van Houten J.v.H.

Subject: Briefing for Staff Visit

A short brief of this type may be appropriate for exploratory discussions--as we believe should be the case. Nonetheless, even for such discussions the brief is cast in overly general terms, and lacks specifics in most areas, including the key one of fiscal policy. Substantive negotiations would require a far more detailed brief--notwithstanding the existence of a medium-term strategy brief.

For present purposes, the following issues should be clarified:

1. The brief points out that management and staff have taken the position that a more ambitious target than the zero public sector operational balance envisaged by the authorities is needed to underpin an effective stabilization program. The medium-term strategy paper indicated that an operational surplus of 2 percent of GDP would be necessary under a heterodox stabilization program, and the brief should indicate whether this continues to be the position of the staff.

2. Some indication of the type of fiscal measures contemplated--and which ones depend on constitutional reform--would be helpful. At the same time, it is surely premature to discuss contingency fiscal measures at this stage.

3. There is only passing reference to the de-indexation mechanism proposed by the authorities, and some elaboration of what is envisaged for this crucial element of the program is needed, particularly as the brief hints that there may be problems with it.

4. The brief is completely silent on structural policies and it should at least mention the main structural elements that would need to be incorporated in the program.

5. Mr. Kuhn has advised that the phrase "which would consider Brazil's request . . . is in place" on page 3 should be deleted, as it does not reflect the view of all the export credit agencies.

6. Given the exploratory nature of this mission it would not be appropriate to raise the issue of access and phasing. Nonetheless, the mission could reiterate that a possible financial arrangement would be of a precautionary nature, although the moderate use of Fund

resources could be envisaged to help finance the enhancements under the debt package with commercial banks.

7. Drafting suggestions are attached. We would also propose that a briefing memorandum of this potential importance be cleared by PDR.

Attachment

cc: FAD, LEG, MAE, RES, STA, TRE, WHD

WHD

STB
FVB
IO
F

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

93 NOV -1 AM 9:38

To: Mr. Fajgenbaum

October 29, 1993

From: Richard Hemming

Subject: Brazil--Briefing Paper

We agree with the thrust of the staff position, but have a few questions and comments.

1. We note that the primary surplus is projected to decline during 1993, but the projected public sector operational balance for year-end is not mentioned and the reasons for the decline are not discussed. We also had some difficulty tracing the link between the projected 1993 fiscal outturn and the fiscal program for 1994.

2. To better assess the feasibility of achieving a public sector operational balance of zero in 1994, the brief should provide more detail about the specific measures proposed by the authorities and the measures that the staff would like to endorse. What would be the revenue yield of tax measures and the savings from expenditure cuts? We are especially concerned that the expenditure cuts proposed by the authorities are short-term rather than lasting impact solutions. As we have indicated in past reviews, the authorities have to be fully committed to a comprehensive policy package along the lines recommended by the various technical assistance missions.

3. The brief states that: "Preliminary official estimates indicate that achieving the authorities' objective would require measures with a fiscal yield of at least 7 percent of GDP." This is very obscure and needs clarification. What are the foundations for believing that the Government will be in a position to come up with such a large fiscal adjustment given current political and economic uncertainties? Some of the fiscal measures, such as modifying the revenue sharing formula, the reallocation of expenditure responsibilities among the various levels of governments, and the reduction in the earmarking of taxes, require amendments to the Constitution. These measures are facing considerable political opposition and will be difficult to materialize. Besides, what are the contingent fiscal measures to be implemented by the authorities if the required amendments to the Constitution do not materialize before the end of the year?

4. The proposed constitutional amendments include measures such as a comprehensive civil service retrenchment program, reduction of pension benefits, and the transfer of education and health care responsibilities to state and local governments that will have an adverse effect on certain groups of the population. Some of these

measures could also lead to a transitory increase in the number of the poor. In view of these negative social implications, and also in view of the limited coverage of the social security arrangements, one important issue for the mission and the authorities to address will be the possibility of implementing a comprehensive and cost effective social safety net.

Contributor: Juan Amieva

cc: FAD
LEG
MAE
PDR
STA
TRE
WHD ✓

(F)

✓ (1) Brazil
(2) AM - Special Brief

INTERNATIONAL MONETARY FUND
September 30, 1993

Mr. Mussa
Mr. Van Houtven
Mr. Boorman
Mr. Gianviti
Mr. Tanzi
Mr. Williams
Mr. Zulu/Mr. Guitian

The attached note contains material of some sensitivity and I would appreciate it if you would not make copies.

Attachment

S.T. Beza

Office Memorandum

To: The Managing Director
The Deputy Managing Director

September 25, 1993

From: S. T. Beza

Subject: Brazil--Meeting with Minister Cardoso

In the last two days we have held discussions with Brazilian officials on their economic program for 1994. As described in the back-to-office report of September 15, 1993, the program would seek a sharp reduction of inflation in 1994 on the basis of a strengthening of fiscal policy and a deindexation of the economy, culminating in the introduction of a currency board arrangement, say, at the end of March 1994.

We were told that the intention is to present the program to the Congress by mid-November, with the hope that the fiscal package would be approved by the end of the year. They would include the proposed currency board arrangement in the November presentation, with the proviso that its introduction would depend upon the adoption of a suitable fiscal policy.

We have made some progress in understanding the process of deindexation envisaged by Brazilian officials, but a number of questions remain to be answered. The mechanism for the synchronization in the adjustment of wages and prices (so as to permit a sudden deindexation without disturbing relative prices) is complex, and we are trying to identify the elements of the proposal that are vital for this mechanism to work as expected. Also, we are concerned (as are the officials) that the synchronization of wage and price adjustments, together with fears that a wage price freeze is in the offing, may induce a sharp acceleration of inflation. In fact, it is difficult to envision the conditions that could prevail in this transition period under the approach favored by officials of announcing at an early stage the preparation of deindexation and the establishment of a currency board.

On the fiscal side, officials say that their aim is to achieve a public sector operational balance of zero in 1994. We have been suggesting more. Preliminary official estimates indicate that to achieve the objective of a zero operational balance would require measures with a fiscal yield of around 7 percent of GDP, and this estimate is likely to be revised upwards; it should be noted that estimates of expenditure have been raised considerably in recent weeks because of court rulings and budget decisions. A part of this gap could be closed by measures that prevent unintended increases in real wages and social security benefits stemming from the reduction of inflation.

Officials have prepared a list of possible fiscal measures, but their effect is still being quantified. Some of these measures could be implemented immediately, but others would require congressional approval, including amendment of the Constitution. Some of these measures have been submitted to Congress in the past and have faced considerable political opposition. However, the Brazilian officials believe that by presenting their economic program as a comprehensive package of fiscal adjustment and deindexation to reduce inflation sharply, they will be able to obtain the political support needed for Congressional approval.

Brazilian officials have a long way to go to complete the framing of a comprehensive plan as a number of policies (in the fiscal and other areas) remain to be defined and quantified. Indeed, having all of the parts of their package ready for presentation to the Congress by mid-November is an ambitious objective.

Brazilian officials said that they would continue to work on the program in the coming weeks, and asked about the possibility of a staff team visiting Brazil around end-October to help them with this work. They agreed that for a visit to be the most productive we should receive some preliminary estimates of the effects of the measures contemplated, before such a visit.

We had a discussion of the timing of Fund involvement, on the assumption that a suitable fiscal package is legislated or otherwise put in place by the end of this year. On this assumption they would like to have us present a request for a SBA in the course of January 1994 for Board discussion in February. However, they would not be ready to implement the currency board arrangement at that stage because under existing legal provisions backward indexation of wages and other contracts could not be completed before the end of March. This would mean going to the Board while inflation could be running very high under the pressure of bringing wages and other contracts up to date. They had difficulty with the alternative we raised of waiting to go to the Board after the currency board was in operation because this would mean delaying further the completion of the commercial bank debt package (they have a tentative agreement with the lead banks to shift the closing date of the package from November 30, 1993 to end-February 1994)

cc: FAD, LEG, MAE, PDR, RES, SEC, TRE, WHD
Ms. Saunders

STAE

9/93

Brazil--Economic Program for 1994

During the recent staff visit to Brazil there was little discussion on the specific features of the economic program for 1994. As the measures to be included in the fiscal effort were still to be defined, and the mechanism for deindexation was to be re-examined, there are several issues that need to be clarified or developed further. Also, there is a need to discuss policies other than those of the fiscal area to be included in the program for 1994.

With the purpose of making the forthcoming discussions in Washington the most productive possible, we are providing below a provisional list of issues and questions that would need to be elaborated in some detail if we are to understand and to be able to evaluate the authorities' economic program. In order to shorten our questions, we refer to the moment in which the deindexation is to be introduced as "D-day."

Public finances

1. Which measures would be adopted to achieve the authorities' fiscal objective (zero operational balance of the public sector) in 1994? (Please note that to achieve this objective the yield of the measures may need to exceed the difference between the baseline prepared by the staff and the authorities' objective; some categories of expenditure may be underestimated (in real terms) in the baseline because the rate of inflation assumed in the baseline is likely to be higher than the one envisaged in the program.) For each of the measures it would be important to know:

a. Does it require Congressional approval?
b. When would it become effective?
c. What would be its fiscal yield, and how was this yield estimated?

2. Do these measures compensate for the possible loss of the IPMF?

3. Are the tax measures in the program likely to be approved by the end of the year so as to avoid the problem of "anualidade"?

4. Given that the budget has been submitted already to Congress, how would expenditure reduction measures be implemented without "contingenciamento"?

5. What alternative contingency measures are being envisaged in case of slippages or shortfalls? How fast could they be implemented?

Deindexation

We understand that a new price index will be created to help synchronize the adjustment of some key prices and wages on a monthly basis, and that this index could be used also as a reference for all types of private sector contracts on a voluntary basis.

1. What is gained with the creation of a new index that could not be obtained by using one of the indices currently available?

2. When would the new index and price adjustment mechanism be in place?

3. Policy regarding the minimum wage, before and after D-day.

4. Policy regarding private sector wages, before and after D-day.

5. Policy regarding public sector wages, before and after D-day.

6. Policy regarding public sector tariffs, before and after D-day.

7. How would the average levels of public prices, the minimum wage, other wages, etc., under the proposed policies (before and after D-day) compare with the average levels of those variables at present?

8. Will D-day be chosen so as to coincide with a day of price adjustments?

9. Will there be any price-wage freeze after D-day?

10. Will the private sector be free to continue using the existing indexation mechanisms (including periodicity and index)?

11. Which are the main private sector contracts that the authorities envisage will switch the index used or the periodicity of adjustment due to the creation of the new index?

12. What is the probability of the private sector refraining from using the new index because it is calculated by an official entity and may be perceived to be subject to manipulation? How would the process of deindexation be affected if a significant proportion of the transactions in the private sector does not shift to the new index?

13. How would you assess the possibility that the synchronized price adjustment would lead to a shortening of the period of adjustment, increased volatility of the price level, and an acceleration of inflation?

<u>Financial sector</u>

1. How would you define the stance of monetary policy (before and after D-day)? How would monetary policy be managed (before and after D-day)?

2. What would be the real interest rate envisaged in the program (before and after D-day)?

3. What would be the public-sector domestic interest bill resulting from this interest rate policy?

4. What would be the effect (quantified) of a sharp reduction of inflation in the solvency and liquidity positions of public and private financial institutions (taking into account that they now share in the inflation tax)? How would the authorities respond to a large adverse impact on the profitability of these institutions?

5. Do you envisage any financial system reform in conjunction with the program? Are there any plans to change reserve and/or loan portfolio requirements?

External sector

1. Does the program envisage unification of the foreign exchange markets? How and when would this be achieved?

2. Does the program envisage the use of capital controls? If yes, under which circumstances?

3. What would be the policy response to real appreciation of the exchange rate after D-day? Would a margin be created to allow for real appreciation?

4. What would be the path expected for international reserves, before and after D-day?

5. How would the currency board operate? Will it be a department of the Central Bank? What will be its relationship with the rest of the Central Bank and with the public sector?

6. What type of liability will be backed by the currency board? Will these liabilities have 100 percent backing in foreign exchange? What will be the initial endowment of foreign exchange of the currency board? If foreign exchange holdings exceed this endowment, how would the difference be handled?

Other questions

1. What is the expected path of inflation, before and after D-day?

2. How do you evaluate the possibility that despite detailed explanations the public finds the deindexation plan complex to understand and decides to shift its portfolio out of domestic currency thereby causing an acceleration of inflation or loss of reserves or both?

3. What would be the effect of the policy measures included in the program on aggregate demand and output in 1994 and over the medium term?

4. If inflation is not eliminated after D-day, how would the public finances be affected (it would seem that without indexation revenues would decline in real terms while expenditures would increase)? How would this affect the sustainability of the program?

5. In view of the above, is an operational fiscal balance of zero sufficient for the success of the program?

F

Office Memorandum

To: The Managing Director
The Deputy Managing Director

September 15, 1993

From: S.T. Beza

Subject: Brazil--Back-to-Office Report

Attached is the back-to-office report of the recent visit of Mr. Lizondo and Mr. Traa (both WHD) to Brazil. The Brazilian authorities are working on an economic program that aims at a sharp reduction of inflation in 1994 on the basis of a deindexation of the economy and a strengthening of fiscal policy. They are still in the process of defining many aspects of their program, and the explanations they provided were incomplete (and may be revised). Discussions with the staff will resume at headquarters on September 23, 1993 (prior to the meeting between Minister Cardoso and the Managing Director on September 25). I ask that recipients of this back-to-office report not make copies.

I cannot say I understand fully how the process toward deindexation referred to in the attached note is to work and how prices will behave in this context (apparently officials have some questions in this regard too). Also, the baseline fiscal projection for 1994 worked out by our staff shows a large gap to be filled by measures if the authorities' objective of a zero operational balance as described in the attached note is to be fulfilled. It may be recalled that we have been suggesting an operational surplus in order to permit some domestic debt repayment and thus to make the program safe for any pegging of the exchange rate.

Given the apparent state of preparation by Brazilian officials of remedial fiscal measures, the week that remains before they meet with us may not be sufficient to enable them to develop a consistent and quantified plan.

Attachment

cc: FAD, LEG, MAE, PDR, SEC, TRE, WHD
Ms. Saunders

Contributors
J. Saul Lizondo (WHD)
Bob Traa (WHD)

Office Memorandum

CONFIDENTIAL

To: The Managing Director
The Deputy Managing Director

September 15, 1993

From: S. Lizondo SL

Subject: Brazil--Back-to-Office Report

Mr. Traa and I visited Brasilia during August 31-September 12, 1993 to examine the progress made by the Brazilian authorities in designing an economic program that might be supported by the Fund. We held discussions with officials from the Ministries of Finance, Planning, and Social Security, and the Central Bank. The authorities are working on an economic program that they hope will yield a sharp reduction of inflation in 1994 on the basis of a deindexation of the economy and a strengthening of fiscal policy, although their efforts seem so far to have been centered on the former.

The Administration faces sizable political difficulties at this time. The largest political party (PMDB) is considering withdrawal of its support in the Congress, and the Executive seems to have made only limited progress in framing a set of proposals for the constitutional review scheduled to start on October 6, 1993. Rising inflation and pressures for a quick response to that problem are giving rise to expectations about the imminent adoption of an economic shock program based on heterodox (control) measures.

Monthly inflation has continued to increase, reaching 34 percent in August 1993 compared with 24 percent in the last quarter of 1992. Real interest rates have declined during 1993 to virtually zero in July and August, compared with 10 percent (on an annual basis) during the first quarter of the year and much higher levels in 1992. The external trade balance registered a surplus of US$8 billion in the period January-July 1993 (US$8.6 billion during the same period of 1992). Gross international reserves have increased by about US$2 billion since end-1992 to an estimated US$25.9 billion by end-July 1993, reflecting in part a new surge in private capital inflows.

Fiscal policy has weakened significantly during 1993, despite a relatively strong recovery in tax collections during January-May. The staff now projects a public sector primary surplus of 1.5 percent of GDP in 1993 compared with 2.1 percent of GDP in 1992. This deterioration reflects increases in the wage bill and pension benefits, as well as higher "other" current and capital expenditure. Also, the tax on bank debits (IPMF), which was expected to strengthen the finances of the Central Government during the second semester, is now expected to yield about half the amount originally envisaged by the authorities.

The Brazilian officials stated that no new measures are contemplated for the next few months, and indicated that they expect monthly inflation to continue at around 35 percent a month for the rest of the year. As a consequence of the sharp reduction in domestic real interest rates, the operational fiscal deficit is now projected to decline from 2.3 percent of GDP in 1992 to 0.5 percent of GDP in 1993 (demonstrating that the operational balance cannot be utilized as an indicator of the fiscal stance without specification of an appropriate interest rate policy).

It should be noted that in the absence of new policy initiatives, a major further deterioration of the public finances can be expected in 1994, as the budget proposal recently submitted to Congress envisages increases in the public sector wage bill, pension benefits, health spending, and unspecified current expenditure, not offset by additional revenue. On this basis, the staff projects a public sector primary deficit of 1.8 percent of GDP in 1994 (even after making some favorable adjustments that may not turn out to be justified in the last analysis) and an operational deficit of nearly 4 percent of GDP on the basis of real interest rate assumptions that hold down the deficit artificially. Furthermore, Brazilian officials indicated that the various proposals for tax reform elaborated by members of Congress (and to be discussed in the context of the constitutional review) could lead to a reduction in revenue in 1994.

To deal with the inertial components of inflation, the Brazilian officials explained that they would implement a deindexation of the economy. As we understand it, this process would first involve a transitional period (say, four months) that would be used to synchronize the adjustment in some key prices (such as wages and public tariffs) on a monthly basis. The purpose of this synchronization is to avoid distortions in relative prices at the next stage when the exchange rate is to be fixed together with other nominal variables (other countries have chosen to deal with this problem on an ex-post basis). The authorities are aware that synchronizing contracts and price adjustments will have the effect of reducing the lag of indexation and may result in an increase in the inflation rate. This worrisome possibility is leading officials to re-examine their approach to deindexation.

After the period of synchronization is completed the officials said they would introduce a new currency pegged to the U.S. dollar under a currency board arrangement. As they wish to avoid surprising the public with a shock program, the mechanisms involved in the period of synchronization and the date to achieve a fixed exchange rate would be discussed with Congress and announced publicly, perhaps sometime in October.

To deal with the basic fiscal problem, the Brazilian officials indicated that their plans are to aim at a zero operational balance in 1994. This objective would be achieved through two kinds of measures (to be announced jointly with the presentation of the deindexation program). One would consist of immediate measures designed to yield improvements in the fiscal balance starting early in 1994. The second would be structural in nature and would require constitutional amendments; hence their effect on the fiscal balance would materialize more slowly. The Brazilian officials are still in the process of defining these two kinds of measures and did not provide us with any detailed explanations. They also noted that they might resort to means to reduce interest payments on the public debt, but they did not elaborate on this possibility.

The Brazilian officials said they would continue to work on defining their fiscal program in the next week or so and they also would review the deindexation mechanism they were considering. Discussions with the staff would resume at headquarters on September 23, 1993 (prior to the meeting between Minister Cardoso and the Managing Director on September 25). The authorities suggested that a Fund mission might visit Brazil soon after the Annual Meetings, but no date was established. We stressed the need for the measures in the fiscal and other areas to be identified in specific terms and their effects quantified for the mission to be useful.

STB
FvB
w/att JF
IO
F

Brazil

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

RECEIVED
INTERNATIONAL
MONETARY FUND
1993 SEP 28
COMMUNICATIONS
DIVISION

Washington D.C., September 10, 1993

017350

The Honorable Michel Camdessus
Director
International Monetary Fund - IMF
700 19th Street, NW
Room 10-100
Washington, D.C. 20431

ORIG:& ENCS: WHD
CC: MS. R. SAUNDERS

Dear Mr. Camdessus:

I am pleased to enclose three brochures prepared by the Brazilian Embassy on topics of importance to Brazil in the nineties.

The first text, "Brazil and the Environment", describes the variety of Brazilian ecosystems, as well as Brazil's environmental policies and initiatives.

The second text, "Brazil-United States Trade Relations", highlights the far-reaching liberalization of Brazil's trade regime and points out the main features of the Brazil-US trade relationship.

The third text, "Brazilian Policy on Indigenous Population", relates the main policies adopted by the Brazilian Government in recent years to protect Brazil's indigenous population. The recent episode of violence against the Yanomami Indians demonstrates the complexity involved in ensuring adequate protection of the indigenous populations living in the rainforest.

These brochures form part of a series which will also cover such topics as privatization in Brazil and the main features of Brazilian history, geography, economy and culture, which will be published soon.

I hope you find these texts informative and useful. Should you desire any further information please feel free to contact the Documentation Center at the Embassy.

Sincerely,

Rubens Ricupero

(Rubens Ricupero)
Brazilian Ambassador

INTERNATIONAL MONETARY FUND

Mr Beza

The MD thinks this is unnecessary, since he has spoken to Malan.

File

GRS 9/10

Ruth Saunders

Office Memorandum

Brazil

To: The Managing Director

September 10, 1993

From: S.T. Beza

Subject: Brazil--Congratulations to Mr. Malan

Please find attached a letter congratulating Mr. Malan on his becoming President of the Central Bank of Brazil. Mr. Malan took office yesterday.

Attachment

cc: The Deputy Managing Director
Ms. Saunders

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

September 10, 1993

I would like to extend to you my congratulations as well as those of my colleagues on your assumption of the Presidency of the Central Bank of Brazil.

Your considerable achievements as foreign debt negotiator and your wide experience in the international financial community put you in a unique position to guide the Central Bank in a period in which this institution will need to carry a very heavy burden as the effort to strengthen policies is intensified.

We in the Fund have appreciated your candid manner and spirit of cooperation, and I trust our relations will be very close inasmuch as we share common objectives.

With best wishes, I remain,

Yours sincerely,

Michel Camdessus

Mr. Pedro Malan
President
Banco Central do Brasil
Sede - Setor Bancario Sul
Caixa Postal 1102/11
7000 Brasilia, D.F.
Brazil

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

93 SEP 13 PM 3:22

Mr. Beza

STB
FJB
JFE
IO
F

Brazil

September 7, 1993

Dear Dr. Malan:

I am pleased by the positive response of the Brazilian authorities to the proposed academic seminar for non-officials to be held in Brazil in the first half of 1994, and I welcome the suggestion that the seminar be co-sponsored by the Central Bank of Brazil. To facilitate its preparation, I am enclosing a description of the format and organization of the seminars for non-officials sponsored by the IMF and a list of the seminars held since 1981.

In order to ensure that seminar preparations proceed expeitiously, it would be most useful for us to meet during the Annual Meetings of the IMF/World Bank in Washington to discuss, among other matters, the following issues:

- Date and possible venue for the 2-1/2 day seminar (experience indicates that it is best to select a venue outside a major city).

- Possible university co-sponsor, in addition to the IMF and the Central Bank of Brazil.

- Theme of the seminar. I would propose for consideration one of the following, but, of course, I would welcome any suggestion you may have:

    - The Effects of Inflation on Economic Growth and Income Distribution - Macroeconomic and Structural Policy Issues

    - Requirements and Determinants of High Quality Growth - Macroeconomic and Structural Policies and Social Equity

- Participants. I would suggest a total of 35-40 participants, distributed as following: 10 economists from Brazil; 3-4 each from Argentina, Colombia, Chile, Mexico and Venezuela; one each from the Economic Commission for Latin America and the Caribbean (ECLAC), the World Bank, the Inter-American Development Bank (IDB) and the Organization for Economic Cooperation and Development (OECD); 5-6 from the IMF; and some 4 internationally known economists.

- Selection of a moderator. The moderator plays a key role in ensuring the success of the seminar and in editing the eventual seminar volume.

- Allocation of responsibilities among co-sponsoring institutions.

We are also in contact with Dr. Fritsch at the Ministry of Finance to follow-up on the organization of the seminar. It would be helpful if you would nominate a coordinator at the Central Bank, who could also participate in our meeting, with you and Dr. Fritsch, to follow-up on the organizational aspects. Mr. Roberto Bräuning, of the IMF's External Relations Department, will initially be responsible for the IMF's participation.

Sincerely yours,

S Anjaria

Shailendra J. Anjaria
Director
External Relations Department

Enclosure

Mr. Pedro Sampaio Malan
Presidente
Banco Central do Brasil
Edificio Sede do Banco Central
Setor Bancário Sul - Quadra 3 -Bloco B
70074-900 Brasília, D.F.
Brasil

bcc: Mr. Kafka
Mr. Beza
Ms. Kelly
Mr. Fajgenbaum
Mr. Puentes
Ms. White

INTERNATIONAL MONETARY FUND
WASHINGTON D C 20431

September 7, 1993

Dear Dr. Fritsch:

I am pleased by your positive response to the proposed academic seminar for non-officials to be held in Brazil in the first half of 1994, and I welcome your suggestion that the seminar be co-sponsored by the Central Bank of Brazil. To facilitate its preparation, I am enclosing a description of the format and organization of the seminars for non-officials sponsored by the IMF and a list of the seminars held since 1981.

In order to ensure that seminar preparations proceed expeditiously, it would be most useful for us to meet during the Annual Meetings of the IMF/World Bank in Washington to discuss, among other matters, the following issues:

- Date and possible venue for the 2-1/2 day seminar (experience indicates that it is best to select a venue outside a major city).

- Possible university co-sponsor, in addition to the IMF and the Central Bank of Brazil.

- Theme of the seminar. I would propose for consideration one of the following, but, of course, I would welcome any suggestions you may have:

    - The Effects of Inflation on Economic Growth and Income Distribution - Macroeconomic and Structural Policy Issues

    - Requirements and Determinants of High Quality Growth - Macroeconomic, Structural and Social Policies and Social Equity

- Participants. I would suggest a total of 35-40 participants, distributed as following: 10 economists from Brazil; 3-4 each from Argentina, Colombia, Chile, Mexico and Venezuela; one each from the Economic Commission for Latin America and the Caribbean (ECLAC), the World Bank, the Inter-American Development Bank (IDB) and the Organization for Economic Cooperation and Development (OECD); 5-6 from the IMF; and some 4 internationally known economists.

- Selection of a moderator. The moderator plays a key role in ensuring the success of the seminar and in editing the eventual seminar volume.

- Allocation of responsibilities among co-sponsoring institutions.

We are also in contact with Dr. Malan at the Central Bank. I understand that Ambassador Jose Arturo Denot Medeiros will coordinate the Ministry of Finance's participation, and it would be most helpful to have our meeting jointly with them. Mr. Roberto Bräuning, of the IMF's External Relations Department, will initially be responsible for the IMF's participation.

Sincerely yours,

S. Anjaria

Shailendra J. Anjaria
Director
External Relations Department

Enclosure

Dr. Winston Fritsch
Secretario de Política Económica
Ministerio da Fazenda
Esplanada dos Ministerios
Bloco P - 3o. andar
70048 Brasilia, D.F.
Brasil

bcc: Mr. Kafka
Mr. Beza
Ms. Kelly
Mr. Fajgenbaum
Mr. Puentes
Ms. White

INTERNATIONAL MONETARY FUND
SEMINAR PROGRAM FOR NON-OFFICIALS

Background and Purposes

In 1981 the Fund initiated a program of seminars for non-officials aimed at promoting a broader understanding of the role of the Fund; by addressing questions of concern to the membership; and by exchanging views with academic, business, and other groups of a non-official character. The seminar program also aims at helping to improve the Fund's knowledge of thinking in these circles. In organizing seminars in different countries, an effort is made to maintain a degree of regional balance, as well as to reach out to participants (and to the readers of seminar papers and proceedings) in their own languages. To date, twenty-five seminars have been held. The proceedings of twenty seminars have been published, or are in the process of being publishing, in one or more of six languages.

Seminar Format and Organization

1. Co-Sponsoring

In many instances, a co-sponsor with the Fund is desirable as well as necessary for administrative feasibility. The Finance Ministry or the Central Bank may wish to co-sponsor the seminar, or they may agree to a non-governmental institution assuming this role. The co-sponsors jointly determine dates and location for the seminar, the overall theme, the titles of individual papers, and jointly select the non-Fund authors and discussants of papers as well as participants.

2. Theme

Subjects to be examined are chosen so as to draw primarily on interests and concerns of the region. The focus could be on the role the Fund can play, given the circumstances and the problems faced; issues of reform and the future role of the Fund; or the application of conditionality and the design of adjustment programs. In order to explore the overall theme of the seminar in a comprehensive way up to six individual papers are presented.

3. Authors

Contributors of papers are both Fund staff and knowledgeable outsiders, and for some seminars it is appropriate to invite participation by the World Bank. Outside discussants for each paper are selected from seminar participants to provide divergent points of view.

4. Participants/Observers

Participants in the seminar include businessmen, bankers, trade unionists, and other non-officials including economic writers and serious financial journalists as well as university teachers and researchers with an interest in Fund matters. It is also possible to include a number of officials. The number of active participants is held to between 30-40 to allow for effective discussion, although observers, who take no formal part in the proceedings, have been invited in addition.

5. Time-table and Role of Moderator

Four to five half-day sessions appear normally to be the appropriate length, with a concluding session where the principal issues which emerge are summarized and discussed. From past experience it has been useful for all sessions of the seminar to be chaired by one moderator who, in addition to his/her responsibilities for keeping the discussion on track, would provide the summing up, it is recognized that this task should be performed by an academician for former official whose technical expertise in the international monetary and financial field is unquestioned. In order to ensure a frank and informal exchange of views, all participants attend the seminar in a personal capacity. While the seminar papers are on-the-record, and are meant for publication later, the actual discussions are off-the-record.

6. Publication

It is not assumed that each seminar will produce a volume for publication. Only where the theme and papers are of exceptionally quality, the Fund may consider publication of the proceedings. Such publication of the proceedings will contain the papers delivered at the seminar, and the moderator's summing up. Unless alternative arrangements are made, the moderator will be responsible for overall editing of the proceedings for publication.

7. Communication with the Host Country

All communications between the Fund and the country interested in hosting a seminar are through the Executive Director representing the country, unless the Executive Director authorizes the staff to directly contact his authorities, or institutions in the country represented by him. Following initial informal contacts between the Fund and the authorities of a member country and after agreement has been reached in principle to organize a seminar, the authorities of the host country formally invite the Fund to organize a seminar for non-officials. When this invitation has been received, ideally six to 12 months before the envisaged date, the first procedural steps are taken.

Responsibilities of Co-Sponsors and Related Costs

Each co-sponsor nominates a contact person who is responsible for preparing and conducting various aspects of the seminar. The contact persons keep each other informed on all aspects of their respective work. The overall responsibility for the seminar lies with the Director of the Fund's External Relations Department, working in close collaboration with the Executive Director representing the host country, as appropriate. The following is a typical breakdown of specific responsibilities of the Fund and the other co-sponsor(s):

(a) The Fund

- Commissioning seminar papers
- Remunerating discussants
- Selecting the moderator in agreement with co-sponsors and providing reimbursement for his/her services

- Inviting participants
- Distributing papers to participants outside the host country
- Providing business class air tickets for authors and participants
- Providing board and lodging for participants at the hotel or conference center selected in collaboration with co-sponsor
- Farewell lunch or dinner.

(b) Co-sponsor(s):

- Conference facilities (conference room, recording facilities)
- Providing a summary of proceedings
- Secretarial services
- Opening ceremony
- Welcoming reception
- Local transportation
- Invitations to observers and distribution of seminar papers to local participants
- Assisting participants with visa and return travel arrangements.

Once the points described above are determined and agreed upon by the authorities, the co-sponsoring institution(s), and the External Relations Department of the Fund, a proposal will be submitted to Fund management for final approval.

March 1991

November 1991 SEMINARS FOR NON-OFFICIALS ORGANIZED BY THE INTERNATIONAL MONETARY FUND

1) "Adjustment and Financing in the Developing World: The Role of the International Monetary Fund," co-sponsored with the Overseas Development Institute, October 16-18, 1981, Croydon, England.

2) "Le système monétaire international face aux déséquilibres," co-sponsored with l'université Paris I, November 23-25, 1981, Paris, France.

3) "The International Fund and Developing Countries," co-sponsored with the Central Bank of Kenya, March 3-5, 1982, Nairobi, Kenya.

4) "Exchange Rate Regimes and Policy Interdependence," co-sponsored with the National Bureau for Economic Research, August 31, 1982, Washington D.C., USA.

5) "The Fund and China in the International Monetary System," a symposium co-sponsored with the Bank of China, October 20-28, 1982 Beijing, China.

6) "La Función del Fondo Monetario Internacional en el Proceso de Ajuste," co-sponsored with the Central Bank of Chile and the University of Santa Maria, April 5-8, 1983, Viña del Mar, Chile.

7) "Geldwertstabilitat und Wirtschaftswachstum," co-sponsored with the Austrian National Bank, October 11-14, 1983, Baden, Austria.

8) "Programmes d'adjustement et croissance économique," co-sponsored with the Ministry of Economy and Finance, Senegal, and the Central Bank of West African States, April 24-27, 1984, Dakar, Senegal.

9) "Ajustamento e Crescimento na Atual Conjuntura Economica Mundial," co-sponsored with the Central Bank of Portugal, January 16-19, 1985, Estoril, Portugal.

10) "International Monetary Adaptation, 1972-1985," co-sponsored with the Overseas Development Institute, March 29-31, 1985, London, England.

11) "Africa and the International Monetary Fund," co-sponsored with the Association of African Central Banks, May 13-15, 1985, Nairobi, Kenya.

12) "Economic Adjustment: Policies and Problems," co-sponsored with The Reserve Bank and Treasury of New Zealand, February 17-19, 1986, Wellington, New Zealand.

13) "Economic Policy, Growth and External Equilibrium in the Maghreb Countries," Symposium co-sponsored with the Central Bank of Tunisia and the Institute of Development Financing (IFID), April 28-30, 1986, Tunis, Tunisia.

14) "External Debt, Saving and Growth in Latin America," co-sponsored with the Instituto Torcuato di Tella, October 13-16, 1986, Buenos Aires, Argentina.

15) "Macroeconomic Management, Growth, and the Role of the International Monetary Fund," Colloquium co-sponsored with the People's Bank of China, November 11-17, 1986, Beijing, China.

16) "Adjustment and Economic Growth--The Asian Experience," co-sponsored with the Indian Council for Research on International Economic Relations (ICRIER), December 8-10, 1986, Bombay, India.

17) "Adjustment Policies and Development Strategies in the Arab World," co-sponsored with The Arab Monetary Fund, February 16-18, 1987, Abu Dhabi, United Arab Emirates.

18) "Fiscal Policy, Economic Ajustment and Financial Markets," in co-sponsored with the Centre for Monetary and Financial Economics at the Universita Commerciale Luigi Bocconi, January 27-30, 1988, Milan, Italy.

19) "Les politiques pour la croissance dans les pays en développement," co-sponsored with the Moroccan Ministry of Finance, March 21-23, 1988, Mohammedia, Morocco.

20) "National Economic Policies and their Impact on the World Economy: Concepts and the Problem of Coordination," co-sponsored with the HWWA--Institut fuer Wirtschaftsforschung Hamburg, May 5-7, 1988, Hamburg, Federal Republic of Germany.

21) "Privatization and Structural Adjustment in the Arab World," co-sponsored with the Arab Monetary Fund, the Economic and Social Commission for West Asia (ESCWA), and the United Nations Development Program (UNDP). December 5-7, 1988, Abu Dhabi, United Arab Emirates.

22) "Growth, Equity, and External Financing", co-sponsored with the National Autonomous University of Mexico (UNAM). May 17-19, 1989, Mexico City, Mexico.

23) "Exchange Rate Policy in Selected Industrial Countries," co-sponsored with the Macquarie University and Katholieke Universiteit Leuven held at the Center for European Policy Studies. October 12-14, 1989, Brussels, Belgium.

24) "Adjustment, Growth, and International Trade in Small, Open Economies," co-sponsored by the University of Costa Rica. November 29 through December 1, 1990, San Jose, Costa Rica.

25) "Structural Adjustment, External Debt and Growth in Africa," joint symposium of the Association of African Central Banks (AACB) and IMF under the auspices of the Bank of Botswana, February 25-27, 1991, Gaborone, Botswana.

26) "Central and Eastern Europe: Roads to Growth," co-sponsored by the National Bank of Austria. April 15-18, 1991, Baden, Austria.

27) "Structural Adjustment and Macroeconomic Policy Issues," co-sponsored by the Pakistan Administrative Staff College. October 26-28, 1991, Lahore, Pakistan.

STB
FVB
JF
F

Office Memorandum

To: The Managing Director
The Deputy Managing Director

September 3, 1993

From: S. T. Beza MB

Subject: Brazil--Partial Suspension of Debt Service Payments to Paris Club Creditors

We have learned that the Central Bank of Brazil has issued a circular suspending service payments (as of September 1, 1993) on public sector pre-cutoff date debts to Paris Club creditors not rescheduled in February 1992; that rescheduling covered debt servicing through August 31, 1993. The authorities are reported to have met on this matter with (Embassy) representatives of the G-7 in Brasilia.

We were surprised by this action because in the last Paris Club meeting on Brazil the message was that there should be no further reschedulings, given Brazil's strong international reserve position. In this connection, the paper on financing for developing countries for today's Board meeting states that Brazil was expected to graduate from Paris Club reschedulings after August 31, 1993.

We are seeking to clarify our understanding of what happened and its background (Mr. Kafka is challenging our interpretation of the scope of the suspension), but I thought I should notify you about the news we have received in view of today's Board meeting.

cc: PDR
Ms. Saunders

Office Memorandum

①Brazil ②travel – approval memo

REVISED

STB
FvB
JF
IO

To: The Deputy Director of Administration August 25, 1993

From: S. T. Beza

Subject: Brazil--Staff Visit

I wish to note that the staff visit to Brazil included in the current travel schedule will as of now comprise only two staff members rather than six and will depart from Washington on August 30 for about 10 days. Depending on what they encounter, however, we may find it advisable to increase the size of the team, but of course within the aforementioned limit of six.

Mission ID No. 94026500 (already assigned)
Program No. 412

cc: Mr. van Beek
Mrs. Braña (o/r)

Office Memorandum

STB
FvB
JF
IO
F

To: The Acting Managing Director August 25, 1993

From: S. T. Beza

Subject: Brazil--Staff Visit

-OFFICE/DMD--

5 AUG 93 9 : 50

8/26/93

You will recall that in the recent meeting between management and Brazilian officials it was agreed that a mission would visit Brasilia around end-August to hold discussions on an economic program that might be supported by the Fund, subject to the progress made by the authorities in developing their economic program. These discussions were to include coverage of the objectives and contents of the fiscal reform to be introduced in the context of the revision of the Constitution (scheduled to start in October 1993), and the general framework of the anti-inflation program to be implemented in 1994.

In the meantime monthly inflation has continued to increase, to 32-33 percent in July and August, compared with 24 percent in December 1992. Real interest rates have declined further, to 2 percent (at an annual rate) in July compared with 5 percent during the first half of 1993 and much higher levels in 1992. As you are aware the President of the Central Bank has been changed following a clash with the President of the Republic, partly over interest rate policy. Also, Congress recently approved an intensification of the wage indexation mechanism that would (other things remaining the same) have the effect of raising real wages sharply, with obvious adverse effects on the public finances and inflation. (The authorities regard the wage indexation result as a victory because they fought back a more extreme measure that had been under consideration by the Congress.)

Furthermore, we have not received information from the authorities that their work on policy plans has proceeded to the stage that would justify a full-fledged mission. Mr. Kafka understands this and he has suggested instead that a few staff members visit Brasilia to ascertain the status of the work being done by the economic team and to encourage the team to be sufficiently ambitious on policy proposals.

I think Mr. Kafka's suggestion is useful from a number of angles, and in particular it will help us to prepare for the discussions with the authorities at the Annual Meetings. Therefore, I propose that Messrs. Lizondo and Traa visit Brasilia for about 10 days, departing from Washington on August 30, 1993.

****

Mr. Fajgenbaum and I discussed with Mr. Kafka issues relating to Brazil's financing package with the banks. Mr. Kafka is trying to get his authorities to focus on two alternatives: (1) to seek from the banks a shift forward of the November 30 deadline (by 3 to 6 months) or (2) an interim closing of the deal with the banks through Brazilian deposits in an escrow account in place of the zero coupon bonds which the U.S. Treasury appears unlikely to sell to Brazil in the absence of a program with the Fund.

cc: The Managing Director (o/r)
FAD, LEG, MAE, PDR, RES, TRE
Ms. Saunders

OED-9303256
FM-PM-JC/FM

ORIGINAL: PORTUGUESE

ITAMAR FRANCO ADMINISTRATION
Ministry of Finance

File Brazil

IMMEDIATE ACTION PROGRAM
June 1993

Introduction

Only four countries in the world had inflation rates greater than 1,000 percent last year: Russia, Ukraine, Zaire, and Brazil. But while the "superinflation" in the other three countries resulted from a collapsed economy, that was not the case in Brazil. Although shaken by the long recession, the Brazilian economy remains strong, as shown by the growth of exports, the increase in industrial productivity, the expansion of the agricultural frontier, and the resumption of GDP growth in recent months.

The Brazilian economy is healthy, but the government is sick.

The diagnosis of the fundamental cause of the illness of inflation is already known. <u>It is the financial and administrative disarray of the public sector</u>, with its multiple symptoms:

- shortage of resources to finance basic services and the government investments essential to the nation's development;

- leakage of the nation's scarce resources through the drains of waste, inefficiency, corruption, tax evasion, and loan defaults;

- uncontrolled indebtedness of states, municipalities, and state banks;

- exacerbation of distributional conflicts at all levels;

The financial disarray ultimately compromises an absolutely essential role of the government, namely, that of interpreting the nation's priorities in ordering public spending.

While the government is unable to pursue a future-oriented fiscal policy, the Central Bank is prevented from pursuing an active monetary policy.

The essential prescription for treatment is also well known. <u>The government must set its own house and its accounts in order</u>.

A financial and administrative reorganization of the public sector has implications that go far beyond the economic sphere. This is a task of national salvation and a political challenge, which may be summarized as follows;

- Brazil will not consolidate its democracy and reaffirm its unity as a sovereign nation unless it overcomes its acute shortages and the social imbalances that torment the daily life of the people.

- The social debt will not be repaid unless there is a simultaneous resumption of self-sustained growth of the economy.

- The Brazilian economy will not begin to grow again unless it defeats the superinflation that paralyzes investment and disrupts productive activity.

- Superinflation will not be definitively pushed away from the horizon until the government--both at the federal level and at that of states and municipalities--corrects the disarray in its accounts.

- And government accounts will not be corrected unless the political powers decide to move firmly in that direction, setting aside smaller interests.

This is what Brazilian society expects from its legitimately constituted authorities. One cannot postpone the decisions, nor pretend normalcy exists, under pain of compromising belief in democracy and in the very future of the country.

<u>We must act, and we must act immediately</u>.

Rehabilitation of the government's accounts is not merely a matter of spending less and collecting more. It involves a broad reorganization of the public sector and its relations with the private economy, including:

i. expenditure cuts and more effective spending;

ii. recovery of tax revenues;

iii. end of the states' and municipalities' debt arrears to the federal government;

iv. control and strict supervision of state banks;

v. rehabilitation of federal banks.

The set of measures presented below faces this challenge from its most difficult side: the establishment of <u>budgetary truth</u> in the federal government's accounts, to include both expenditure and revenue.

A warning is called for at this point: assuming that reorganization of the public sector is a fundamental mission of government does not exempt the economic elite from its share of responsibility.

Enterprises--particularly large ones--cannot continue to bet on reducing output levels and increasing profit margins by raising prices, while workers show their maturity by defending the employment level.

While the government is largely responsible for the inflation, banks have been privileged partners of inflation. Many banks have high profits, not because they are efficient, but because of the high market interest rates. If inflation declined, making it possible for interest rates to drop, many institutions would have to turn to the Central Bank in order to survive. This is why rehabilitation of the banking system, including both public and private banks, is essential for it to function satisfactorily in a low inflation environment.

Lastly, tax avoidance cannot be allowed to continue to transfer an inordinate share of the tax burden to wage earners, nor to give some enterprises a spurious competitive advantage over those that do meet their tax obligations.

I. Expenditure Cuts

In any mature democracy, the government budget is the basic instrument through which constituted authority arbitrates the competition of the various sectors of society over existing public resources. This has not been the case in Brazil.

In recent years the federal budget has authorized outlays much greater than potential receipts. Attempts to increase collections through tax packages have yielded mediocre results, given the exhaustion of taxpayers. A portion of the expenditure is then financed through further public borrowing, putting pressure on interest and inflation rates. Another portion is not executed, through disbursement ceilings, nonpayment or delayed payment decided upon arbitrarily and irrationally. Yet another portion is simply eroded by actual inflation, which is always much higher than estimated when the budget law is prepared. So, the government somehow ends up using inflation as a means to make expenditure match available revenue.

It has been no different in 1993. No one who has any notion of the realities of government finance believes it will be possible to execute the full amount of expenditure envisaged in this year's federal budget. This is a fiction that must be abolished for the sake of mutual respect between the executive and legislative branches and of the credibility of both before public opinion.

But it is not enough for the executive to precariously repress the budget deficit through expenditure cuts achieved by cutting cash outlays by the Treasury. This only postpones the outlays. Moreover, it has been a tremendous inducement to pork-barrel politics and corruption in the race for budgetary payments, as was pointed out, incidentally, in the final report of the Senate's parliamentary commission of inquiry on the actions of Mr. Paulo César Farias in the Collor de Mello administration.

Budgetary truth presupposes that the executive and legislative branches act together transparently and realistically to eliminate the public deficit, not through repression but through suppression of sources of expenditure. This is a thorny task, but one which is unavoidable in order to get away from the fiction and prepare a budget that faithfully reflects the nation's priorities and can be actually and fully executed.

Accordingly, the following measures are being submitted immediately to President Itamar Franco:

1. Expenditure cuts equivalent to $6 billion in the 1993 budget, extending over all ministries. Each ministry, acting in accordance with the priorities defined by President Itamar Franco and in consultation with the National Congress, must define where and how to cut its expenditures. These understandings will lead to a draft law on budgetary reprogramming, to be submitted to Congress by June 30.

2. While the new law is pending approval, the cuts will be implemented through quarterly expenditure quotas to be set for each ministry with a view to making the expenditure flow consistent with actual revenue collection.

3. Preparation of a budget proposal for 1994 based on realistic revenue estimates. This will allow the executive to commit itself to actual execution of authorized expenditure, also defined realistically and transparently.

4. Work with the Senate to ensure fast handling of the draft law (already approved by the Chamber of Deputies) that limits civil service wages to 80 percent of current revenues of the federal government and of state and municipal governments.

5. Transmittal to Congress of the supplementary draft law provided for in the sole paragraph of Article 23 of the Constitution, to lay down the rules for cooperation between the federal government and the states and municipalities. This law will clearly specify the programs in which the federal government cannot act directly or indirectly, by virtue of their being typically the responsibility of other levels of government, and will set limits to the federal government's involvement in areas constitutionally attributed to multiple levels of government. In these cases, aid will be given only to states and municipalities that are current in their debts to the federal government and its agencies.

II. Revenue Recovery

Even with drastic expenditure cuts, congressional approval of the law regulating the provisional tax on financial transactions (IPMF) by end-June is essential to the effort to balance the federal government's accounts in 1993/94.

The IPMF is a precarious solution, although an essential one in view of the dramatic scale of the fiscal crisis. Budgetary truth, the counterpart of a realistic budget, will only be achieved on the basis of broad reform as part of the revision of the Constitution. The government will strive to expedite the process by providing Congress with information and suggestions that will enable it to vote by the end of the year on a new fiscal and tax system to take effect in 1994.

Tax avoidance has reached dramatic levels in Brazil. Data collected by the Secretariat of Revenue and the Senate's commission of inquiry suggest that for each cruzeiro taken in, another cruzeiro is not collected due to evasion. A revenue recovery effort is needed immediately, through a fight against evasion that will mobilize public opinion and make full use of the enforcement tools the law provides to the federal revenue authorities.

The following are some of the measures being taken in this regard:

1. The Secretariat of Federal Revenue will directly monitor compliance with tax liabilities on the part of the 30,000 largest enterprises in the nation, which have monthly turnover in excess of $150,000. The monitoring effort, which now covers 3,000 enterprises, will be extended by August to the 7,000 largest firms, which have monthly billings of over $500,000.

2. Federal Revenue will immediately begin the process of collecting tax debts from the 115,000 individuals who failed to pay tax on the amounts they declared in 1992.

3. Federal Revenue will also immediately begin to notify over 300,000 individuals who failed to file a tax return.

4. Federal Revenue will immediately begin an intensive examination of 600 enterprises selected according to size in the branches of activity identified as having the highest delinquency levels.

5. The Integrated Financial Administration System will mandatorily forward to Federal Revenue its data on payments made, which will be used by the latter to cross-check payments of tax liabilities and verify the consistency of other tax-related information provided by government contractors.

6. Federal Revenue will immediately assess additional tax from the 15,000 individuals already identified by the computer systems as having had income greater than reported in their 1992/1991 returns.

7. An amendment of Law 8383/91 will be proposed to broaden the possibility of offsetting tax credits, thus benefitting the Treasury and taxpayers who comply with their tax obligations.

8. The Government Property Service will be instructed to accelerate the resurvey of federal property and to reform its administration so as to obtain the full potential revenue, estimated at approximately $1 billion a year.

9. Urge the Public Prosecutor's Office to act as quickly as possible to finish processing the hundreds of tax evasion proceedings sent to it by Federal Revenue, and to file charges in those cases where it is determined that crime is involved.

10. Creation of a general register of individuals and corporations in arrears toward the federal government, including Federal Revenue, the Treasury, the National Social Security Institute (INSS), and the Unemployment Guarantee Fund (FGTS). Explicit prohibition on delinquents entering into contracts with the government, participating in public competitive bidding, borrowing from official banks, and receiving or maintaining any kind of government franchise (radio and television, higher education establishments, ports, airports, etc.) (draft law).

11. Set late interest rates for tax liabilities and debts to the Treasury so that delinquency toward Federal Revenue, the Treasury and Social Security will be subject to an additional compensatory fine equivalent to the borrowing rates paid by the Treasury in its securities auctions.

12. Discourage extraordinary operations intended to avoid exclusive taxation at source of financial gains of artificial persons (National Monetary Council resolution).

13. Promotion, jointly with the states, of consumer/taxpayer education campaigns against tax evasion.

It should be noted that <u>the goal is not to reduce evasion in order to increase government spending</u>. The goal is to achieve tax justice by preventing a few clever people from profiting at the expense of the majority and, in addition, to create the conditions for a future rate reduction and simplification of the tax system, which will improve the efficiency and competitiveness of the Brazilian economy.

III. <u>Relationship with States and Municipalities</u>

For many people, government in Brazil means nothing else than the federal government. Nothing could be further from the truth. State and municipal governments account for over 46 percent of available tax revenue. Their overall wage bill is three times the size of the federal government's, and they invest five times more. They owe the cruzeiro equivalent of $40 billion to the federal government, and they have not been paying it back. Between September 1991 and December 1992, they failed to repay over $2 billion to the federal government.

Consequently, states and municipalities cannot be left out of any austerity program. The federal government will act towards them flexibly but firmly in order to:

- reduce unconstitutional transfers of resources from the federal budget;

- regularize overdue debt payments to the federal government;

- prevent states and municipalities from returning to an unsolvable debt position.

It is therefore necessary:

1. To suspend the signature of new agreements and the transfer of federal resources (except constitutional transfers) to states and municipalities in arrears to the federal government and its agencies (presidential decree).

2. To suspend for all financial institutions the exceptional payments grants provided for in National Monetary Council (CMN) Resolution 1718, including operations in expectation of budgetary revenues. This measure will extend to all public sector agencies and cover all types of credit, except those of a commercial nature (CMN resolution).

3. To complete the negotiation for rollover of states' debt, so as to enable them to resume payments to the federal government.

4. To withhold up to 100 percent of the resources of State and Municipality Revenue-Sharing Funds for those in arrears to the INSS and other federal agencies (presidential decree).

5. To order federal banks to immediately call in the contractual guarantees on all overdue debts (presidential decree).

6. To suspend the authorization of borrowing transactions of any kind with federal agencies by state and municipal governments in arrears to the federal government and its agencies (presidential decree).

7. To suspend the granting of National Treasury endorsements for external borrowings of state and municipal governments as long as they remain in arrears to the federal government and its agencies (presidential decree).

8. To require electric power utilities to make full payment of the energy supplement to electricity suppliers from January 1, 1993 onwards, with imposition of severe penalties, including intervention, for noncomplying utilities (presidential decree).

9. To establish criteria for providing National Treasury guarantees to states and municipalities. Such guarantees will be explicitly forbidden without exception for those in arrears to the federal government and its agencies and will in all cases require the furnishing of counter-guarantees based on the borrower's own receipts (draft law).

10. The Office of the Attorney General of National Finance will expedite tax claim proceedings pertaining to state and municipal indirect administration agencies, treating them on the same basis as private debtors (administrative measure).

11. Definition of overall terms for public borrowing, including all funded and floating debt. Full exercise of taxation authority will be required as a prerequisite, approval of supplemental debt ceilings will be prohibited, and the estimation of future savings and ability to pay will be improved (draft supplementary law and Senate resolution).

IV. State Banks

With rare exceptions, in the recent past state banks have acted as financing agencies for their states' treasuries, overdone the issuance of securities, and held insufficient reserves relative to deposits. With such a source of financing, state governments were tempted into ignoring the need for fiscal adjustment. For their part, the state banks, due to the meddling of their controlling shareholders, cause the federal government's monetary and fiscal targets to be exceeded and end up knocking on the Central Bank's doors. In the final analysis, the bill for the imbalances is sent to the National Treasury.

For these reasons, and to ally state banks with the federal government's adjustment effort:

1. The Central Bank will independently exercise the functions of executing, warning, and if necessary intervening in the activities of state banks. Enforcement of the rules setting minimum capital requirements for these institutions and limits on lending to public sector agencies (including the holding of securities of their respective treasuries) will be strengthened.

2. Orders will be given for application of the provisions of the White Collar Crime Law to the official financial system. This law subjects board members of financial institutions that approve loans to their controlling shareholders or to enterprises under their control to six years' imprisonment, preventing state banks from lending to their states or their states' enterprises (National Monetary Council resolution).

3. The Central Bank will rigorously comply with its obligation to inform the Public Prosecutor's Office of violations of the White Collar Crime Law for imposition of the prescribed sanctions.

4. The Central Bank and the National Treasury will be forbidden to grant financial "bail-outs" to help state banks' rehabilitation programs.

5. Promote a state bank restructuring program, in order to:

a. convert development banks into their respective state bank portfolios;

b. reduce the number of branches and eliminate those operating at a loss.

6. Banks of states whose governments are in arrears to the federal government and its agencies will lose their accreditation as financial agents of the National Bank for Economic and Social Development (BNDES), the National Savings Bank (CEF), and funds and programs of the official credit operations budget.

V. Federal Banks

Federal banks and financial agencies share a number of problems:

- overlapping of operations, as they compete in the same markets and offer identical or similar products;

- dependence on federal resource flows;

- opening of new branches based on political criteria, leading to self-destructive competition and operational deficits in existing branches;

- political influence in lending;

- heavy pressure on the Ministry of Finance, the National Monetary Council and the Central Bank to grant special treatment contrary to the law on the financial system;

- a tendency to evade the Central Bank's supervision and the rules of the National Treasury, their controlling shareholder.

In view of the above, the following measures will be adopted:

1. Extension of the application of the White Collar Crime Law to cover board members of federal banks.

2. Redefinition of the functions of federal banks, with a view to streamlining their organization and preventing duplication and mutually predatory competition while consolidating the position of Banco do Brasil as a financial conglomerate and principal fiscal agent of the National Treasury.

3. Strengthen the agricultural financing role of Banco do Brasil, by identifying sources of financing and forms of operation that make it independent of capital resources from the Treasury and special financing from the Central Bank.

4. By July 16, the ministries of Agriculture and Finance will define jointly with Banco do Brasil the terms for financing the next crop, making the agricultural policy rules perfectly clear and having in mind the Itamar Franco administration's goals of achieving technological modernization in agriculture, reducing rural-urban migration, and increasing the supplies of basic foodstuffs.

5. Mopping up the federal bank branch network by closing superfluous ones in accordance with the banks' reorganization programs (presidential decree).

6. The Central Bank's legal independence to control and supervise the performance of federal banks will be strengthened to include conservatorship and liquidation authority.

7. Privatize Banco Meridional.

VI. Privatization

The public enterprises established in Brazil since World War II played a crucial role in the country's industrialization. But today the government must reorganize itself in order to be able to act in other areas: the health, education, food and housing programs the country needs in order to repay its social debt; infrastructure; science and technology; justice and security; defense of the national currency and market equilibrium; and expansion of foreign trade.

Privatization is a necessary step in this <u>change of course</u> by the federal government. But it is also essential to financial equilibrium. Between 1982 and 1992 the National Treasury channeled resources equivalent to $21 billion to enterprises included in the current privatization program; $2 billion was wasted in the steel sector alone. And even though they were financially rehabilitated in 1987, virtually all of this sector's enterprises fell back into debt.

The fact is that most public enterprises fell victim to a veritable collusion between corporate, political and economic interests. They remained public in name only--and in the public burden borne by the Treasury, which can no longer bear these losses or finance the investments needed in many of the enterprises.

The following guidelines have the general purpose of <u>accelerating and expanding the boundaries</u> of the privatization process:

1. Rapidly complete the privatization of enterprises in the steel, petrochemicals and fertilizer sectors in accordance with the program already established.

2. Begin privatization of the electricity and railroad sectors.

3. Simplify and speed up the sale of the government's small equity share in enterprises, held by Banco do Brasil and BNDES.

4. In the case of potentially profitable enterprises, sell the controlling share, but have the Treasury retain a portion of the preferred shares so that the government can benefit from the enterprise's increased value under private management.

5. Allow the use of workers' claims on corporate funds to purchase shares in the privatization process.

6. Reaffirm the government's commitment to swift congressional approval of the draft law expanding the possibility of foreign capital participation in the privatization process by eliminating remaining obstacles.

7. Allow state and municipal electricity and sanitation enterprises to swap part of their overdue debt to the federal government for their own shares, which may then be sold under state privatization programs (draft law).

8. Promote the swap of securities received by the seller or successor from the sale of its shares for special long-term government securities, in order to solve the balance sheet problem arising from acceptance of such securities by controlling shareholders (draft law).

9. Transfer enterprises to be privatized from the jurisdiction of the respective ministries to that of the Ministry of Finance, so as to facilitate the privatization process (draft law).

10. Strengthen mechanisms for protection of competition, so as to prevent the creation of oligopolies or monopolies in sectors where overconcentration of capital is undesirable from the economic and social standpoint (draft law).

11. Publication of appraisals by independent consultants in the official press.

12. The proceeds from the sale of public enterprise shares must be shown on the budget and on the Treasury's financial statements (draft law).

13. Establishment of a Privatization Fund with the domestic currency resources collected by the Treasury from the sale of public enterprises (draft law).

14. Public enterprises remaining under government ownership will be subject to strict criteria of budgetary realism and austerity. They will have fair tariffs and prices, but will be accountable for their wage policy and operating efficiency and will have to adjust their investment programs to the government's priorities.

15. Resume and enhance, jointly with the Ministry of Planning, the regulatory function of the State Secretariat for State Enterprises (SEST), so that it can effectively coordinate compliance with government decisions on wage policy, contributions to pension funds, distribution of dividends, and investment priorities.

16. Order the Treasury to freeze the accounts of public enterprises in arrears which are not taking steps to become current with their obligations.

Final Remarks

The government believes that effective implementation of this Immediate Action Program and the gradual improvement in government accounts will bring down the risk premium currently charged by the financial markets; accordingly, the Central Bank should adopt domestic interest rates increasingly closer to international rates for similar maturities. Moreover, the Central Bank will prevent currency overvaluation from adversely affecting Brazilian exports. In principle, depreciation of the currency should keep pace with inflation and decline in line with it as public confidence in the effective implementation of the government's program of action increases.

The government is instructing the Central Bank and the Treasury to proceed with the task of making their relationship more transparent by consolidating and publishing their accounts, so as to make clear that the public sector's aggregate financing requirements are being held within the limits dictated by the demand for money and government securities. This process will strengthen the independence of both institutions, allowing each to perform its classic functions: for the Central Bank, maintenance of the domestic and external stability of the currency, prudential regulation of the financial system, and control of the liquidity of the payments system; for the Treasury, maintenance of the equilibrium between government revenue and expenditure, timely release of resources for government programs, administration of the federal government's financial assets and securities claims, and management of the public debt.

The government will continue to define the second phase of the opening of Brazil's foreign trade. With this it intends to bring to an end a period in our history marked by government control, closed doors to the outside world, exclusion of portions of society, and monetary instability. It also intends to open the way to a new stage in the nation's development, in which the government's regulatory power is maintained but leadership is turned over to private initiative open to worldwide competition and oriented toward social integration and economic stability.

Our fundamental objective is to ensure the resumption of economic growth on a sustainable basis and with the clear purpose of building a more just society.

So far inflation has played havoc with government finances and the management of the State, encouraged financial speculation, made the poor totally destitute, crushed the middle class, and throttled Brazil's productive enterprises.

The Itamar Franco administration has an Anti-Hunger Program, which is to be expanded, and an economic policy whose objective is to expand employment through a resumption of growth. These guidelines are not negotiable. The time has come, therefore, to reiterate these commitments of the government by saying no to inflation and no to recession.

In order to do this, it is imperative to regain the public's confidence.

This can only be done with the support of the Congress and the nation.

That is the challenge, and we shall meet it.

INTERNATIONAL MONETARY FUND
66 AVENUE D'IÉNA, 75116 PARIS
FRANCE
PRINCIPAL OFFICE, WASHINGTON, D.C.

OFFICE IN EUROPE

CABLE ADDRESS
INTERFUND PARIS
TELEPHONE: (1) 40.69.30.70
TELEX: 645712
FACSIMILE: (1) 47.23.40.89

cc: JFL
F

Brazil

Facsimile Service Cover Sheet
(TYPE)

MSG. NO. (For Cable Room use only)	DATE August 19, 1993	PAGE 1 OF 1

TO

NAME Mr. Bonangelino

AGENCY Western Hemisphere Department, IMF

CITY/COUNTRY Washington D.C. 20431, USA

FACSIMILE TELEPHONE NO. 1 (Country Code) 202 (City Code) 623 7499 (Number)

TEXT

INTERNAL DISTRIBUTION

<u>Message of congratulations to Governor Malan</u>

The Managing Director approves the draft text which you submitted to him, with the amendment you proposed in your conversation with Mr. Rosenblatt (inserting "would" before "like" in the 1st line).

The Managing Director requests that the message be typed in Washington, with his "stamped" signature, and be sent to Governor Malan when his appointment has been cleared by the Senate.

Rapado
J B

FROM

NAME Jacques Baldet

DEPT./DIV.

ROOM NO.	EXTENSION 40-69-30-80	ACCOUNT CODE
AUTHORIZED BY (TYPE)	SIGNATURE J Baldet	

OE-4, Rev. 2
1-22-92

(F)

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

Brazil

FACSIMILE NUMBER
(202) 623-4661

FACSIMILE INQUIRIES
(202) 623-6262

Facsimile Cover Sheet

MSG. NO. (Fax Center use only)	DATE August 18, 1993	PAGE 1 OF 3

TO

NAME The Managing Director

AGENCY Paris Office

CITY/COUNTRY Paris, France

FACSIMILE TELEPHONE NO. 9-011-33-1-47.23.40.89 (Country Code) (City Code) (Number)

TEXT

INTERNAL DISTRIBUTION

FROM

NAME M. E. Bonangelino

DEPT./DIV. WHD/IO

ROOM NO.	EXTENSION 37148	ACCOUNT CODE
(TYPE) AUTHORIZED BY M. E. Bonangelino	SIGNATURE Miguel E Bonangelino	

IMF-42 (PREVIOUSLY SEC-56)
6-24-92

Office Memorandum

To: The Managing Director August 18, 1993

From: M. Bonangelino MEB

Subject: <u>Congratulations to Mr. Malan</u>

Please, attached find the draft of a letter congratulating Mr. Malan for his appointment as President of the Central Bank of Brazil. I would like to note that Mr. Malan's appointment is still pending confirmation from the Brazilian Senate, expected to occur in the next few days.

Attachment

cc: The Acting Managing Director
Ms. M. Kelly
Ms. R. Saunders

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

August , 1993

I like to offer you my personal congratulations on your appointment as President of the Central Bank of Brazil. Your considerable achievements as foreign debt negotiator and your experience in the international financial community put you in a unique position to guide the Central Bank in the times ahead.

We in the Fund have appreciated your openness and cooperation and I hope that in your new position our relations may be even further strengthened by the sense of purpose we share.

Yours sincerely,

Michel Camdessus

Mr. Pedro Malan
President
Banco Central do Brasil
Sede - Setor Bancario Sul
Caixa Postal 1102/11
7000 Brasilia, D.F.
Brazil

STB
FVB
JF
IO
F

Office Memorandum

To: The Acting Managing Director August 11, 1993

From: Günter Wittich GW

Subject: Brazil - Change in the Representative Rate

Attached for your information is a paper proposing a change in the definition of the representative rate for the currency of Brazil, as a consequence of the authorities' decision to introduce a new national currency, cruzeiro real, replacing the cruzeiro, as of August 1, 1993. The paper is being circulated for lapse of time decision of the Executive Board.

The paper has been cleared with the Western Hemisphere, Legal, and Monetary and Exchange Affairs departments.

Attachment

cc: The Managing Director (o/r)
Mr. Williams (o/r)
Mr. Beza
Mr. Gianviti
Mr. Zulu/Guitián
Ms. Saunders

Contributor:
Leylâ Ecevit (TRE)

INTERNATIONAL MONETARY FUND

Change in the Representative Rate for the Currency of Brazil

Prepared by the Treasurer's Department

(In consultation with the Western Hemisphere, Legal,
and Monetary and Exchange Affairs Departments)

Approved by Günter Wittich

August 11, 1993

The Central Bank of Brazil (Banco Central do Brasil) has informed the Fund of the introduction of a new national currency, cruzeiro real, replacing the cruzeiro, at the rate of 1,000 cruzeiros per cruzeiro real, as of August 1, 1993.

Brazil maintains a floating exchange rate system under which the official exchange rate for the cruzeiro real is freely determined in the foreign exchange market. The Fund staff has consulted with the authorities of Brazil regarding a change in the current definition of the representative rate for the currency of Brazil, last amended on May 1, 1986 (Executive Board Decision No. 8274-(86/75) G/S, adopted May 1, 1986). 1/ As a result of these consultations, it is proposed that the representative rate of the cruzeiro real be the prevailing market rate for the U.S dollar as ascertained and reported to the Fund by the Banco Central do Brasil. It is understood that Banco Central do Brasil will continue to report to the Fund the representative rate for the currency of Brazil on a daily basis, and will advise the Fund immediately of any change in exchange arrangements that may affect the determination of the representative rate. On August 3, 1993 the market rate for the cruzeiro real reported by the Banco Central do Brasil was equal to cruzeiro real 72.068 per U.S. dollar (see Attachments).

1/ On February 28, 1986 a new monetary unit named "Cruzado" for the currency of Brazil was established, replacing cruzeiros at the rate of 1,000 cruzeiros per cruzado. On January 15, 1989 the new cruzado, equal to 1,000 old cruzados, was introduced. On March 16, 1990 the name of the new cruzado was changed to cruzeiro. The rate of the cruzeiro against the U.S. dollar has been communicated to the Fund on a daily basis.

Accordingly, the following draft decision is proposed for adoption by the Executive Board:

The Fund finds, after consultation with the authorities of Brazil, that the representative exchange rate for the cruzeiro real, under Rule O-2(b)(i), against the U.S. dollar is the prevailing market rate for the U.S. dollar as ascertained and reported by Banco Central do Brasil.

Attachments

FROM: BANCO CENTRAL DO BRASIL

DEORI/93018494-001

TO : INTERNATIONAL MONETARY FUND

ATTN. TREASURER'S

OUR RE DEORI/DIOFI/SUFIN-93/762, BRASILIA (DF), JULY 30, 1993

WE INFORM YOU THAT THE BRAZILIAN GOVERNMENT SET UP A NEW CURRENCY, FROM AUGUST 01, 1993, ON. THE NAME CRUZEIROS WILL CHANGE TO CRUZEIRO REAL, AND EQUALS 1/1.000 OF THE OLD ONE, I.E. 1.000,00 CRUZEIROS EQUALS 1,00 CRUZEIRO REAL. THE MINOR CURRENCY UNIT WILL BE CONTINUE TO BE DECIMALS. THE RATE OF CRUZEIRO REAL WILL BE A FLOATING ONE.

REGARDS,

MR. LUIZ AFONSO SIMOENS DA SILVA
HEAD OF THE DEPARTMENT OF INTERNATIONAL
ORGANIZATIONS AND AGREEMENTS

Received in Fund on August 2, 1993

FROM: BANCO CENTRAL DO BRASIL

TO : INTERNATIONAL MONETARY FUND

ATTN: TREASURER'S

OUR RE DEORI/DIOFI/SUFIN-RATE AUGUST 03, 1993

CRUZEIRO REAL RATE PREVAILING TODAY: U.S. DOLLAR ONE EQUALS CRUZEIROS REAIS 72.068.

REGARDS,

IRENE A. KOCH
BANCENTRAL

Received in Fund on August 3, 1993

STB
FvB
JFL
IO
F

S&S Draft (Revised)
7/30/93

To: The International Financial Community

From: Republica Federativa do Brasil

[CC: The Bank Advisory Committee for Brazil]

Date: [July][August] __, 1993

Re: 1992 Financing Plan
Initial Collateral

Reference is made to (i) the 1992 Financing Plan dated December 29, 1992 (the "1992 Financing Plan") of Republica Federativa do Brasil ("Brazil") and (ii) the communication dated May 26, 1993 from Brazil requesting the Lenders to reallocate their Old Debt (the "Reallocation Request"). Capitalized terms, unless otherwise defined herein, are used herein as defined in the 1992 Financing Plan.

The Brazilian delegation has met with the Bank Advisory Committee for Brazil (the "Committee") during July 28 through July 30, 1993 to discuss the steps necessary to implement the 1992 Financing Plan, including, among other things, the distribution among the Principal Options following the Reallocation Request. Since the stock of Old Debt is less than originally thought and taking into account constraints on available Initial Collateral, Brazil has requested and the Committee has agreed that (i) the amount of Initial Collateral to be provided as a condition precedent to the occurrence of the Exchange Date will be revised from U.S.$3.2 billion to U.S.$2.8 billion, as set forth below, and (ii) in connection with such revision, the Lenders will be permitted to reallocate their Old Debt to various Principal Options in accordance with the terms and conditions hereof. There will be no change in the total amount of collateral to be provided under the 1992 Financing Plan.

I. Revised Initial Collateral Condition

A. Original Initial Collateral Condition

Under the 1992 Financing Plan, one of the conditions precedent to the occurrence of the Exchange Date is that the amount of Initial Collateral available on the Exchange Date shall be not less than U.S.$3.2 billion, subject to the special waiver provisions set forth therein (the "Original Initial Collateral Condition").

B. Revised Initial Collateral Condition

1. The Original Initial Collateral Condition will be revised as follows and such revised condition precedent (the "Revised Initial Collateral Condition") will be included in the documents implementing the 1992 Financing Plan (the "Documents").

> "The amount of Initial Collateral available on the Exchange Date shall be not less than U.S.$2.8 billion."

2. The Revised Initial Collateral Condition will not be subject to any waiver provision and the special waiver provisions included in the Original Initial Collateral Condition will not be contained in the Documents.

C. Occurrence of the Exchange Date

The Documents will provide that the Exchange Date (i) may not occur unless the Lenders holding at least 95% of the aggregate principal amount of the Eligible Debt committed to the 1992 Financing Plan sign the relevant Documents and (ii) must occur on or before November 30, 1993 (the Termination Date under the 1992 Financing Plan).

D. Further Information

Lenders are requested to contact their regional coordinator if they have questions regarding the matters set forth in this Part I.

II. Reallocation of Old Debt

Pursuant to the terms of this communication and the Reallocation Request, as further explained below, the Lenders will be permitted to reallocate their Old Debt to one or more Principal Options on or before September 9, 1993.

A. Lenders who have submitted their First Reallocation Responses on or before the date hereof.

1. Each Lender that has submitted its response to the Reallocation Request (a "First Reallocation Response") on or before the date hereof may, at its option, reallocate all or a portion of its Old Debt to one or more Principal Options by submitting a response to this communication substantially in the form of Annex A hereto (a "Second Reallocation

Response") on or before September 9, 1993; provided, that such reallocation shall comply with the guidelines set forth in the Reallocation Request; and provided, further, that the percentage of Old Debt committed to Par Bonds specified in the Second Reallocation Response shall not be greater than such percentage specified in such Lender's First Reallocation Response. Brazil would appreciate it if the percentage of Old Debt committed to Discount Bonds specified in the Second Reallocation Response were at least equal to such percentage specified in such Lender's First Reallocation Response.

2. If any such Lender does not submit its Second Reallocation Response on or before September 9, 1993, such Lender's First Reallocation Response will be deemed to be effective for the purpose of implementing the 1992 Financing Plan.

3. Any Lender that has submitted its First Reallocation Response on or before July 9, 1993 will be permitted to modify its specification (set forth in such First Reallocation Response) as to whether such Lender wishes to (i) have the percentage of its Old Debt committed to Par Bonds adjusted pursuant to the second paragraph of Part III.2 of the Reallocation Request (the "Optional Par Adjustment") and (ii) have the percentage of its Old Debt committed to Discount Bonds adjusted pursuant to the third paragraph of Part III.2 of the Reallocation Request (the "Optional Discount Adjustment"); provided that any Lender that indicated it would not participate in the Optional Par Adjustment pursuant to its First Reallocation Response shall not be permitted to change such indication; provided, further, that any Lender participating in the Optional Par Adjustment may specify the maximum percentage of its Old Debt committed to Par Bonds which will result from the final Optional Par Adjustment.

4. Any Lender that has submitted its First Reallocation Response after July 9, 1993 and before the date hereof will not be entitled to the Optional Par Adjustment or the Optional Discount Adjustment, as stated in the Reallocation Request.

5. Each Lender, regardless of the date of its First Reallocation Response, will be subject to the adjustment of the percentage of its Old Debt committed to Discount Bonds pursuant to the second paragraph of Part III.1 of the Reallocation Request (the "Mandatory Discount Adjustment"; together with the Optional Par Adjustment and the Optional Discount Adjustment being collectively the "Adjustments").

6. In order to assist the Lenders in connection with the foregoing reallocation of their Old Debt, the Closing Agent will notify the Lenders of their respective percentages of Old Debt committed to each Principal Option (after giving effect to interim Adjustments based on the First Reallocation Responses received as of the date hereof) as soon as practicable but no later than August 9, 1993. Please note that such percentages will be provided for information purposes only and should not be considered as indicative of the final percentages for any Lender. The final percentages of any Lender's reconciled Old Debt committed to various Principal Options will be determined after giving effect to the final Adjustments (which will occur after the Critical Mass Signing Date) and notified to the Lenders shortly before the Exchange Date.

B. Lenders who have not submitted their First Reallocation Responses before the date hereof.

1. Each Lender that has not submitted its First Reallocation Response before the date hereof is hereby urged to do so as soon as practicable. Any First Reallocation Response shall comply with the guidelines set forth in the Reallocation Request.

2. Each such Lender is also reminded that such Lender will not be entitled to the Optional Par Adjustment or the Optional Discount Adjustment but will be subject to the Mandatory Discount Adjustment.

3. If any such Lender does not submit its First Reallocation Response before the commencement of signing of the Documents, such Lender will be permitted to participate in the 1992 Financing Plan only if it has committed to exchange 40% of its Old Debt to Option A for Par Bonds, 40% of its Old Debt to Option A for Discount Bonds and 20% of its Old Debt to FLIRBs.

C. Reallocation Responses.

Please note that each Lender should send its First or Second Reallocation Response from the same location that it sent its Commitment Telex.

D. Questions

Lenders are requested to contact the Closing Agent (Attention: Melinda Harris, Brand Livingstone, Nancy Lissemore or Louise Barbrack, telephone no. (212) 559-4757,

(212) 559-5650, (212) 559-5648 or (212) 559-7618, respectively) if they have any questions regarding the matters set forth in this Part II.

III. Other Matters

Representatives of the Central Bank, the Ministry of Finance, the Ministry of Planning and counsel have met, and will continue to meet, in New York with the Chairmanship of the Committee and its counsel to discuss the drafts of Documents. It is expected that the final drafts of the Documents will be sent to the International Financial Community in the near future.

Brazil is fully committed to normalizing its relations with the international financial community by implementing the 1992 Financing Plan by the Termination Date. Implementation of the Plan is an essential element of Brazil's broader objectives of achieving macro-economic stability and sustained growth in the years ahead. Brazil remains confident that the country will continue to receive the support of the International Financial Community as it moves toward the completion of the 1992 Financing Plan.

Regards,

Fernando Henrique Cardoso
Minister of Finance

ANNEX A

TO: CITIBANK, N.A., AS CLOSING AGENT

ATTN: ELAINE ROKAW
SUSAN SAPRA

TELEX: RCA INTL 236066
WUD 681047
WUI 661934
WUI 662528
WUI 662409
WUI 669830

TELEFAX: (212) 688-9844
(212) 308-5164
(212) 421-1658

CC: [APPROPRIATE BANK ADVISORY COMMITTEE AREA CONTACT], FOR INFORMATION

CC: REPUBLICA FEDERATIVA DO BRASIL
C/O BANCO CENTRAL DO BRASIL

ATTENTION:	HEAD OF EXTERNAL DEBT MANAGEMENT DEPARTMENT (DEDIV)
TELEX NO:	61-1299 BCBR-BR 61-2098 BCBR-BR
TELEFAX:	(0) 61-224-9261

FROM: [NAME OF LENDER]

DATE: ______________________, 1993

RE: 1992 FINANCING PLAN
INITIAL COLLATERAL

WE REFER TO (i) THE 1992 FINANCING PLAN DATED DECEMBER 29, 1992 (THE "1992 FINANCING PLAN") OF REPUBLICA FEDERATIVA DO BRASIL, (ii) THE COMMUNICATION DATED MAY 26, 1993 FROM BRAZIL TO THE INTERNATIONAL FINANCIAL COMMUNITY (THE "REALLOCATION REQUEST") AND (iii) THE COMMUNICATION DATED [JULY][AUGUST] __, 1993 FROM BRAZIL TO THE INTERNATIONAL FINANCIAL COMMUNITY (THE "INITIAL COLLATERAL COMMUNICATION"). TERMS DEFINED IN THE 1992 FINANCING PLAN ARE USED HEREIN AS THEREIN DEFINED.

I. PURSUANT TO THE 1992 FINANCING PLAN, THE REALLOCATION REQUEST AND THE INITIAL COLLATERAL CONDITION WE WISH TO ALLOCATE OUR OLD DEBT COMMITTED TO THE 1992 FINANCING PLAN AS FOLLOWS:

PRINCIPAL OPTION	PERCENTAGE OF OLD DEBT
PAR BONDS:	
OPTION A:	
OPTION B:	
DISCOUNT BONDS:	
OPTION A:	
OPTION B:	
FLIRBS:	
CAPITALIZATION BONDS:	
RESTRUCTURING OPTION:	
DEBT CONVERSION BOND/ NEW MONEY OPTION:	
	100%

WE REPRESENT AND WARRANT THE PERCENTAGE OF OLD DEBT COMMITTED TO PAR BONDS SET FORTH ABOVE IS NOT GREATER THAN SUCH PERCENTAGE SPECIFIED IN OUR RESPONSE TO THE REALLOCATION REQUEST.

[__ IF THE AGGREGATE AMOUNT OF OLD DEBT COMMITTED BY ALL LENDERS TO PAR BONDS IS LESS THAN THE MAXIMUM PAR LEVEL, WE WISH TO INCREASE THE PERCENTAGE OF OUR OLD DEBT COMMITTED TO PAR BONDS PURSUANT TO THE SECOND PARAGRAPH OF PART III.1 OF THE REALLOCATION REQUEST.

_____ YES _____ NO

SUCH INCREASE SHOULD BE EFFECTUATED BY REDUCING THE PERCENTAGE OF OLD DEBT COMMITTED TO [SPECIFY THE RELEVANT PRINCIPAL OPTION OTHER THAN DISCOUNT BONDS (EXCEPT WHERE THE LENDER HAS COMMITTED ALL OF ITS OLD DEBT TO PAR BONDS AND DISCOUNT BONDS, IN WHICH CASE SUCH LENDER MAY SPECIFY DISCOUNT BONDS AS THE PRINCIPAL OPTION TO BE REDUCED)]*.

* To be included only if the Lender has indicated "YES" to this adjustment pursuant to its response to the Reallocation Request.

[IN ANY EVENT, THE PERCENTAGE OF OLD DEBT COMMITTED TO PAR BONDS SHALL NOT EXCEED __%.]*

____ IF THE AGGREGATE AMOUNT OF OLD DEBT COMMITTED BY ALL LENDERS TO DISCOUNT BONDS IS LESS THAN THE MINIMUM DISCOUNT LEVEL, WE AGREE TO INCREASE RATABLY THE PERCENTAGE OF OUR OLD DEBT PURSUANT TO THE SECOND PARAGRAPH OF PART III.2 OF THE REALLOCATION REQUEST BY DECREASING THE PERCENTAGE OF OLD DEBT COMMITTED TO [SPECIFY THE RELEVANT PRINCIPAL OPTION OTHER THAN DISCOUNT BONDS].

____ IF THE AGGREGATE AMOUNT OF OLD DEBT COMMITTED BY ALL LENDERS TO DISCOUNT BONDS EXCEEDS THE MINIMUM DISCOUNT LEVEL, WE WISH TO REDUCE THE PERCENTAGE OF OUR OLD DEBT COMMITTED TO DISCOUNT BONDS PURSUANT TO THE THIRD PARAGRAPH OF PART III.2 OF THE REALLOCATION REQUEST.

____ YES ____ NO

SUCH REDUCTION SHOULD BE EFFECTUATED BY INCREASING THE PERCENTAGE OF OLD DEBT COMMITTED TO [SPECIFY THE RELEVANT PRINCIPAL OPTION OTHER THAN PAR BONDS]

____ LENDING OFFICES.

WE REPRESENT AND WARRANT THAT WE ARE ACTING ON BEHALF OF THE FOLLOWING LENDING OFFICES:

[IDENTIFY EACH LENDING OFFICE].

____ CONFIRMATION OF COMMITMENT TELEX.

EXCEPT AS AMENDED BY OUR RESPONSE TO THE REALLOCATION REQUEST AND HEREBY, OUR COMMITMENT TELEX IS RATIFIED AND CONFIRMED IN ALL RESPECTS.

REGARDS,

[NAME OF LENDER]

BY: ____________________
NAME:
TITLE:

---

* To be included only if the Lenders want to specify a maximum percentage for its Old Debt committed to Par Bond.

STB
FuB
JFL
IO
F

Office Memorandum

July 28, 1993

MEMORANDUM FOR FILES

Subject: Brazil--Meeting of Delegation with the Managing Director and the Deputy Managing Director 1/

Mr. Fritch explained that Brazil was embarked on a major economic program based on a front-loaded fiscal adjustment. Once the fiscal consolidation was firmly in place, de-indexation of wages and the exchange rate would follow, backed by a tight monetary policy. This program, in his view, reversed the sequencing which had characterized the failed stabilization attempts of recent years. It also implied that substantial progress on the inflation front could not be expected until 1994.

He asked for Fund support through an arrangement of 12 to 18 months to underscore the credibility of the Government's program and unlock the Brady deal and the Paris Club. Financing from the Fund was not a significant consideration.

He described two options for Fund involvement. The preferred option was a precautionary stand-by arrangement (with or without a token up front first credit tranche purchase). The fallback position was a staff monitored program. He understood that the staff had agreed to a mission in late-August to continue discussions.

The Managing Director agreed that the basic problem was tackling the disarray of public finances. He liked the idea of a front loaded fiscal program, but questioned the reasons for delaying monetary tightening and disindexation. "We need a comprehensive program from the start." Mr. Fritch replied that a severe monetary tightening would erode support for the essential upfront fiscal adjustment. Monetary policy, nonetheless, would not be lax, it would maintain market interest rates high enough to defend the balance of payments. The degree of tightness could be discussed by the mission.

1/ The meeting took place at 5:30 pm, July 27, 1993. The Brazilian delegation included Messrs. Winston Fritch, Secretary of Economic Policy, Edmar Bacha, Advisor to the Minister, and Jose A. Denot Medeiros, Secretary of International Affairs, all of the Ministry of Finance. The meeting was attended by Mr. Kafka (Executive Director), and Messrs. Beza, Fajgenbaum (both WHD), and van Houten (PDR).

De-indexation, in his view, could only be successful once inflation had begun to moderate under the pressure of fiscal adjustment, because its success depended critically on credibility. He admitted that the timing of the second phase was uncertain. In his view, it would take at least six months to establish a serious fiscal consolidation. But it could be longer. The timing of de-indexation would be a judgment call.

The Managing Director emphasized the importance of strong, visible measures in the upfront fiscal package to gain the confidence of a highly skeptical market. He also stressed that the authorities' fiscal objective for the first year was not ambitious enough; the proposed objective of a 4 percent of GDP primary surplus--and operation balance--was at the low end of the scale.

The discussion then shifted to the timing and type of arrangement. The ideal would be to have a stand-by in place in time for the Brady deal deadline in November. This scenario would require a late-September indication of substantial progress as a decision had to be made at that time to move ahead on the debt deal. Given the need for serious upfront fiscal measures, the Managing Director questioned the realism of this timetable. Mr. Fritch, in reply, proposed that in that event, Brazil would fall back to a monitored program, even though this would be highly unsatisfactory. The Managing Director agreed to this procedure. "Let's go for a stand-by of acceptable quality based on upfront fiscal action, and rely on a monitored program as a fall back."

Mr. Fritch cautioned that many measures on the fiscal front could not be taken before the Constitutional Reform process which started in October, adding "we'll have to be creative and find a way to proceed." On this unsatisfactory note the meeting ended.

J. F. van Houten

Jan F. van Houten
Policy Development and Review Department

cc: Mr. Boorman
Mr. Beza
Mr. Fajgenbaum
Mr. Szymczak

F

Office Memorandum

Brazil

To: The Managing Director
The Deputy Managing Director

July 27, 1993

From: S.T. Beza

Subject: Meeting with Brazilian Officials

In their presentation of the general policy framework, the Brazilian officials said that the main task is to reduce inflation, but stressed that only after fiscal adjustment had taken place would it be possible to adopt measures such as deindexation or to use of the exchange rate to help bring inflation down.

The fiscal adjustment is to take place in two stages. Under the Immediate Action Plan an attempt is to be made in 1993 to contain expenditure, improve tax administration (although many of the proposals made by an FAD technical assistance team apparently are not being implemented), limit the state and municipal governments' access to domestic financing, and widen the scope of the privatization program. The second stage would be based mainly on a fiscal reform in the context of the constitutional revision scheduled to start on October 6, 1993. They spoke of a process extending through February 1994. In the meantime, they expect inflation to stay at around 30 percent a month.

The fiscal outlook for the rest of 1993 appears weak as the expenditure cuts announced so far concentrate on capital outlays, only partially offsetting increases in current expenditure. The authorities are projecting a primary fiscal surplus of a little above 2 percent of GDP in 1993 (roughly the same as in 1992), with the surplus declining from nearly 4 percent of GDP in the first half of the year to around 1 percent of GDP in the second half. Clearly, a great deal needs to be specified as to how the needed fiscal adjustment is to be achieved. As discussed in the strategy brief for Brazil and stressed by many Directors during the recent discussion, a significant operational surplus in 1994 may be necessary. The officials seem reluctant to go this far, but this matter requires further discussion. In any event the envisaged fiscal reform provides a unique opportunity to achieve a major and sustained fiscal adjustment.

The officials said they would like Fund support in the form of a stand-by arrangement starting as early as, say, October, with only a first credit tranche purchase initially, and with further drawings available only after they were embarked on the inflation reduction portion of the program. (They also noted that they would accept the SBA being treated as precautionary apart from financing for the debt arrangement.) They mentioned in this regard the need to be able to show the Brazilian public that they were working closely with the Fund to strengthen confidence and also to be able to conclude the debt deal.

I said this approach would be very difficult to support in view of experience. I suggested to them an informal monitoring program while the fiscal measures were being prepared and implemented up to the critical mass that would enable them to commit to inflation reduction. They felt that this would not assist them sufficiently vis-a-vis the general public and for the debt deal.

We also discussed briefly the possibility of an arrangement without any purchase from the Fund until the inflation reduction portion could be started. I did not favor this approach, and they did not seem to think that it would ~~not~~ be sufficiently helpful to them.

cc: Mr. Tanzi
Mr. Guitian
Mr. van Houten
Ms. Saunders

THE INTERNATIONAL MONETARY FUND ARCHIVES

RECORD CLOSURE NOTICE

The item identified below has been closed in accordance with the International Monetary Fund's IMF's Open Archives Policy (Decision No. 14498 – (09/126), adopted 2009-12-17 and effective 2010-03-17, as amended. This policy can be found on the International Monetary Fund website.

This record ☒ or file ☐ has been closed as it belongs to one of the following exemptions:

☐ **Legal records and other material that are protected by attorney client privilege**

☐ **Personnel files, medical information, or other records containing personal information**

☐ **Records and proceedings of the Grievance Committee**

☒ **Records acquired by the Fund by Third Parties, including Member Countries, with security classifications of 'CONFIDENTIAL' or above.** (Declassification can be requested)

☐ **Other sensitive nature:** N/A

Archival Ref No.:	588175
File Title & Dates:	Brazil, 1993.
Fonds:	Western Hemisphere Department Records, 1946-2003
Sous-fonds	Western Hemisphere Department Immediate Office Records, 1949-2000
Series:	WHDAI Country Files, 1971-1995
Box Number:	A588018-192
File Number:	5
Date Reviewed:	2025-01-08

DETAILS OF WITHDRAWN MATERIAL

DATE	1993-07-21
TYPE	Special Alert
TO	Various
FROM	R.J. Perkins
SUBJECT/TITLE	Special Alert No. 238 - Brazil
NO. OF PAGES	3
AUTHORITY	FAO
LANGUAGE	English

F

July 12, 1993

MEMORANDUM FOR FILES

Subject: Brazil--1993 Article IV Consultation
Executive Board Discussion

The Executive Board met on July 2 to consider the staff report on the 1993 Article IV consultation discussions with Brazil--(EBS/93/74, 5/20/93; EBS/93/74 Supplement 1, 6/30/93; and SM/93/125, 6/15/93). Directors expressed disappointment with Brazil's general economic performance since the last Article IV consultation was concluded in October 1991 and were in agreement that the underlying cause was the very weak fiscal situation. While recognizing the recently announced Program of Immediate Action as a step in the right direction, Directors were nearly unanimous in pointing out that it was probably not sufficiently broad-based and urged the authorities to adopt a comprehensive program that would address the weakness in the public finances so as to lay the foundation for a sustained reduction in inflation.

1. Past efforts at adjustment

Directors (Messrs. Dawson, Tabata, Marino, Peretz, Zoccali) noted that past efforts at economic adjustment have failed primarily because of weakness in the implementation of programs. The pattern was one of inadequate fiscal measures, weakness in following through on proposals for constitutional amendments, inadequate public sector reform, and excessive (unbalanced) reliance on monetary policy. The main results were large borrowing requirements of the public sector, rapid inflation and high real interest rates, while indexation remained widespread in the economy. Although there was some improvement in the economic situation in 1992--particularly in regard to structural reforms and the external accounts--a strong commitment to adjustment and perseverance with difficult measures are required to completely turn the situation around. Mr. Kagalovsky and several other Directors emphasized that past price and wage freezes were not supported by fiscal policy, with deeply institutionalized aspects of expenditures rendering the fiscal situation very difficult. Mrs. Hetrakul observed that the country's "stop-go" approach without a period of sustained austerity and the authorities' delays in carrying through the necessary reforms led to significant costs to the economy and necessitated more severe adjustments.

2. Adjustment efforts

Some Directors (Messrs. Marino, Landau, Wei, and Zoccali) welcomed the authorities' recent program as an adequate first step. The avoidance of a shock approach was viewed as appropriate but Directors stressed that the fiscal problem should be tackled with determination. In particular, the privatization efforts, limitations on the wage bill to 60 percent of revenue, the tightening of credit policy and the announced US$6 billion cut in budgeted expenditures were all in the right direction.

However, other Directors (Mr. Dawson, Tabata, Havrylyshyn) felt that substantially more work was required in order to carry out the intentions of the Government. The program is not backed by solid actions, with further revenue measures and expenditure cuts being necessary even to achieve the elimination of the operational deficit, a target which they qualified as modest. Nevertheless, even this target may be too optimistic without further measures. The recently proposed monthly indexation of salaries up to 20 minimum wages and the additional increase of minimum wage by 3 percent per month in real terms could have adverse impact on the fiscal targets, in part through its impact on social security expenditure. Moreover, the announced US$6 billion cut in expenditure may be deceptive as it is from a base that was already significantly inflated and thus may not be ambitious enough. Also, the various pronouncements on constraining the wage bill could be inconsistent with the proposed wage indexation. Directors also pointed out that, according to the staff, the revenue estimates now programmed for the budget may be overly optimistic. As a consequence, and in light of past Government's failure to deliver on policies, a "wait-and-see" attitude was felt to be most appropriate.

3. Future program

Directors urged the authorities to adopt a comprehensive program that would be sufficiently ambitious to reduce inflation on a lasting basis. This was to be enhanced primarily through a significant fiscal tightening. Such a program should include a restructuring of the public service to reduce the wage bill; appropriate revision of public sector prices to cover costs; a reduction in deficit of the public enterprises; a reform of the financial system; and the avoidance of more frequent wage indexation and controls on capital flows.

As regards Fund support for a program, Directors referred to the strong BOP position of Brazil and high level of international reserves, and this indicated that an arrangement with Brazil should be of a precautionary nature. Some Directors indicated that, for a program to be credible, it should incorporate a number of prior actions, including those related to constitutional amendments to improve the structural situation; an appropriate balance between the transfer of resources from the Central Government to state and local governments and their respective expenditure responsibility and accountability. Also, Directors felt that prior actions should include adjustments in public prices to make up for past losses; expenditure cuts, with contingent plans for further cuts to make up for any slippages; and prompt financial sector reform.

Directors emphasized that the scheduled completion of Brazil's agreement with its commercial bank creditors by end-November 1993 should not be construed as an artificial deadline by which a program should be presented to the Fund. The Fund should continue to require a program of high quality.

4. Exchange rate

Directors agreed that competitiveness is not currently a problem and the external position remains fairly comfortable. Messrs. Dawson, Havrylyshyn, Peretz, Tabata and Landau indicated that a consolidation of the fiscal situation was a necessary precondition for real exchange rate targeting to be abandoned in favor of an exchange rate that would help bring inflation down faster.

5. Consultation

Many Directors expressed concern about the delay with the Article IV consultation. They noted that Brazil, despite its difficult economic situation, did not abide by its appropriate frequency in the consultation cycle and thus made it more difficult for the Fund to properly fulfill its surveillance role. Mr. Esdar pointed out that the consultation cycle delays have been difficult to reconcile with the Fund's role, the importance of Brazil in the global picture, and for Brazil in the management of its economic difficulties. Mr. Peretz emphasized that consultation should be regular, with more timely Board discussions in the future.

JF for Sam Itam

Samuel Itam
Deputy Division Chief
Western Hemisphere Department

cc: Mr. Beza
AFR
CTA
EUR I
EUR II
MED
SEA

ccs: Mrs. Greaves
Bd. Attendance Book
Department Liaison
Ms. Puckahtikom
F/B Collab. Book

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

STB
FvB
JF
IO
F

Brazil

DATE: June 30, 1993

TO: Files

FROM: S. H. Choi, Adviser, SEC

EXTENSION: 80201

SUBJECT: Proposed Attendance of Bank Staff at IMF Board

Place of Meeting	:	**IMF 12-120 (Fund Board Room)**
Date of Meeting	:	**Friday, July 2, 1993**
Agenda Item	:	**BRAZIL: 1993 Article IV Consultation**
Staff Attending	:	**Mr. Demitris Papageorgiou** **Division Chief, Country Operations** **Latin America and the Caribbean Region** **473-1910 Room I7-059** and **Ms. Beth O'Laughlin** **Country Officer for Brazil** **Latin America and the Caribbean Region** **473-1916 Room I7-026**

cc:	Vice President	-	Mr. Husain, I8-015
	Director	-	Mr. Steckhan, I7-015
	Bank Representative	-	Mr. Papageorgiou, I7-059
	Bank Representative	-	Ms. O'Laughlin, I7-026

FROM:OMNIFAX TO: 202 623 6694 JUN 18, 1989 2:46PM #080 P.01

F

Office Memorandum

To: The Managing Director
The Deputy Managing Director

June 30, 1993

From: S. T. Beza MEB for STB

Subject: Brazil--Supplement to Staff Report

Attached is a supplement to the Staff Report for the Article IV consultation with Brazil (EBS/93/74). Its purpose is to summarize developments since the report was issued on May 20. As the supplement is mainly descriptive and does not contain controversial material, it also is being sent to Documents Preparation to speed up its circulation to the Executive Board given that the Board meeting on Brazil is scheduled for July 2, 1993. Mr. Van Houtven agrees with this procedure.

The paper has been reviewed by FAD, LEG, MAE, PDR, RES, and TRE.

Attachment

cc: Ms. Saunders

F

Office Memorandum

To: The Managing Director
The Deputy Managing Director

June 30, 1993

From: S.T. Beza

Subject: Brazil--Article IV Consultation

Attached are notes for the summing up of the Executive Board discussion on the 1993 Artivle IV consultation with Brazil scheduled for July 2.

Attachment

cc: Mr. Van Houtven
LEG
PDR
Ms. R. Saunders

Contributors
Jose Fajgenbaum (WHD)
J. Saul Lizondo (WHD)
Bob Traa (WHD)

The Chairman's Summing Up at the Conclusion of the
1993 Article IV Consultation with Brazil
Executive Board Meeting 93/ - July 2, 1993

Executive Directors expressed concern about the continued high rates of inflation and generally weak economic performance of Brazil in recent years, but were encouraged by the authorities' intention to implement an economic program that would deal with the underlying causes of these problems. They considered the Plan for Immediate Action announced recently by the Minister of Finance as a step in the right direction, although they observed that its quantification and the specification of key macroeconomic variables had not yet been completed. Thus Directors found it difficult to say whether this plan would prove to be suitable for achieving a lasting reduction of inflation and setting the basis for sustained economic growth. They urged the authorities to complete the design of the plan and to implement without delay a program consistent with the attainment of these economic objectives.

Directors stressed that a major strengthening of the public finances clearly was indispensable. A fiscal policy aimed at eliminating the operational deficit in 1993 would represent a good advance, but this would need to be followed by a further strengthening of the public finances in subsequent years. While Directors welcomed the various revenue measures that had been adopted or that the authorities expect to implement, they pointed out that achieving a balanced operational position in 1993 would require measures that still needed to be identified. They encouraged the authorities to define and implement these measures promptly because of the danger that delays would result in a further acceleration of inflation.

They also emphasized that these measures should include an adequate margin to meet potential claims on funds with public sector guarantees and to allow for possible slippages.

Directors noted that the forthcoming revision of the Constitution provided a crucial opportunity for addressing the structural obstacles that have thwarted past Brazilian efforts to strengthen the public finances on a sustained basis. They welcomed the intention of the authorities to begin the preparation of a proposal for this reform and to arrange discussions with Congress on a timetable that would ensure that the reform becomes effective at the start of 1994. Directors stressed that the reform proposal should be ambitious, tackling both the revenue and expenditure aspects of the public finances while dealing comprehensively with the structural problems that were confronted.

Directors remarked that credit policy would have to make a substantial contribution to the effort of combating inflation and expressed concern about its relaxation in recent months. Moreover, a tightening of credit policy would provide an unequivocal signal of the authorities' commitment to fight inflation, even though it was likely to result in high interest rates in real terms until the strengthening of fiscal policy takes hold. In view of previous experience in Brazil, Directors agreed that such a credit policy stance may induce large capital inflows; the best response to these inflows would be a rapid improvement of the public finances whereas an intensification of capital controls was likely to be effective only transitorily and ran the risk of having adverse effects on expectations.

A number of Directors expressed concern about the granting of tax incentives and subsidized credit to selected economic activities to stimulate production. Such a policy introduces distortions in the allocation of resources, is costly to the public finances, and usually is ineffective in stimulating production beyond the very short term. Directors emphasized that sustained growth of output and employment would be the result of a lasting reduction of inflation that restored confidence and led to increased investment.

Several Directors also expressed concern about the proposal to intensify the indexation of salaries and the minimum wage currently under consideration in the Senate. They encouraged the authorities to resist the pressures for such a measure. A more frequent and comprehensive indexation of wages would have adverse repercussions on the stabilization effort and on employment, and endangered the public finances.

Directors noted that the present policy of adjusting the commercial exchange rate in line with domestic inflation had been successful in maintaining an adequate degree of competitiveness, and had been an important factor in the recent expansion of Brazilian exports. Some Directors suggested that a less active adjustment of the nominal exchange rate could help obtain a faster decline in inflation, but most Directors stressed that this could be done only after the public finances had been strengthened and the credibility of the Government's commitment to sound financial policies had been won.

A number of Directors welcomed the authorities' decision to improve the targeting of Brazil's social programs. They noted that this effort would help alleviate the situation of the poorest in Brazil, while at the same time avoiding raising public spending above the levels that are appropriate under present circumstances. Directors agreed with the authorities that the most important contribution to the alleviation of poverty would come from a lasting reduction of inflation.

Directors commended the authorities for the progress in the implementation of structural reforms. They noted the advances made in the privatization of public sector enterprises, and welcomed the authorities' plans to accelerate and broaden the scope of this program, which would contribute to the improvement of the public finances by reducing public sector debt. Directors also welcomed the continuation of the multiyear trade liberalization program and noted the elimination of the remaining quantitative restrictions. They encouraged the authorities to intensify this process in order to enhance further the efficiency of Brazil's productive sectors.

Directors commented favorably on the progress that has been made in re-establishing relations with external creditors. The completion of the debt restructuring deal with commercial bank creditors could contribute to enhancing external and domestic confidence in the prospects of the Brazilian economy.

Directors welcomed the authorities' commitment to eliminate all external payments arrears by the end of 1993, and encouraged the authorities to make effective their intention to remove all remaining exchange restrictions subject to Fund approval as soon as possible. They also encouraged the authorities to move to Article VIII status.

A number of Directors expressed concern that for the second consecutive time the Article IV consultation with Brazil was being concluded after a significant delay. Directors urged that the next Article IV consultation with Brazil be held within 12 months.

STB
FJB
IO
F

Office Memorandum

To: Mr. Fajgenbaum June 29, 1993

From: G.A. Mackenzie G.A.M

Subject: Brazil--Buff Statement

This brief account of recent developments suggests that the risk of financial instability has, if anything, increased since the issue of the Staff Report. In particular, although some adjustment in the real value of the minimum wage may be justified, the program of increases proposed and the proposed indexation mechanism for wages appear to increase the Brazilian economy's vulnerability to inflationary shocks.

We agree that it is not yet possible to assess the adequacy and consistency of the program set out in the Plan for Immediate Action document. It does set out a number of potentially valuable measures to improve tax administration and federal state finances, although the timing of measure 1 in the Revenue Recovery section looks pretty ambitious, and a number of potentially important measures require parliamentary approval. Perhaps it may be asking too much of such a document, but at the same time it does not address some of the fundamental issues in the fiscal federalism area. The document also has little to see about tax policy measures, except for the temporary tax on financial transactions. As we stated in our comments on the Staff Report, there are other and far more preferable tax policy measures the Federal Government could take.

Contributor: Lorenzo Figliuoli

cc: FAD
LEG
MAE
PDR
RES
TRE
WHD

(F)

Office Memorandum

To: The Managing Director
The Deputy Managing Director

June 4, 1993

From: S. T. Beza

Subject: Brazil--Meeting with Central Bank President
Paulo Cesar Ximenes

In the recent cabinet reshuffle President Franco replaced the Minister of Finance and the Minister of Planning, but Mr. Ximenes stayed as President of the Central Bank. (Mr. Ximenes has been on the job for about 2 1/2 months and formerly was the Executive Director in the BID.)

During late-April and early-May 1993 we discussed with Brazilian officials the economic program that was being prepared by the previous economic team. These discussions were described in the Staff Report for the Article IV consultation that was issued three weeks ago.

The program envisaged a primary fiscal surplus of 4 percent of GDP and an operational balance of zero for 1993. Credit policy was to keep interest rates in the overnight market at 15 percent in real terms, and exchange rate policy was to keep the real exchange rate constant. On the basis of these policies, the authorities expected monthly inflation to decline from 29 percent at present to 17 percent by December 1993. In the discussions the Brazilian officials and staff came to the conclusion that real interest rates probably would need to be higher than envisaged in the draft program, and thus that the primary surplus also would need to be somewhat higher if the operational fiscal position were to be in balance.

A major difficulty was (and this was made clear in the Staff Report) that the projected fiscal position was very far from the objective for 1993. In fact there was a need to identify measures equivalent to 2 1/2 percent of GDP in order to attain the outcome outlined by the authorities.

It was agreed (in early May) that discussions would continue after the authorities had formulated specific measures to fill the fiscal gap just mentioned. However, there was a change of Minister not long after these discussions. The new Minister says that he agrees with the approach of his prececessor, but we have not yet had discussions with the new team. The good reputation of the new Minister has had positive effects on the exchange and stock markets, but obviously this will not last if inflation keeps moving up.

A question for Mr. Ximenes is how he is currently handling credit policy. The figures we have available show interest rates to be perhaps around 10 percent a year in real terms, which is high by most standards but well below the rates we had been discussing with officials.

cc: Mr. Zulu/Mr. Guitian
Mr. van Houten
Ms. R. Saunders

STB
FvB
IO
F

Office Memorandum

To: Mr. Fajgenbaum May 24, 1993

From: Hassane Cissé H.C.

Subject: Brazil - Right to Make a First Credit Tranche Purchase Under the Current Stand-by Arrangement

You asked (i) whether Brazil could make a first credit tranche purchase under the current stand-by notwithstanding the fact that Brazil's program is off track; and (ii) whether the new decision regarding the elimination of floating (Decision No. 10186-(92/32) of November 3, 1992) would affect the availability of a first credit tranche purchase under the current stand-by.

1. I confirm that, notwithstanding the fact that Brazil's program under the current stand-by is off track, Brazil has the right to make a first credit tranche purchase, as long as the stand-by is in effect, because first credit tranche purchases are not subject to performance criteria and phasing.

2. With respect to the policy regarding the elimination of floating, the new decision does not automatically apply to arrangements approved prior to its adoption. Therefore, unless the stand-by for Brazil is amended to reflect the change introduced by the decision, the availability of a first credit tranche purchase under the stand-by will not be affected. In the absence of such an amendment (which would require Brazil's consent), the controlling language remains that of Para. 2(b) of the current stand-by for Brazil.

cc: PDR

Revised

STB
FvB
~~JF~~
IO
F

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1993 MAY 20 AM 9:50

OFFICE OF MD
19 MAY 93 12 12

To: The Managing Director May 19, 1993

From: S. T. Beza

Subject: Brazil

Mr. Erb has cleared the staff report on the Article IV consultation with Brazil, and we are ready to issue it. fine

Mr. Kafka said that he wishes to have the report numbered, and he also asked me if you would be reading the report. I told him that the customary procedure was that if you were away the Acting Managing Director cleared the report. He said that he was interested in your reading the report before it is issued.

Please let me know if you wish to see a copy of the report (in the form ready to be sent to the printer).

STB

Send to the printer numbered. I will see it later

L

cc: Ms. R. Saunders

STB
FvB
JF
IO
F

Office Memorandum

To: The Acting Managing Director May 13, 1993

From: S. T. Beza

Subject: Brazil--Article IV Consultation

Attached for your approval is the staff report for the 1993 Article IV consultation with Brazil.

The report has been reviewed by the following departments:

Fiscal Affairs:	Mr. MacKenzie
Legal:	Mr. Cissé
Monetary and Exchange Affairs:	Mr. Guitián
Policy Development and Review:	Mr. van Houten
Research:	Mr. Khan
Statistics:	Mr. Joyce
Treasurer's:	Mr. Gupta
Western Hemisphere:	Mr. van Beek and myself

The report also has been reviewed by Mr. Steckhan from the World Bank.

A summary of the report is attached.

Attachments

-OFFICE/DMD--

13 MAY 93 8 : 40

cc: The Managing Director (o/r)
Ms. R. Saunders

Brazil--Summary of the Staff Report

1. Recent economic developments

Following a series of unsuccessful attempts to bring inflation down rapidly on the basis of packages that relied heavily on price and wage freezes, in late 1991 Brazil adopted an economic program that sought a gradual reduction of inflation through the pursuit of a very tight credit policy while the public finances were being strengthened. In the event, inflation remained high because of shortfalls in fiscal policy implementation and political developments that led to the impeachment of the President. The performance criteria relating to the public finances (under the stand-by arrangement approved in early 1992) were not met, but the balance on external transactions improved markedly and international reserves rose sharply in 1992.

2. Report on the discussions

The authorities acknowledge that the reduction of inflation to very low levels is a pre-condition for sustained economic growth, and that implementation of restrained fiscal and credit policies are crucial to achieving such a reduction. Because a major and lasting strengthening of the public finances requires a comprehensive fiscal reform, the authorities recently adopted an economic program based on a two-stage approach to reducing inflation in 1993 and subsequently.

For 1993 the program seeks a limited reduction of inflation on the basis of the elimination of the operational deficit and a credit policy designed to keep interest rates positive in real terms. The program also includes measures aimed at stimulating activity in selected sectors, and an exchange rate policy geared at maintaining the real exchange rate constant. For 1994 the authorities envisage a more ambitious attack on inflation on the basis of a further improvement in the public finances through a comprehensive fiscal reform to be introduced in the context of a revision of the Constitution scheduled for late 1993.

While the two-stage approach may be the realistic option at present, it involves important risks. Inflation may not fall as planned in 1993 because some of the fiscal assumptions probably are too optimistic and because much of the intended fiscal correction in 1993 still needs to be identified, particularly in expenditure cuts that may not be feasible. Even if the fiscal adjustment for 1993 is carried out as planned, it will leave much to be done in this area to achieve a sound position on a lasting basis.

Brazil has made considerable progress in implementing structural reforms. The authorities' program includes a continuation of these policies, notably an acceleration and widening of the scope of the privatization program, and further trade liberalization. The authorities are hoping to complete in 1993 the agreement with creditor commercial banks on a comprehensive restructuring of the medium- and long-term debt, including debt and debt service reduction.

Office Memorandum

STB
FuB
JO
F

To: Mr. Fajgenbaum

May 3, 1993

From: Jan F. van Houten J.H.

Subject: Brazil--Staff Report

I would suggest that given Brazil's track record and the present state of our discussions, the Article IV consultation report (the first in 18 months) be more analytical and critical, and bring out more clearly the differences in policy views between the staff and authorities. This would be consistent with the Board's views on the nature of consultation reports upon concluding the recent review of surveillance. As it stands, the <u>background section</u> is a good guide to recent stabilization attempts, but does not fully do justice to the complexity of the problems facing Brazil. A more analytically oriented section, backed by a chart-show, would have been welcome--and also would permit considerable saving in length.

The section on <u>policy discussions</u> comes across as a rather uncritical presentation of the authorities' views. Admittedly, the mission held the discussions at a time when the authorities' views had not yet been fully worked out, and there may have been little opportunity for dialogue. Still, this would have been a good occasion to weave into the report the staff's views about the type of policies that we would recommend (as described in the CSP).

The <u>staff appraisal</u> also misses an opportunity to present the staff's views more pointedly. As it is, it runs the risk of appearing too complacent about the authorities' views and intentions. Could it not be more tightly focussed about a central theme (such as the last two sentences of the full paragraph on page 26)? I suspect that the final statement of the mission (which I understand was presented orally) consisted of a pointed assessment which could be appropriately paraphrased for purposes of the staff appraisal.

A few specific comments consistent with the above overall view follow below.

- The body of the report does not provide support for the staff view on page 26 that the authorities' broad objectives and policy guidelines constitute an adequate basis for the formulation of an ambitious economic program. Not enough is known about their plan to give such a strong endorsement. Specifically, the report does not quantify the authorities' <u>fiscal objective</u>, which would appear to be the key to a stabilization program. The draft mentions that the staff foresees a reduction of the primary surplus from 1½ percent of GDP to less than 1 percent in 1993. Do the authorities agree with this? If so, does the staff believe this is adequate to hold a lid on inflation?

- On privatization, the report does not specify how the authorities intend to use the proceeds. From discussions this past week, I understand that the intention is to reduce domestic debt. The staff appraisal should strongly endorse such a policy.

- The authorities appear to be following a real exchange rate rule. The discussion fails to evaluate this policy and hence implicitly endorses it. The report, as a minimum, should provide arguments why such a policy may be the best that can be done to protect the balance of payments until fiscal policy can be substantially tightened. (This, I understand, was the thrust of the mission's recommendation on exchange rate policy in its concluding statement.) However, it should also make the point that it may be impossible to bring down inflation without abandoning this rule. As it is, the economy would appear to be without a nominal anchor. What does the staff have to say about letting the exchange rate float, without major CB intervention, during the transition phase of tightening fiscal control? This would at least allow any gains from whatever fiscal adjustment that occurs to be translated into lower inflation.

- The authorities' experience with sterilized intervention is also worth a more thorough discussion (the Board, moreover, is very much interested in this topic).

- There is a reference to sectoral credit agreements on page 12, but the staff is silent on this issue thereafter. If these arrangements are relevant enough to be mentioned, should not the appraisal state that they contravene the general thrust of structural reforms? Should not the report address their impact on fiscal and credit policies?

- The staff appraisal is also overly complacent about Brazil's trade policy stance and gives the impression that not much more needs to be done I would suggest that the report call on the authorities to deepen planned reforms. In this regard, some clarification would be helpful for the statement that Brazil will "...consolidate the gains from the trade liberalization effort through the MERCOSUL initiative" (page 21). It would be a matter of concern if the statement implies that Brazil favors regional integration through MERCOSUL over further multilateral liberalization, especially in view of the fact that Brazil is a major trading nation in the world and that the major part of its trade is outside MERCOSUL.

Other comments

- As regards exchange restrictions, we understand that Brazil no longer maintains restrictions under Article XIV. This should be mentioned explicitly in the text (see Appendix I, Section VII). With respect to the restrictions subject to approval under Article VIII, as there is no timetable for their removal, the staff appraisal should state that approval is not recommended.

- The staff appraisal should encourage the authorities to eliminate the existing exchange restrictions and move to Article VIII status.

- Section VII in Appendix I should indicate the three exchange markets--the commercial, tourist and parallel--in Brazil's exchange system, and provide the latest buying and selling rates for each exchange rate vis-à-vis the U.S. dollar.

- The main assessment of the medium-term outlook (page 23) is surprisingly positive given the imbalances in the economy. Is this the staff view or that of the authorities? Does it apply to just the balance of payments, or to other macroeconomic objectives (inflation, growth) as well? The scenario apparently is based on the authorities' assumption of a successful program in 1993-94. Does the staff have views about the realism of this program (which is not described in the paper). What are the risks in the context of the sensitivity analysis if the authorities' fiscal objectives are not met?

- The report should make clear whether military expenditure is fully reflected in the budget and in the balance of payments data. (We appreciate that the issue was raised during the mission and is a sensitive one.) Has the lack of transparency in this area been an obstacle in the macroeconomic analysis? Has it allowed the staff to adequately assess the size of the public sector in the economy?

- We assume that the date in Appendix I, Section VIII which refers to the last Article IV consultation is meant to be October 1991.

- On the presentation of the balance of payments, we suggest that the report provide assumptions on trade volumes and prices as memorandum items. It would also be useful to separate the exceptional financing included in the capital account from the spontaneous flows, and to show private and official flows separately.

- Footnote 2, page 22, last line: replace "reaching a new agreement" with "concluding a new arrangement."

cc: Mr. Tanzi, Mr. Gianviti, Mr. Zulu/Mr. Guitian, Mr. McLenaghan, Mr. Williams, Mr. Beza

STB
FVB
JFL
IO
F

Office Memorandum

To: Mr. Kafka

April 30, 1993

From: John B. McLenaghan

Subject: Brazil: Letter to Minister of Finance

I was very glad of the opportunity to meet with Minister Resende yesterday to discuss issues relating to the quality of economic and financial statistics in Brazil.

I undertook to prepare for the Minister a brief description of our major concerns in the areas of government finance and monetary statistics. I attach to this memorandum a letter for the Minister (together with a copy for you), and I would be most grateful if you would convey the letter to the Minister before he leaves Washington.

Thank you for your assistance in this matter.

Attachment

cc: Mr. Beza
Mr. Fajgenbaum

1993 MAY -3 PM 5: 37
INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

04/30/93 - G:\WHD\BRA\JMKAF430.CVM

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

CABLE ADDRESS
INTERFUND

REF: CY - G:\WHD\BRA\MOF430.LTR

April 30, 1993

Dear Mr. Minister:

I was very pleased to be able to meet with you yesterday to discuss issues relating to economic and financial statistics in Brazil. As you will recall, I undertook during the meeting to prepare for you a brief description of the concerns that we have in relation to the quality of monetary and government finance statistics. The following paragraphs will, I hope, serve to clarify the issues that we discussed. I would like to emphasize that our wish is to assist the authorities in the development of a data base that is of the greatest utility for supporting the formulation, implementation, and monitoring of economic and financial policies and the economic and financial analysis that underlies the policy work.

In the area of monetary statistics, Brazil regularly reports to the Fund data for the monetary authorities that broadly meet international standards and are presented in the Fund's publication International Financial Statistics. However, the introduction of a new accounting system in 1988 led to reporting and other difficulties in respect of data for the remainder of the financial system. The Western Hemisphere Department has invested a considerable amount of resources in compiling monetary data suitable for the Fund's internal analysis but still has a number of unresolved methodological questions. The Statistics Department has not been able to resolve methodological issues that impede the presentation of data in the Fund's publications. The Central Bank of Brazil in late 1992 sent the Statistics Department a large volume of monetary data for commercial banks, multiple banks, and other banking institutions in the new accounting format; data for the Bank of Brazil continue to be furnished in the old accounting format. These data are being examined, but it is clear that a number of issues cannot be resolved without detailed discussions with Brazilian monetary officials.

In the interests of reducing the burden on the authorities in reporting monetary statistics, as well as sparing resources of the Western Hemisphere Department that are currently devoted to data compilation, it would be useful to develop a unified reporting system that would meet the requirements of both departments of the Fund. Technical discussions with Brazilian monetary officials would also help to clarify a large number of methodological issues, thereby providing assurance that the monetary statistics used by the authorities and Fund staff conform with international standards and are suitable for policy and analytic purposes.

In the area of government finance statistics, data reported by the authorities for publication in the Fund's Government Finance Statistics Yearbook suggest that significant problems may exist in the coverage of government, the sectorization of the nonfinancial public sector, and the classification of accounts. These problems may result to a considerable extent from inclusion in the government sector of units that rightly belong in the financial institutions sector. They manifest themselves in an implausibly high ratio of expenditure to GDP, which is, of course, a key macroeconomic indicator that has important implications for budgetary policy. Thus we consider that a detailed review of the coverage of the government sector, the available sources of data, and the procedures for compiling data on government financial operations is essential.

The Fund's Western Hemisphere Department is in agreement with the assessment that I have presented above and is anxious for these issues to be resolved. A mission from the Fund's Statistics Department, with possible participation from the Western Hemisphere Department, would be able to work with officials to carry out a more detailed analysis of requirements and make recommendations to the Brazilian authorities on action that needs to be taken to rectify the difficulties to which I have referred. This, we believe, would have benefits not only for the authorities in their policy work but also for the Fund in its operational requirements and would enable us to present in the Fund's own publications current and analytically meaningful data for Brazil. I would, therefore, be prepared to have a team visit Brazil in a timely manner if you were to endorse this proposal.

Sincerely yours,

John B. McLenaghan
Director
Statistics Department

The Honorable Eliseu Resende
Minister of Finance
Ministry of Finance
Esplanada dos Ministérios
Bloco 6,
70048 Brasilia - DF
Brazil

Revised
STB
FvB
JF
IO
F

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1993 MAY 20 AM 9:50

OFFICE OF MD

19 MAY 93

To: The Managing Director May 19, 1993

From: S. T. Beza

Subject: Brazil

Mr. Erb has cleared the staff report on the Article IV consultation with Brazil, and we are ready to issue it. fine

Mr. Kafka said that he wishes to have the report numbered, and he also asked me if you would be reading the report. I told him that the customary procedure was that if you were away the Acting Managing Director cleared the report. He said that he was interested in your reading the report before it is issued.

Please let me know if you wish to see a copy of the report (in the form ready to be sent to the printer).

cc: Ms. R. Saunders

STB
Send to the printer numbered
I will see it later
L

05/19/93 16:07 ☎ 2241162 DEORI/GABIN 01

STB
FvB
JF
IO
F

RECEIVED INTERNATIONAL MONETARY FUND
IMF FAX CENTER WESTERN HEMISPHERE DEPT.

BANCO CENTRAL DO BRASIL

037749 1993 MAY 20 AM 1993 MAY 19 PM 3: 2

ORIG: TRE

CC: MR. KAFKA

WHD

CENTRAL BANK OF BRAZIL

DEPARTMENT FOR INTERNATIONAL ORGANIZATIONS AND AGREEMENTS - DEORI

Reference Nº	Date	Number of Pages (Including Cover)	Fax number
DEORI/DIOFI/SUFIN-93/481	19.05.93	03	202-6234661

TO..: ATTN. BONNIE ETHERTON
TREASURER'S,
ACCOUNTS AND FINANCIAL REPORTS DIVISION
IMF

FROM: DEORI/DIOFI/SUFIN

MESSAGE:

REYOUR FACSIMILE, DTD JANUARY 21, 1993, RELATED TO BRAZIL'S QUOTA PAYMENTS AS AT DECEMBER 31, 1992.

PLEASE NOTE THAT BRAZIL'S PAYMENT OF QUOTA INCREASE UNDER THE NINTH GENERAL REVIEW, IN NOVEMBER 1992, AMOUNTS TO SDR 177.375.000,00, (TELEX REFNO: OCRA9070, 12 NOV 1992, GRA NO. 60, PARAGRAPHS NO. 4, 5 AND 7), INSTEAD OF SDR 177,373,000, AS MENTIONED IN YOUR INFORMATION.

PLEASE VERIFY AND CONFIRM THIS AS SOON AS POSSIBLE.

REGARDS,

.417.860-4 [illegible] Albino Koch
CHEFE DE SUBDIVISAO
DEORI/DIOFI, SUFIN

0.183.590-2 Shirley R. do P. Menezes
ASSISTENTE
DEORI/DIOFI/SUFIN

Any problem with this transmission, please call
(61) 226.8272 / 224.1309 FAX Number: (61) 224.1162

1113.0124
611702BCBRA BR
YRQQQ IMF UW

DEORI
~~[illegible]~~ 215
CORIN

2392
2222 11/12 06206912 SMCD8156.0000
OCRA9070
ATTN DEPARTMENT FOR INTERNATIONAL OPERATIONS
ATTN BANCO CENTRAL DO BRAZIL
ATTN SEDE - SETOR BANCARIO SUL
ATTN BRASILIA (BRAZIL)
ATTN TEST NO. [redacted]
ATTN CALCULATED FOR 4 037 675 005 824 ON 92-11-12 (THU)

CHAVE CONFERE
13/11/92
DEPIN/DIPAG/SUTEL

.REFNO: OCRA9070

12 NOV 1992
GRA NO.60
REFERENCE PAYMENTS OF QUOTA INCREASE UNDER THE NINTH GENERAL REVIEW, BORROWING OF RESERVE ASSET PORTION OF PAYMENT AND REPAYMENT THROUGH RESERVE TRANCHE PURCHASE, AND YOUR REPLY TO FUND CABLE OF MAY 22, 1992 REGARDING MEDIA OF RESERVE ASSET PAYMENT.

MO.

THE QUOTA PAYMENTS BY ALL MEMBERS MUST BE COMPLETED NOT LATER THAN DECEMBER 11, 1992. TO AVOID LAST MINUTE COMPLICATIONS AND TO ALLOW FOR ORDERLY COMPLETION OF BORROWING OPERATIONS, WE SUGGEST THAT YOU MAKE THE PAYMENT VALUE DATE NOVEMBER 30, 1992. PLEASE CONFIRM YOUR AGREEMENT BY TESTED TELEX.

2. IN ORDER TO ACTIVATE BORROWING ARRANGEMENTS DESCRIBED IN SECUNDO BELOW, PAYMENT OF DOMESTIC CURRENCY PORTION MUST BE COMPLETED ON THE SAME VALUE DATE AS THE RESERVE ASSET PAYMENT IN SDRS.

3. PORTION OF THE QUOTA INCREASE PAYABLE IN YOUR CURRENCY IS EQUIVALENT TO SDR 532,125,000 AND BASED ON PRESENT HOLDINGS RATE OF SDR 0.000307618 PER BRAZILIAN CRUZEIRO AMOUNTS TO BRAZILIAN CRUZEIROS 1,729,824,002,496.60. PLEASE ARRANGE TO CREDIT THIS AMOUNT TO FUND'S NO. 1 ACCOUNT VALUE NOVEMBER 30, 1992 AND IMMEDIATELY CONFIRM AS INDICATED IN SECUNDO PARAGRAPH 1 BELOW.

4. IF YOU WISH TO SUBSTITUTE NONNEGOTIABLE, NONINTEREST ARING NOTES FOR CURRENCY PAYMENT OF QUOTA INCREASE, EASE NOTE THAT SUFFICIENT BRAZILIAN CRUZEIROS MUST BE CREDITED TO FUND'S NO. 1 ACCOUNT TO MAINTAIN BALANCE IN THAT ACCOUNT AT NOT LESS THAN ONE QUARTER OF ONE PERCENT OF THE INCREASED QUOTA.

SECUNDO.

TO ACTIVATE BORROWING ARRANGEMENTS TO PAY RESERVE ASSET PORTION, PLEASE URGENTLY SEND THE FOLLOWING CABLE REQUEST BEARING TEST NUMBER, ATTENTION TREASURER'S DEPARTMENT, AT LEAST FOUR BUSINESS DAYS BEFORE VALUE DATE.

QUOTE

1. FUND'S NO. 1 ACCOUNT WITH OURSELVES WILL BE CREDITED WITH BRAZILIAN CRUZEIROS 1,729,824,002,496.60 VALUE NOVEMBER 30, 1992. IF NOTES ARE SUBSTITUTED FOR ALL OR PART OF CURRENCY PAYMENT, PLEASE INDICATE AMOUNTS CREDITED, AND ALSO NEW BALANCES IN FUND'S NO. 1 AND SECURITIES ACCOUNTS.

2. BRAZIL REPRESENTS THAT IT DOES NOT HAVE SUFFICIENT FOREIGN EXCHANGE AND SDR HOLDINGS WITH WHICH TO PAY THE RESERVE ASSET PORTION OF ITS QUOTA INCREASE AND WISHES TO BORROW SDR 177,375,000 FROM ANOTHER PARTICIPANT AS ARRANGED BY THE FUND FOR THAT PURPOSE.

3. THEREFORE, PLEASE ARRANGE A LOAN OF THIS AMOUNT AND CREDIT OUR SDR ACCOUNT ACCORDINGLY, VALUE NOVEMBER 30, 1992.

4. PLEASE DEBIT OUR SDR ACCOUNT WITH SDR 177,375,000, REPRESENTING 25 PERCENT OF THE QUOTA INCREASE CONSENTED TO UNDER THE NINTH GENERAL REVIEW, VALUE SAME DAY THAT PROCEEDS OF BORROWING ARE CREDITED TO OUR SDR ACCOUNT AS DESCRIBED ABOVE.

5. AS FISCAL AGENCY FOR THE GOVERNMENT OF BRAZIL WE DESIRE TO PURCHASE FROM THE INTERNATIONAL MONETARY FUND SDR 177,375,000 IN ACCORDANCE WITH TERMS OF ARTICLE V, SECTION 3.

6. WE DO HEREBY REPRESENT THAT THIS PURCHASE IS NEEDED IN ACCORDANCE WITH THE PROVISIONS OF FUND AGREEMENT.

PLEASE CREDIT BRAZIL'S SDR ACCOUNT WITH SDR 7,375,000 ON VALUE DATE OF PURCHASE.

8. THE EQUIVALENT OF DESIRED PURCHASE NAMELY BRAZILIAN CRUZEIROS 576,608,000,832.20 WILL BE CREDITED TO FUND'S NO. 1 ACCOUNT WITH OURSELVES ON THE VALUE DATE OF PURCHASE OR IF YOU ISSUE NONNEGOTIABLE, NONINTEREST BEARING NOTES IN SUBSTITUTION OF CURRENCY, THE SECURITIES ACCOUNT WILL BE CREDITED

9. UPON CREDIT TO OUR SDR ACCOUNT OF THE SDR PROCEEDS OF THE PURCHASE, PLEASE DEBIT OUR SDR ACCOUNT WITH SDR 177,375,000 AND CREDIT SAME AMOUNT TO THE SDR ACCOUNT OF THE ORIGINAL SDR LENDER, SAME VALUE.

10. EACH LOAN AND ITS REPAYMENT SHALL CONSTITUTE OPERATIONS IN SDRS UNDER ARTICLE XIX, SECTION 2(C), IN ACCORDANCE WITH THE APPLICABLE RULES AND PRESCRIPTIONS OF THE FUND.

UNQUOTE

TERTIO.

NEW QUOTA WILL COME INTO EFFECT FOLLOWING COMPLETION OF MENTS DESCRIBED ABOVE AND WILL BE CONFIRMED BY US AFTER EIPT OF CONFIRMATION OF ALL CREDITS TO FUND'S ACCOUNTS.

TREASURER'S

INTERFUND

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

With the Compliments of

Alexandre Kafka

Executive Director

Brazil F

5/7/93

BANCO CENTRAL DO BRASIL

Guia de Transmissão de Fax (Fax Message)

DE (FROM)		UNIDADE (DEPARTMENT)
SERGIO RUFFONI GUEDES		BACEN/DEDIV
FAX (61) 224.9261	TELEFONE (TELEPHONE) (61) 226.6762	TELEX

PARA (TO)		EMPRESA (COMPANY)
Prof. ALEXANDRE KAFKA		F M I
FAX (202) 623 4994	TELEFONE (TELEPHONE) (202)623.7880	TELEX

MENSAGEM N° (MESSAGE N.)	DATA (DATE)	TOTAL DE FOLHAS (INCLUINDO ESTE FORMULÁRIO) (TOTAL NUMBER OF PAGES, INCLUDED THIS ONE)
	05.05.93	11 (onze).

REFERÊNCIA (REFERENCE)

Prof. Kafka,

Conforme recomendado pelo Sr. Diretor José Roberto Novaes de Almeida, encaminho anexas cópias dos seguintes documentos:

- AGREED MINUTE assinada em 26.02.92, em Paris;
- Carta de 01.02.93, do Sr. Ministro da Fazenda, endereçada ao Sr. Jean-Claude Trichet, solicitando dispensa do cumprimento da obrigação ("waiver") a que se refere o Art.IV.4 da "Agreed Minute"; e
- Resposta do Clube de Paris, concedendo prazo até 31.05.93 para o cumprimento da referida obrigação.

O Dr. José Roberto informa que manterá contato por telefone com V.Sa. amanhã (06.05) para tratar do assunto.

Sergio

ATENÇÃO (ATTENTION PLEASE)
SE NÃO RECEBER TODAS AS PÁGINAS MENCIONADAS, FAVOR COMUNICAR-NOS, IMEDIATAMENTE, ATRAVÉS DO FAX, TELEFONE OU TELEX ACIMA INDICADO.
(IF YOU DO NOT RECEIVE ALL PAGES, PLEASE FAX, TELEPHONE OR TELEX IMMEDIATELY, TO THE ABOVE NUMBER).

AVISO nº 002/MF

Brasília, February 01, 1993.

Dear Mr. Chairman,

I have the honor to refer to the Agreed Minute signed in Paris on February 26, 1992 which sets forth the basic principles for the restructuring of the Brazilian public sector external debt owed to Paris Club creditors.

2. Since the Agreed Minute was signed, Brazil has made significant progress toward the re-establishment of relations with its external creditors. Brazil has already signed bilateral agreements with France, United States, Canada/EDC, Germany, United Kingdom, Sweden and Japan, and has been dutifully abiding by them. Consultations with Switzerland, Italy and the Netherlands have already begun. Discussions with Austria, Belgium and Spain are yet to commence. In July, 1992 Brazil reached an agreement on a comprehensive debt restructuring with the Bank Advisory Committee which was approved by the Federal Senate on December 21, 1992.

3. Paragraph 4 of Article IV of the Agreed Minute states as a necessary condition for the rescheduling of debt falling due from February 1, 1993 up to August 31, 1993 that the Executive Board of the International Monetary Fund has completed by December 31, 1992 the review of the program under the stand-by arrangement scheduled to be completed by end-August 1992.

4. As a matter of fact, a review of performance under the stand-by arrangement was initiated in June 1992 but was not completed because the then Minister of Economy was not in a position to frame policies for the remainder of 1992 in the prevailing political circumstances known to all. After taking office, my predecessor in the Ministry of Finance of the new Government sent to Washington in November 1992 a high level technical mission to resume contact with the staff of the IMF. Another such mission has just returned from Washington to keep the Fund's staff informed about recent developments in the Brazilian economy. These two missions have laid the ground for the conversations I expect to have with the Managing Director of the IMF during the week of February 8th. I hope then to agree that an IMF mission come to Brazil soon thereafter to conduct an Article IV.4 consultation and continue discussions on a revised stand-by agreement that could be supported by the Fund.

The Honorable
Mr. JEAN-CLAUDE TRICHET
Chairman of the Paris Club

5. Taking into account, Mr. Chairman, the discussions that Brazil is already holding with the IMF and the "strong support" provided by the Fund to the aforesaid agreement with the private creditors (expressed by Mr. Camdessus in a letter to the International Banking Community dated December 23, 1992), I would like to ask your support that the deadline of December 31, 1992 referred to in Article IV.4 of the Agreed Minute of February 26,1992 be postponed to a later date to be agreed with the Fund. Meanwhile, the Brazilian Government will continue to fully implement the bilateral agreements already signed and endeavour to conclude the pending ones as soon as possible.

Please accept, Mr. Chairman, the assurances of my highest esteem and consideration.

Paulo R. Haddad

PAULO ROBERTO HADDAD
Minister of Finance
Federative Republic of Brazil

Delegation of Japan

Y. Shinhara

Delegation of Sweden

Delegation of the Netherlands

Delegation of Switzerland

A. Riemer

Delegation of Spain

Delegation of the United Kingdom

Delegation of the United States of America

Joseph A Saloom III

For this purpose, the Government of Brazil agree that the International Monetary Fund inform the Chairman of the Paris Club regarding the status of Brazil's relations with the International Monetary Fund.

5. To facilitate the implementation of this Agreed Minute, the Government of Brazil will deposit in a special account to be established with the Central Bank of one of the Participating Creditor Countries or with the Bank for International Settlements, the equivalent of at least SDR 180 million at the end of each period of three months, commencing on April 30, 1992 and finishing on July 31, 1993 inclusive. The Government of Brazil undertakes to inform the Chairman of the Paris Club by the end of March 1992 of the Bank chosen for this purpose and will arrange to have this Bank notify the Chairman of the Paris Club as soon as each deposit has been made. The total amount approximates the amounts estimated to be payable to all Participating Creditor Countries from January 1, 1992 up to August 31, 1993 inclusive under the terms of the bilateral agreements to be concluded pursuant to this Agreed Minute on account of interest due on the consolidation. As specific payments under these agreements become due, the Government of Brazil will draw on the special account to meet these payments. The Bank will notify immediately to the Chairman of the Paris Club any drawing on this account. This scheme could be continued by agreement between the parties.

6. The representatives of the Governments of each of the Participating Creditor Countries and of the Government of Brazil agreed to recommend to their respective Governments or appropriate institutions that they initiate bilateral negotiations at the earliest opportunity and conduct them on the basis of the principles set forth herein.

Done in Paris, on February 20, 1992
in two versions, English and French,
both texts equally authentic.

The Chairman
of the Paris Club

The Head of the Delegation
of Brazil

Delegation of Austria

Delegation of France

Delegation of Belgium

Delegation of Germany

Delegation of Canada

Delegation of Italy

8. The Government of Brazil guarantees the immediate and unrestricted transfer of the foreign exchange counterpart of all amounts paid in local currency, as at the date of the present Agreed Minute as well as of amounts falling due on debts pursuant to Article II 1) a) (i) and Article II 1) b) (i) owed to or guaranteed by the Participating or Observer Creditor Countries or their appropriate institutions, with the exception of those debts with an original maturity of more than one year for which the corresponding payments in local currency were deposited on or before December 31, 1990 in the Central Bank of Brazil or, as regards debt owed by PETROBRAS or CVRD, of payments which fell due on or before March 31, 1991.

9. For payments due on contracts entered into by entities that are majority owned by the Government of Brazil, the Government of Brazil will take all measures under applicable law to obtain deposits or transfers.

IV - IMPLEMENTATION

The detailed arrangements for the rescheduling or refinancing of the debts will be accomplished by bilateral agreements to be concluded by the Government or the appropriate institutions of each Participating Creditor Country with the Government of Brazil on the basis of the following principles :

1. The Government or the appropriate institutions of each Participating Creditor Country will either :

- refinance debts by placing new funds at the disposal of the Government of Brazil according to existing payment schedules during the reorganization period and for the above mentioned percentage of payment. These funds will be repaid by the Government of Brazil according to schedules mentioned above in Article II paragraph 2 ;

- or reschedule the corresponding payments.

2. All other matters involving the rescheduling or the refinancing of the debts will be set forth in the bilateral agreements which the Government of Brazil and the Governments or the appropriate institutions of the Participating Creditor Countries will seek to conclude with the least delay and in any case before October 31, 1992. As regards debts referred to in Article II 1 a) ii) and Article II 1 b) ii), the Government of Brazil or its appropriate institutions, are comitted to complete promptly the reconciliation of amounts due jointly with the creditors.

3. The provisions of the present Agreed Minute will come into force provided that :

- all the bilateral agreements pursuant to the July 29, 1988 Agreed Minute have been signed before March 31, 1992 ;

- the Government of Brazil has made, on the due date, the payments referred to in Article III, paragraph 7 b) hereabove ;

- and that the Government of Brazil has reached agreement before March 31, 1992 with each of the Participating Creditor Countries with respect to the recognition and the reconciliation of the debts consolidated pursuant to the relevant Agreed Minutes dated November 23, 1983, January 21, 1987 and July 29, 1988. Recognition by the Government of Brazil of debt owed or guaranteed by the Government of Brazil and covered by the aforementioned Agreed Minutes as well as by the present Agreed Minute shall not be dependent upon prior deposits in local currency.

4. The provisions of the present Agreed Minute will continue to apply until January 31, 1993 provided that the Government of Brazil continues to have an appropriate arrangement with the International Monetary Fund.

They will also apply from February 1, 1993 up to August 31, 1993 provided that the Executive Board of the International Monetary Fund has completed by December 31, 1992 the review of the program under the stand by arrangement scheduled to be completed by end-August 1992, and provided that the payments referred to in Article II, paragraph 2. B/ I. above have been made as at the dates scheduled according to these paragraphs.

JL AC GK A

III - GENERAL RECOMMENDATIONS

1. In order to secure comparable treatment of public and private external creditors on their debts, the Government of Brazil commits itself to seek from its external creditors, including banks and suppliers, rescheduling or refinancing arrangements on terms comparable to those set forth in this Agreed Minute.

The Participating Creditor Countries encourage these efforts, since the present Agreed Minute sets the basis for a fair burdensharing between all categories of creditors in the context of Brazil's economic adjustement program supported by the International Monetary Fund, associated with a projected debt servicing capacity to foreign creditors in 1992 and 1993.

2. The Government of Brazil agrees that it will promptly negotiate rescheduling or refinancing arrangements with all other creditors on debts of a comparable term.

The Government of Brazil will inform in writing the Chairman of the Paris Club not later than October 31, 1992 of the progress made for this purpose in negotiations with other creditors. The Government of Brazil will also inform without delay the Chairman of the Paris Club of the content of any agreement reached with its other external creditors.

3. The provisions set forth in this Agreed Minute do not apply to creditor countries with principal and interest falling due during the reorganization period on debts specified in Article II paragraph 2, including arrears, of less than SDR 2,000,000. The payments owed to these countries should be made on the original due dates. Payments already due and not paid should be made as soon as possible and, in any case, not later than April 30, 1992.

4. Each of the Participating Creditor Countries agrees to make available, upon the request of another Participating Creditor Country, a copy of its bilateral agreement with the Government of Brazil which implements this Agreed Minute. The Government of Brazil acknowledges this arrangement.

5. Each of the Participating Creditor Countries agrees to inform the Chairman of the Paris Club of the date of the signature of its bilateral agreement, of the interest rates and of the amounts of debts involved. The Government of Brazil acknowledges this arrangement.

6. The Government of Brazil will inform the Chairman of the Paris Club of the content of its bilateral agreements with creditors mentioned in paragraphs 1, and 2 above.

7. The Government of Brazil undertakes to pay all debt service due and not paid as at the date of the present Agreed Minute, on consolidations, on loans, on credits or pursuant to contracts or other financial arrangements payable on cash terms, extended or guaranteed by the Governments of the Participating or Observer Creditor Countries or their appropriate institutions, and not covered by the present Agreed Minute, as follows :

a) as regards the amounts of principal and interest (excluding late interest) due as at December 31, 1991 inclusive and not paid on the consolidation agreements concluded according to the Agreed Minute dated November 23, 1988 :

(i) 20 % of these amounts will be paid as soon as possible and any case, not later than June 30, 1993 ;

(ii) the 80 % remaining due will be paid in 6 equal and successive semi-annual instalments, the first one to be made on June 30, 1994 and the final one to be made on December 31, 1996 ;

b) the other amounts will be paid as soon as possible and in any case, not later than April 30, 1992.

Late interest will be charged on those amounts.

2/

2/ As regards amounts due as at December 31, 1991 inclusive and not paid :

I. a) The Government of Brazil agrees to complement as soon as possible and in any case not later than January 31, 1993, the payments to the Participating Creditor Countries made as from April 1, 1990 (excluding late interest), so as to have paid by January 31, 1993 at least 10 % of the amounts of principal and interest originally due from April 1, 1990 up to December 31, 1991 inclusive, on credits and loans mentioned in paragraphs 1 a) and 1 b) above. Late interest will be charged on those amounts.

b) The Government of Brazil agrees to complement as soon as possible and in any case not later than January 31, 1993, the payments to the Participating Creditor Countries made as from January 1, 1990 (excluding late interest), net of arrears as at December 31, 1989, so as to have paid by January 31, 1993, at least 1[illegible] % of the amounts of principal and interest originally due from January 1, 1990 up to December 31, 1991 inclusive, on the consolidation agreements concluded according to the Agreed Minute dated January 21, 1987. Late interest will be charged on those amounts.

c) The Government of Brazil agrees to complement as soon as possible and in any case not later than January 31, 1993, the payments to the Participating Creditor Countries made as from January 1, 1990 (excluding late interest), net of arrears as at December 31, 1989, so as to have paid by January 31, 1993, at least 5 % of the amounts of principal and interest originally due from January 1, 1990 up to December 31, 1991 inclusive, on the consolidation agreements concluded or to be concluded according to the Agreed Minute dated July 29, 1988. Late interest will be charged on those amounts.

II. After the application of paragraph I above :

100 % of the amounts of principal and interest (excluding late interest) due as at December 31, 1991 inclusive and remaining due on credits, loans and consolidations mentioned in paragraph I above will be rescheduled or refinanced.

Repayment by the Government of Brazil of the corresponding sums will be made as follows :

- 0.01 % on June 30, 1995 ; 0.01 % on December 31, 1995 ;
- 1.96 % on June 30, 1996 ; 2.14 % on December 31, 1996 ;
- 2.32 % on June 30, 1997 ; 2.52 % on December 31, 1997 ;
- 2.72 % on June 30, 1998 ; 2.94 % on December 31, 1998 ;
- 3.16 % on June 30, 1999 ; 3.39 % on December 31, 1999 ;
- 3.64 % on June 30, 2000 ; 3.89 % on December 31, 2000 ;
- 4.16 % on June 30, 2001 ; 4.44 % on December 31, 2001 ;
- 4.73 % on June 30, 2002 ; 5.03 % on December 31, 2002 ;
- [illegible] % on June 30, 2003 ; 5.68 % on December 31, 2003 ;
- 6.02 % on June 30, 2004 ; 6.39 % on December 31, 2004 ;
- 6.77 % on June 30, 2005 ; 7.16 % on December 31, 2005 ;
- 7.57 % on June 30, 2006 ; 7.99 % on December 31, 2006.

C/ Late interest charges are those interest charges accruing between the contractual payment date of principal and interest due and not paid, and a date to be fixed in the bilateral agreements concluded for the implementation of the present Agreed Minute.

3. Rate of interest

The rates and the conditions of interest on the financial arrangements covered by this Agreed Minute will be determined bilaterally between the Government of Brazil and the Government or appropriate institutions of each Participating Creditor Country on the basis of the appropriate market rate.

b) loans from Governments or appropriate institutions of the Participating Creditor Countries, having an original maturity of more than one year, pursuant to an agreement concluded before March 31, 1983 and :

(i) which were extended to the Government of Brazil, or covered by the guarantee of the Government of Brazil, or ;

(ii) which were extended to other entities as far as the corresponding payments in local currency have been deposited in the Central Bank of Brazil on or before December 31, 1990, or which fell due on or before March 31, 1991 as regards Petroleo Brasileiro S.A. (PETROBRAS) or Companhia Vale do Rio Doce (CVRD) or ;

(iii) which have been rescheduled or reorganized under previous agreements.

c) repayments of principal and interest due as a result of the consolidation agreements concluded or to be concluded according to the Agreed Minutes dated January 21, 1987 and July 29, 1988.

It is understood that debt service due as a result of debts described above in the present Agreed Minute and effected through special payment mechanisms or other external accounts is included in the present reorganization. Participating Creditor Countries will reschedule, refinance, or take other appropriate measures to ensure that this category of debt is treated in a manner comparable to other debt subject to this agreement.

It is understood that debt service due as a result of the consolidation agreements concluded according to the Agreed Minute dated November 23, 1983 is not affected by the present reorganization.

2. Terms of the consolidation

The debt relief will apply as follows :

A) As regards the amounts due from January 1, 1992 up to August 31, 1993 inclusive and not paid :

100 % of the amounts of principal and interest (excluding late interest) due from January 1, 1992 up to August 31, 1993 inclusive and not paid on credits, loans and consolidations mentioned in paragraph 1 above will be rescheduled or refinanced.

Repayment by the Government of Brazil of the corresponding sums will be made as follows :

- 0.01 % on June 30, 1995 ; 0.01 % on December 31, 1995 ;
- 1.96 % on June 30, 1996 ; 2.14 % on December 31, 1996 ;
- 2.32 % on June 30, 1997 ; 2.52 % on December 31, 1997 ;
- 2.72 % on June 30, 1998 ; 2.94 % on December 31, 1998 ;
- 3.16 % on June 30, 1999 ; 3.39 % on December 31, 1999 ;
- 3.64 % on June 30, 2000 ; 3.89 % on December 31, 2000 ;
- 4.16 % on June 30, 2001 ; 4.44 % on December 31, 2001 ;
- 4.73 % on June 30, 2002 ; 5.03 % on December 31, 2002 ;
- 5.35 % on June 30, 2003 ; 5.68 % on December 31, 2003 ;
- 6.03 % on June 30, 2004 ; 6.39 % on December 31, 2004 ;
- 6.77 % on June 30, 2005 ; 7.16 % on December 31, 2005 ;
- 7.57 % on June 30, 2006 ; 7.99 % on December 31, 2006.

AGREED MINUTE ON THE CONSOLIDATION OF THE DEBT OF BRAZIL

I- PREAMBLE

1. The representatives of the Governments of Austria, Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States of America, hereinafter referred to as "Participating Creditor Countries", met in Paris on February 24, 25 and 26, 1992 with representatives of the Government of Brazil in order to examine the request to alleviate Brazil's external debt service obligations. Observers of the Governments of Denmark, Finland and Norway, as well as the International Monetary Fund, the International Bank for Reconstruction and Development, the Interamerican Development Bank, the Secretariat of the U.N.C.T.A.D., the Commission of the European Communities and the Organization for Economic Cooperation and Development also attended the meeting.

2. The Delegation of Brazil described the economic and financial difficulties faced by its country and its strong determination to reduce economic and financial imbalances and to attain the targets of the program supported by the stand-by arrangement with the International Monetary Fund.

3. The representatives of the International Monetary Fund described Brazil's economic situation and the major elements of the adjustment program undertaken by the Government of Brazil and supported by the stand-by arrangement with the International Monetary Fund approved by the Executive Board of the Fund on January 29, 1992. This stand-by arrangement, covering the period ending on August 31, 1993, involves specific commitments in both the economic and financial fields.

4. The representatives of the Governments of the Participating Creditor Countries noted the measures of adjustment in the economic and financial program undertaken by the Government of Brazil and they stressed the importance they attach to the continued and full implementation of this program, and in particular, the revitalization of the productive sector of the economy, and the improvement of public finances and foreign exchange management.

II- RECOMMENDATIONS ON TERMS OF THE REORGANIZATION

In view of the serious payment difficulties faced by Brazil, the representatives of the Participating Creditor Countries agreed to recommend to their Governments or their appropriate institutions that they provide, through rescheduling or refinancing, debt relief for Brazil on the following terms :

1. Debts concerned

The debts to which this reorganization will apply are the following :

a) commercial credits guaranteed or insured by the Governments of the Participating Creditor Countries or their appropriate institutions, having an original maturity of more than one year, pursuant to a contract or other financial arrangement concluded before March 31, 1983 and :

(i) which were extended to the Government of Brazil, or covered by the guarantee of the Government of Brazil, or ;

(ii) which were extended to other entities as far as the corresponding payments in local currency have been deposited in the Central Bank of Brazil on or before December 31, 1990, or which fell due on or before March 31, 1991 as regards Petroleo Brasileiro S.A. (PETROBRAS) or Companhia Vale do Rio Doce (CVRD) or;

(iii) which have been rescheduled or reorganized under previous agreements.

MINISTÉRIO DA ECONOMIA, FAZENDA E PLANEJAMENTO
GAB DO MINISTRO

003088

TELEX NUMERO 93/398 JPR BRASÍLIA-DF

POUR M. ELIZEU REZENDE, MINISTRE DE L'ECONOMIE ET DES FINANCES DU BRESIL.

MR MINISTER,

ON BEHALF OF THE PARIS CLUB CREDITOR COUNTRIES ALLOW ME TO CONGRATULATE YOU ON YOUR APPOINTMENT AS MINISTER. THE CREDITOR COUNTRIES LOOK FORWARD TO A CONTINUING PRODUCTIVE RELATIONSHIP WITH THE BRAZILIAN AUTHORITIES.

IN A LETTER DATED FEBRUARY 1, 1993, YOUR PREDECESSOR, MR PAULO ROBERTO HADDAD, HAS ASKED THE CREDITOR COUNTRIES TO POSTPONE THE DEADLINE OF DECEMBER 31, 1992 REFERRED TO IN ARTICLE IV.4 OF THE AGREED MINUTE OF FEBRUARY 26, 1992.

FIRST OF ALL, CREDITOR COUNTRIES ASKED ME TO CONVEY THEIR CONCERN ABOUT ACCUMULATION OF ARREARS VIS-A-VIS THEM INCLUDING ON POST CUT OFF DATE AND SHORT TERM CLAIMS. THEREFORE THEY URGE YOU TO DO YOUR UTMOST TO CLEAR THESE ARREARS IMMEDIATELY AND COMPLETE A RECONCILIATION OF DEBTS REFERRED TO IN ARTICLE II,1.

HOWEVER, I AM PLEASED TO INFORM YOU THAT THE CREDITOR COUNTRIES HAVE DECIDED TO POSTPONE THE ABOVE MENTIONNED DEADLINE TO MAY 31, 1993. IN THE MEANTIME, THE PROVISIONS OF THE AGREED MINUTE OF FEBRUARY 26, 1992 WILL ALSO APPLY TO AMOUNTS DUE FROM FEBRUARY 1, 1993 ON CREDITS, LOANS AND CONSOLIDATIONS MENTIONED IN PARAGRAPH II.1 OF THE AGREED MINUTE.

LET ME STRESS HOWEVER THAT BEFORE MAY 31, 1993, YOU WILL HAVE EITHER TO COMPLETE THE REVIEW OF THE ARRANGEMENT APPROVED BY THE INTERNATIONAL MONETARY FUND LAST YEAR OR TO REACH A NEW APPROPRIATE ARRANGEMENT WITH THE FUND. PAYMENTS REFERRED TO IN ARTICLE II,2,B/I WILL ALSO HAVE TO BE COMPLETED BEFORE THIS DATE. IF THAT WERE NOT THE CASE, CREDITOR COUNTRIES MAY TERMINATE THE ARRANGEMENT : IN THIS CASE THE EXTENSION OF THE CONSOLIDATION PERIOD WILL CEASE AND ALL MATURITIES DUE FROM FEBRUARY 1, 1993 WILL HAVE TO BE PAID ACCORDING TO THE ORIGINAL SCHEDULES.

PLEASE ACCEPT, MR MINISTER, THE ASSURANCES OF MY HIGHEST ESTEEM AND OF MY BEST REGARDS.

Wednesday

8.15

STB
FvB
JFL
F

Office Memorandum

To: The Managing Director
The Deputy Managing Director

April 27, 1993

From: S. T. Beza

Subject: Brazil--Meeting with Minister Eliseu Resende

Over the last few days the staff has been discussing with Brazilian officials an economic program prepared by the authorities. The program contemplates two stages of fiscal adjustment, the first for 1993 and the second for 1994 on the basis of a comprehensive fiscal reform (still to be defined) in the context of a constitutional revision scheduled to start in October 1993.

The program envisages a primary surplus of nearly 4 percent of GDP in 1993 (compared with 2 percent of GDP in 1992) and an operational balance of zero (compared with a deficit of 2.5 percent of GDP in 1992). Credit policy would keep interest rates in the overnight market at 15 percent a year in real terms (compared with 30 percent in 1992). Real GDP growth is projected at 2 1/2 percent in 1993 versus a decline of 1 percent in 1992. Exchange rate policy would aim at maintaining the real exchange rate constant. On the basis of these policies, the authorities expect inflation to decline from 28 percent a month currently to 17 percent by December 1993.

There are two kinds of issues that arise: (1) The realism of the projection of a primary surplus of some 4 percentage of GDP this year; and (2) the mutual consistency of such a primary surplus, the assumed real interest rate and the inflation reduction objective.

On the first issue, official revenue projections for 1993 seem to be optimistic, particularly in regard to the new tax on bank debits (to start in July) and social security contributions. At the same time, the expenditure projection includes significant spending cuts that remain to be specified. The Brazilian officials who are already in Washington were not able to explain all of the fiscal numbers, but others who are arriving today are expected to be able to do so. It should be noted that the fiscal program involves large increases in both expenditure and revenue, and thus may affect adversely any stabilization effort.

On the second issue, even if the primary surplus were to reach some 4 percent of GDP in 1993, it is not clear that inflation would come down as the authorities project (which is obviously a limited objective), particularly if the real interest rate is to be held to 15 percent a year. (It might be recalled that in the strategy brief prepared late last year, it was emphasized that a primary surplus of some 6 percent of GDP--through measures that could be

- durability [illegible]
- markets
- consultation..

sustained--was needed to deal with the inflation problem.) The inability of the authorities to specify at this time what they intend for 1994 (in part because the outcome of the revision of the Constitution is uncertain) also raises doubts about the durability of the effort to reduce inflation.

From the above, it is clear that we need to work further with the Brazilian officials, particularly after the rest of the team arrives. I would prefer that we continue the discussions at headquarters to see whether there is any chance to strengthen the program as needed.

Finally, ~~I might note~~ that the latest information shows a drop of international reserves of US$1 billion during the first quarter of 1993, mainly ~~because~~ the authorities intervened to contain the spread between the commercial and parallel markets.

This memorandum has been reviewed by PDR.

cc: Mr. Mussa
Mr. Gianviti
Mr. Tanzi
Mr. Guitian
Mr. Gupta
Mr. van Houten
Ms. Saunders

Mr. Begh

STB
FvB
JF
IO
F

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1993 APR 19 PM 4:41

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

April 19, 1993

Senhor Governador:

Minha mulher Brigitte e eu ficamos consternados pela notícia do falecimento da Sra. Neuza Goulart Brizola. Cientes da magnitude da perda que acaba de sofrer, desejamos expressar nossas sentidas condolências e profundo pesar por tão triste desenlace.

Atenciosamente,

Michel Camdessus

A Sua Excelência o Senhor
Leonel Brizola
Governador do Estado do Rio de Janeiro
Palácio das Laranjeiras
Rio de Janeiro
Brasil

Brazil

STB
FvB
JF
IO
F

Washington, D.C., April 16th, 1993

Nº 78

The Honorable
Sterie T. Beza
Counsellor
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Beza:

I am sending herewith the text of my recent lecture *The Brazilian and Economic Process and the Relationship Between Brazil and the United States*. I give therein an up-to-date description of the political and economic process in Brazil, and try to draw some parallels with Russia's situation as well as with the responses of the international community.

Sincerely, best regards,

Rubens Ricupero

Rubens Ricupero
Ambassador

encl.

STB
FvB
JF
IO
F

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1993 APR 20 PM 2:59

Washington, D.C., April 16th, 1993

N° 78

The Honorable
Sterie T. Beza
Counsellor
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Beza:

I am sending herewith the text of my recent lecture *The Brazilian and Economic Process and the Relationship Between Brazil and the United States*. I give therein an up-to-date description of the political and economic process in Brazil, and try to draw some parallels with Russia's situation as well as with the responses of the international community.

Sincerely, best regards,

Rubens Ricupero

Rubens Ricupero
Ambassador

encl.

The Brazilian Political and Economic Process

and

the Relationship Between Brazil and the United States

Ambassador Rubens Ricupero

Trade and Investment Opportunities in Brazil

Conference in San Francisco, CA

April, 1993

Ladies and Gentlemen:

In the last few months Russian events have largely captured and concentrated the world's attention. It is rightly so because so much is at stake in what is unfolding in Moscow.

There are, however, a few good reasons why more thoughtful consideration should be given to what is happening in Brazil. For one, besides being placed among the five or so truly gigantic nations, Brazil has almost the same population as the new Russia, namely, one hundred and fifty million inhabitants.

Also, the two economies are more or less the same size; Brazil's is even somewhat bigger, as steel production and heavy industry have undergone precipitous reductions in Russia, and the service sector is still being created from scratch. We even share the dubious distinction of figuring among the unhappy few that post inflation rates of over 20% a month.

About a week ago, *The New York Times'* Serge Schmemann alluded to the conflicts between Yeltsin and his political foes and wrote: "...the truth is more complex: a system in profound transformation, a nation in search of a new identity."

If we allow for the necessary changes and adaptations, for the two situations have as many differences as they have similarities, the description could in some aspects fit Brazil's plight.

Nowhere is that more evident than in the political sphere. What is now taking place in Brazil is much more than a protracted, seemingly endless transition from a military to a civilian rule which started about twenty years ago, in 1974.

It is in fact the reshaping of a whole system, the reinvention of a fresh national project.

This situation stands out very clearly when we realize that two of the three political events which will shape Brazil's political agenda for the months to come have to do with far-reaching institutional reforms.

The political agenda that will set the limits and the tone of the Brazilian reality in the next future will start in a few weeks, on April 21st, with a national plebiscite to determine the country's form of government. In October, Congress will proceed with the revision of the Constitution; and a year from now, the political campaign will dominate the national scene, preparing the grounds for the November 1994 general elections for President, state Governors and Congress members.

The history of the last few years has barely given us a sense of relief. The gradual transition to a democratic regime in the seventies was followed by an array of unexpected events. From the sudden illness and death of Tancredo Neves in 1985 to President Collor's impeachment process in 1992, Brazilians continually encountered the challenge of making democracy work, facing dramatic tests that seldom, if at all, have assailed other countries in such rapid succession.

A few months ago, in a workshop organized by the Inter-American Dialogue, in Washington, I tried to call the participants' attention to the need to avoid oversimplifications when looking at the reality of a country of the size and complexity of Brazil. The short-term view that from time to time seems to dominate various analyses on the Brazilian reality does not do justice to the country's performance in the longer perspective.

One should avoid, above all, thinking of Brazil in terms of clichés and stereotypes. To put it very simply, those lured by the "economic miracle" of the seventies will be making a serious mistake if they jump to the conclusion that the negative performance of recent years will determine an irreversible pattern.

In the introduction to a study on money and debt published in 1991, Rudiger Dornbusch and Steve Marcus remarked that "democracy does not make it easier to run a tight economy." Without getting into the merit of the argument, I must say that carrying out economic reform while building at the same time a truly democratic society should not foment illusions. It is a hard task that requires time, patience and good will.

Several countries which have been able to manage successful stabilization programs did so in contexts of much less political freedom and social participation than the one now prevailing in Brazil. We know we still have a long way to go both in terms of political and economic organization. Among other topics in our agenda are those of refining political institutions and finding an acceptable compromise between the federal government and the state and local governments. The latter is to cause a major impact on the management of macroeconomic policy, in view of the large degree of autonomy enjoyed by states and municipalities and the high share of the fiscal income that the Union has to transfer to local administrations. In no other country of Latin America can one find a similar scenario.

According to recent indications of public opinion polls, it appears that the April referendum will confirm the presidential system. Expectations are that such a result will usher in a phase of political accommodation. It is true that the result may trigger the beginning of the presidential campaign, a fact that some analysts regard as likely to make it more difficult to reach political consensus on some key and urgent issues. Here again it is necessary to avoid premature judgement. In my view, different trends will become clearer, political alliances will be consolidated and the country will look at the future without the current incertitudes towards the different options of government.

Next year general elections will lead this process to its logical conclusion, with the total renovation of political leadership at all levels and the selection of a President with an unmistakable mandate for completing reform and change. However painful and frustrating it may at times appear, the democratic process is for all Brazilians the only way to generate political consensus. There are no shortcuts, no alternative to democracy.

If I concentrated so much on the political aspects, it was just because we have to start with what comes first in the Brazilian agenda. At the same time Brazil must face the challenge of stabilization and economic reform, both tasks that cannot be postponed or weakened.

In fact, we have here a sort of duality that has misled many observers. While in the short-term picture the conjuncture remains worrisome and has stubbornly resisted several major adjustment attempts, the long-term trends, the structural changes have consistently conquered further ground, without serious setbacks or retrocession.

But we have reasons to feel confident of immediate prospects. In the day-by-day conduction of the economy we have now, as a result of recent changes, authorities with considerable experience in public administration and with solid contacts with the multilateral financial institutions.

Their first tasks will be to guarantee the approval of the remaining part of the fiscal reform program in Congress and to work on measures conducive to stabilization. Inflation remains a matter of central concern, requiring decisive action. The difficulties in tackling the problem have to do, in general terms, with the economic model of the last decades which crystallized practices like indexation and with mandatory financial transfers established by the 1988 Constitution. Nonetheless, for the last three years Brazil has had surpluses in its public sector's primary accounts. The administration of the budget has been severely strict, and the new authorities have already committed themselves to an anti-inflation program that will involve no shock therapy along the lines of previous unsuccessful experiences.

After two years of a painful recession, a few signs of recovery were registered in the economy in the first quarter of this year. Industrial production has been progressively increasing (in São Paulo, industrial activity increased 6.2% in January and February) and employment in key sectors like housing also increased (0.8% in February).

Although it is still not possible to gauge whether the recovery is sustainable in the long run, expectations are that it can be maintained and the general mood among entrepreneurs is more positive. The indications of an excellent crop in 1993, over sixty-four million tons--possibly even greater than the already exceptional 1992 harvest--may also stimulate a positive atmosphere, while at the same time contributing to holding prices down. There is no denying that the short-term picture is still cloudy, in part due to the political storm of the presidential impeachment four months ago. However, the structural reforms in the fields of privatization, the opening of the trade system, deregulation and integration in the international financial community have all advanced and proved irreversible even in the face of deep political upheavals.

The privatization program was put back on track with the selling off of the government's shares of POLIOLEFINAS on March 19. The auction of the largest steel company in Brazil, Companhia Siderúrgica Nacional (CSN) on April 2 and 5, was just another important step. The deep controversy it raised, to a certain extent parallel to the case of USIMINAS, the very first company privatized in the context of the present program, is related not only to the size of CSN, but also to its historic role in the industrial development of Brazil and the contrasting positions of segments of the labor unions. CSN's own employees joined the group of supporters. They will have up to 20% of the enterprises' capital. Four new auctions have already been scheduled: ULTRAFERTIL, on May 4, PETROCOQUE, on May 14, COSIPA, on July 13 and AÇOMINAS on July 26. In 1993, the Brazilian government intends to conclude privatization in two key sectors, namely fertilizers and the steel industry. The new rules applying to privatization as a result of a decree recently issued by President Itamar Franco do not deviate the program from its major thrust. A certain percentage of cash, defined on a case-by-case basis, is now required--a practice that is current in the Mexican and in the Argentinian programs--and the program will be linked to industrial policy. Since 1991 twenty-four enterprises, wholly or partly owned by the State, have been privatized, bringing about public debt reduction of approximately $ 5.5 billion. Privatization programs have also been launched separately by the states of Maranhão, Pernambuco, Paraíba, Minas Gerais and São Paulo.

If analysts do not always seem to grasp the full meaning of Brazilian structural developments, the market has clearly realized the opportunities that have been opened. According to the World Bank, in 1991 Brazil was the third largest recipient of foreign direct investment among developing countries. The trend was maintained last year, when FDI reached its highest level since 1981.

As for portfolio flows, the outcome has been similar to that of other large recipient Latin American nations. Brazilian public enterprises have improved their access to financial sources abroad. A recent report by ECLAC shows that the region's capital account recorded a surplus increase in 1992, essentially attributable to two countries, Brazil and Argentina.

Another source, the International Economics Department of the World Bank, mentions Brazil as one of the five developing countries that have made more remarkable efforts in terms of financial liberalization, removing all significant restrictions on registration procedures, repatriation of income and of capital. Besides, official flows have also been re-established. Just to mention one example, on March 15th Brazil and the Japanese International Economic Cooperation Fund concluded an agreement providing for co-financing operations with IDB for environmental projects amounting to $ 840 million.

As far as the foreign debt is concerned, on March 15th, the crucial mass commitment by banks to the Financing Plan agreed between Brazil and its commercial creditors was achieved. Such commitment was interpreted as proof of the creditors' confidence in Brazil's determination to normalize its international financial relations and as a response of banks to Brazil's strict implementation of the debt deals, both the 1992 deal and the deal on arrears until December 1990. <u>Since 1991, Brazil has made payments of the order of 7.5 billion dollars regarding its public sector debt. This figure does not include payments either by the private sector or by the public sector enterprises free to serve their debts and make remittances abroad. Brazil has always regarded the implementation of the agreement with the banks as a cooperative effort involving the Brazilian government,</u>

creditors, the multilateral institutions and creditor governments. In this spirit, it continues to rely on resources of the multilateral institutions to put the deal to work. An IMF mission went to Brasilia on March 1st-22, and a Brazilian mission is expected in Washington in April to continue negotiations with the Fund.

Brazilian external trade continues to show strong performance. The World Trade Overview just released by the GATT Secretariat on March 22 stresses that, although Brazil's imports fell in 1992 owing to domestic recession, Brazil's exports rose by 15%, almost three times more than the world average (the U.S. increase was 6%). Among the twenty-six leading exporters, only Hong-Kong (20%) and China (17%) posted bigger increases than Brazil's (which were equal to Malaysia's). According to ECLAC, while the Latin American trade balance fell more than 50% in 1992, the Brazilian balance increased at the same rate from 91 to 92, reaching US$ 15 billion dollars at the end of last year. Trade liberalization has followed its path. Brazil is one of the very few countries in the world which has no significant quantitative restriction on imports. Average import tariffs have come down from 40% to 17% and they will be further reduced to 14%.

Deregulation has also come a long way. Sensitive areas have been touched with the end of the State monopoly over the industrialization of wheat, the privatization of ports, the liberalization of transport tariffs, the elimination of bureaucratic procedures for imports and exports and the establishment of a unified system for foreign trade, eliminating prior authorization requirements by a government agency.

Analysts have identified signs of a true microeconomic revolution in some selective sectors in the Brazilian economy, particularly in industry. Owing to a slowdown in economic activity and, at the same time, an environment of greater competition resulting from trade liberalization, many enterprises had to make a series of adjustments in their management structures. Large companies which in the eighties had not squeezed their budgets, despite a general environment of declining investments, started to reduce costs and improve efficiency three years ago. Several among them have now started to reinvest, relying on their own resources. The impact of those adjustments on the general economic picture still cannot be clearly evaluated, but the new trend is an encouraging sign.

Facts like these contribute to reinforcing the view that we should not be prisoners of the short-term approach when dealing with the Brazilian reality. By no means do I intend to deny the absolute importance of stabilization as a requisite for growth resumption. But I insist, one must escape single-sided approaches to Brazil.

<u>This week's news coverage about Russia stressed the level of cooperation that country deserves for the democratic and market revolution to succeed. As I said before, we are roughly the same economic size as Russia, we have the same population as the Federation. We have struggled the same battle for democracy and the market, and we have won it. One of the differences between the two situations is that we do not have thousands of nuclear warheads--actually Brazil is the only gigantic country which is neither a nuclear nor a regional power (unlike the US, Russia, China and India). Now we face the difficulties inherent in a changing economic reality and we think that we are entitled to a credit of good will from our major partners.</u>

<u>In contrast to Russia and Poland we are not being offered, or asking for conditions to meet our special financial obligation. On the contrary, as a major creditor to Poland, Brazil has joined the Paris Club decisions on debt reduction operations. As debtors to official and commercial sources, we have strictly abided by our agreements, as I have just noted. Besides, let me remark that from 1988 through 1992 net transfers from Brazil to the World Bank amounted to $ 4.6 billion, a figure that is quite impressive, especially if we take into account that those resources may be channelled to operations in other countries, including the Bank's new members, the so-called "new market economies". Our attitude has thus been more than positive, more than cooperative, and it is only natural that we expect to count with the strong support of multilateral institutions for the implementation of the debt Agreement, and to receive proper recognition for the</u>

breadth of changes we have effected in such a short period of time.

Let me finally say a few words on Brazil-US relations to conclude this presentation.

Our two countries share many common values and ideals, among which are the defense of democracy, the respect for human rights, the promotion of sustainable development and the purpose of guaranteeing all segments of society a reasonable standard of living. As member of the Security Council of the United Nations--having started in January a two-year term--Brazil has been engaged in close dialogue with the U.S. and other members concerning matters affecting international peace and security. In the economic sphere, Brazil and the United States have been striving for a successful conclusion of the Uruguay Round.

The United States is our largest single partner, absorbing roughly 21% of our exports. Bilateral trade in 1992 reached more than 13 billion dollars, a higher level than in 1991. From 1987 through 1991, US exports to Brazil grew by 55%, from $ 4 billion to $ 6.2 billion, despite the Brazilian recession and the suspension of Eximbank credits for its public sector. Brazil is the recipient of one of the largest amounts of US investments in Latin America. In 1991 such investments totalled $ 15.2 billion.

The emergence of a new Administration in the United States, when both countries are engaged in deep changes, opens a new opportunity for us to improve the bilateral dialogue. On our part we are ready to explore new avenues to improve that dialogue.

Ladies and Gentlemen:

In order to show you that my confidence in a long-term view of Brazil is neither misplaced nor purely subjective, I wish to close my remarks with two quotations from the *Journal of Commerce*.

In the article "Analysts See Opportunities in China, Brazil Stocks" (April 5), after stating that "China and Brazil, two Third World giants in different regions, are presenting stock investors with some of the best opportunities for gain in the world," the author goes on to say that "Brazil (...) has the world's best performing stock market this year, having risen 43% in dollar terms."

In another article of that same issue, Brian Johns (writing from San Francisco) stresses that "Brazil, which ranks 23rd on the state's list of top 25 export markets, purchased 54% more California goods and services in 1992 than it did the year before, reaching $ 843.8 million. That increase followed a whopping 60% jump in its 1990 purchases."

From these two examples you see that I do not exaggerate when I tell you that "you should go long on Brazil."

THANK YOU

Office Memorandum

To: The Managing Director
The Deputy Managing Director

March 29, 1993

From: for S.T. Beza JF

Subject: Brazil--Back-to-Office Report

The mission that visited Brasilia during March 8-22, 1993 only conducted the 1993 Article IV consultation discussions. A new Minister of Finance took office just as the mission began, and he suggested that discussions on an economic program that could be supported by the Fund be postponed until the authorities complete the formulation of their program, possibly by mid-April 1993.

A sizable surplus in the operational balance of the public sector is needed if inflation (now at about 27 percent a month) is to be reduced in a meaningful way. In the mission's view, this would require a surplus in the primary balance of about 6 percent of GDP in 1993. Achieving such an objective would require a very strong fiscal effort because current policies for 1993 yield a primary surplus of only 1/2 percent of GDP.

Although the authorities saw a need for a surplus in the operational balance--which would mean a primary surplus in excess of 4 percent of GDP--they did not indicate the timing they had in mind for achieving this surplus, nor the specific measures that they were contemplating for this purpose. The magnitude of the required fiscal effort and the authorities' intention to consult extensively with the Congress and Governors on the program suggests that the process of framing a program would at least be quite drawn out.

In the meantime, uncertainties regarding the direction of economic policies are leading the private sector to shift from domestic financial claims to goods, shares, and foreign exchange. The latter has resulted in a doubling (to 16 percent) of the differential between the commercial and the parallel exchange rates, despite substantial central bank intervention; reserves have remained relatively stable because of the strength of the trade balance. In addition, expectations are likely to be affected adversely by calls for higher expenditure (particularly public wages) by certain Cabinet members, by indications that the President may reverse the recent decision to adjust public tariffs to make up for certain lags, and by suggestions that there will be government "supervision" of prices.

To limit the risk of calls for a new negotiating mission before the authorities are ready with measures and estimates, the mission agreed with the Minister of Finance that the staff would have a chance to look at the proposed program and its quantification before returning to Brasilia. Sending a mission before these conditions are met would be counterproductive because it would lead to a frustration of expectations in Brazil and abroad.

Attachment

cc: Ms. Saunders

Office Memorandum

To: The Managing Director
The Deputy Managing Director

March 29, 1993

From: J. Fajgenbaum JF

Subject: Brazil--Back-to-Office Report

The mission that visited Brasilia during March 8-22, 1993, only conducted the 1993 Article IV consultation discussions. As the new economic team was taking office during the mission's visit, conversations remained at a general level. The new Minister of Finance agreed with the mission that discussions on an economic program that could be supported by an arrangement from the Fund start once a program had been prepared and quantified, and suggested that a possible date could be around the second half of April 1993. The Minister also indicated that such program would need to be discussed with Congress and the lower levels of government so as to forge the necessary political support for its implementation. In the mission's view, this process may take much more time than envisaged by the Minister. Possibly, it also raises questions on the strength of a program that would result from such discussions.

1. Recent economic developments

Two distinct periods characterized economic developments in 1992. During the first half of the year, economic policies were geared at containing inflation by implementing a gradual strengthening of the public finances and a tight credit policy that resulted in very high real interest rates. Inflation started to decline (from 27 percent a month in January to 19 percent in April) and international reserves grew rapidly, but economic activity fell, particularly in the industrial sector. During the second half of the year, political difficulties faced by the President led to a weakening of financial policies and inflation rose again. Efforts at structural reform continued in the areas of trade liberalization and privatization, although the proposed fiscal reform was shelved by Congress.

With the change of Administration in early October real interest rates were eased markedly and the privatization program was suspended. (It was resumed in March 1993.) The rate of price increase slowed to 24 percent a month in the last quarter of 1992 because adjustments in public prices were contained, but rose to around 27 percent a month in early 1993 as this policy could not be sustained.

For 1992 as a whole, the primary fiscal surplus was 1.4 percent of GDP (compared with a program target of 3 percent of GDP), economic activity declined by nearly 1 percent, and inflation reached about 1150 percent. By contrast, a strong improvement in the external current account and large capital inflows raised gross international reserves from nearly US$9 billion by end-1991 to about US$23 billion by end-1992, more than one year of imports.

In 1992 Brazil reached agreements on the restructuring of its debt to Paris Club creditors and commercial banks. The agreement with the latter has proceeded as scheduled and on March 15, 1993 virtually all creditor banks agreed with the proposed debt restructuring package and submitted their initial choice of instruments; 63 percent of the debt was allocated to the par bond, the most costly instrument for Brazil given the present interest rate structure. As expected, Brazil has requested banks to shift from the par bond to the other instruments in order to achieve a more "balanced" portfolio.

Developments so far this year have been affected negatively by a high degree of uncertainty regarding the direction of economic policies under President Franco and by the replacement of two Ministers of Finance in the last three months. Uncertainty may have been exacerbated by recent calls by Cabinet members for higher expenditure, particularly wages of public employees; a possible reversal in the decision to permit substantial increases in electricity tariffs; and suggestions for government "supervision" of price increases. As a consequence, the private sector seems to be shifting gradually from domestic financial claims to goods, stocks and foreign exchange, with the latter resulting in a doubling (to about 16 percent) of the spread between the commercial and the tourism exchange rates since the beginning of the year, despite substantial central bank intervention.

2. Report on the discussions

Upon taking office, the Minister of Finance announced a set of general policy guidelines and objectives which include a reduction of inflation, a modest recovery of economic activity by providing fiscal incentives and subsidized credit to selected sectors, a strengthening of fiscal policy, observance of all domestic and external commitments, the maintenance of positive real interest rates, the preservation of international competitiveness, a continuation of trade liberalization, an acceleration of the privatization program, and the introduction of a fiscal reform in the context of a review of the Constitution scheduled to start in October 1993. However, it became clear in the discussions that the new economic team had yet to formulate the specific policies and measures of the economic program.

The authorities agreed in principle that a surplus in the operational balance of the public sector was needed, if inflation was to be reduced sharply. Indeed, in the mission's view this surplus should be larger than the 1.5-2 percent of GDP mentioned to the previous economic team because previous estimates did not reflect some public debts that are maturing relatively rapidly (see below). Achieving such an operational surplus would require a major effort to raise the primary surplus to the equivalent of at least 6 percent of GDP from about 1/2 percent of GDP projected for 1993 on the basis of current policies and information. The authorities shared the mission's view that in the absence of corrective measures inflation would continue to increase, but it is not clear whether the Minister of Finance realized the magnitude of the needed effort.

The fiscal projection for 1993 reflects large increases in expenditure, particularly the wage bill, transfers, and subsidies to selected economic activities and includes a number of revenue measures already adopted or being considered by Congress (such as the tax on bank debits) and an increase in the level of public prices in real terms. Some assumptions on revenue may be somewhat optimistic, thereby overestimating the actual baseline for 1993.

The mission encouraged the authorities to adopt promptly measures that are credible and that go in the direction of the planned fiscal reform so that they are sustainable. Moreover, it is important that these measures provide a sufficiently large margin to accommodate possible slippages that normally occur.

The mission noted with concern the very weak financial position of a number of funds (including for income assistance (FGTS) and residential construction (FCVS)) that enjoy Federal Government guarantees and that will result in claims possibly exceeding 6 percent of GDP in the short and medium term. These funds are intermediated through the Federal Savings Bank and as such were not previously recognized by the authorities as presenting a potential fiscal problem. The mission said that if such commitments were to be honored, fiscal policy needed to provide room to address these problems.

The authorities noted their intention to raise <u>public tariffs</u> significantly in real terms, particularly in the areas of telecommunication, electricity and fuel in order to improve the financial position of the public enterprises, but could not indicate any specific detail. Furthermore, they stressed that tariff adjustments would have to take into account production costs and that enterprises would need to become more efficient. They mentioned that in order to meet some of the claims by the funds mentioned above, they would explore the possibility of accelerating the <u>privatization</u> program by adding new enterprises and by selling shares of the largest enterprises, without losing control of them. The mission encouraged the authorities to move rapidly in these areas in any event, and to strengthen the mechanisms that prevent enterprises from spending part of the increased revenue so as to help in the fiscal effort. It also stressed the need for a well defined timetable and clear rules for privatization to make the process more efficient.

The authorities said that they would like to propose a comprehensive fiscal reform in the context of the scheduled revision of the Constitution. The reform would aim at reallocating expenditure among the various levels of government, reducing the public sector wage bill, and raising revenue through a broadening of the tax base and a simplification of the tax system. Modification of some elements of the Social Security System also might be proposed.

Discussions on monetary policy were very limited because the new President of the Central Bank had not yet taken office. The Minister of Finance stated that the authorities' objective was to maintain positive real interest rates, although at a substantially lower level than those prevailing in 1992. Mr. Kafka suggested the possibility of a tightening of capital controls to lessen the impact of capital inflows on the conduct of monetary policy, but agreed with the mission on the need to assess carefully such a step because of its potential adverse effect on expectations that could lead to reversal of capital movements. The Minister mentioned that further studies would be conducted on possible means to separate the accounts of the Treasury from those of the Central Bank to enhance transparency, and to proceed with the strengthening of the financial position of the Federal Savings Bank.

The mission mentioned that irrespective of the approach that the authorities would adopt to reduce inflation, credit policy needed to be very tight, resulting in higher real interest rates than the current ones (around 1 percent a month) until the necessary strengthening of fiscal policy takes hold and expectations turn around. The mission also stressed the need for a reform of the financial system, which is now subject to a host of complex regulations and portfolio requirements, and noted the possible fiscal costs of such a reform.

The mission encouraged the authorities to maintain the price system free of controls to prevent adverse effects on output and expectations. Past attempts at price controls proved counterproductive and destabilizing. The Minister of Finance said that wage policy would be consistent with the economic program, and that forthcoming nominal adjustments to public wages would be consistent with available revenue. The latter, however, might conflict with recent efforts by other ministers to raise public sector wages substantially.

The authorities said that compensatory social programs would be expanded (and properly targeted) to alleviate the situation of the poorest segments of the population. In addition, they stressed that the most important contribution in this area would come from a meaningful reduction of inflation, which has affected the poor the most.

The mission agreed with the authorities on the need to maintain external competitiveness by continuing to adjust the exchange rate in line with inflation, at least until fiscal policy has been strengthened. Subsequently, exchange rate policy would depend on the stabilization approach that would be adopted. With regard to trade liberalization, the mission encouraged the authorities to move beyond what is planned so as to further enhance competition and efficiency. The mission prepared a balance of payments medium-term outlook based on WEO projections and the authorities' assumptions that a stabilization program would be implemented successfully in 1993-94 and that subsequently economic growth would increase to 4-5 percent a year. On the basis of these assumptions, Brazil's balance of payments would remain strong over the medium term, with the current account surplus declining gradually and gross international reserves continuing to provide a comfortable coverage of imports.

The authorities considered it premature to indicate what would be their policy with regard to enhancements for the restructuring of debts to commercial banks if an agreement with the Fund could not be reached by the time of the exchange of debt instruments. Similarly, the authorities preferred to wait for the response of the Paris Club creditors to their request for a postponement of the deadline to complete the review under the stand-by arrangement (originally scheduled for end-December 1992) before they stated a position on the servicing of debts falling due between February and August 1993. (Subsequent to the mission, Paris Club creditors agreed to a postponement until May 31, 1993.)

The authorities expressed interest in further technical assistance from the Fund in the areas of fiscal and social security reform, tax administration, and financial system reform, but formal requests could only be formulated once they had a clear view of their needs. Given that Brazil no longer maintains restrictions under Article XIV, the authorities said that they will review, together with Mr. Kafka, the possibility of accepting Article VIII status and respond as soon as possible.

The authorities agreed that any financial arrangement will need to be of a precautionary nature, given Brazil's strong external position, and acknowledged that passage of time renders inappropriate the possibility of extending and rephasing the current stand-by.

The next Article IV consultation will be held on the standard 12-month cycle.

cc: AFR	LEG	SEC
CTA	MAE	STA
EUR I	MED	TRE
EUR II	PDR	WHD
FAD	RES	IBRD
INS	SEA	
Mr. Saunders		

Mr. Beza

Office Memorandum

Brozzie

CONFIDENTIAL

INTERNATIONAL MONETARY FUND WESTERN HEMISPHERE DEPT.

1993 MAR 29 AM 10: 01

STB
CL
MB
FuB
JPA
CM
JF
AMJ
LP
EW
MLCD
IO
F

To: The Managing Director
The Deputy Managing Director

March 26, 1993

From: Eliot Kalter EK

Subject: Paris Club Meeting--March 22-25, 1993

At this week's regular Paris Club session, creditors concluded rescheduling agreements with Guatemala and Mozambique, reported on separately by area department representatives. This note reports on Wednesday's informal meeting with a Nigerian delegation and Monday's tour d'horizon session.

1. Informal meeting on Nigeria

Creditors held a special session on Nigeria, attended by a Nigerian delegation headed by the Secretary of Finance, in light of the sizeable runup of external arrears since the end of its last Paris Club consolidation period on March 31, 1992. Creditors noted that as of end 1992, Nigeria had outstanding external debt of US$29 billion with external arrears totalling US$3.4 billion; moreover, the accumulation of arrears accelerated during the year. Debt service payments to Paris Club creditors are projected at US$3 billion during 1993 which points to the importance of regularizing these payments.

The Nigerian delegation described recent economic actions to address their economic and financial imbalances and emphasized that it intended to agree on a medium-term program with the Fund by June. It did not indicate readiness to initiate debt-service payments to Paris Club creditors but did stress strong interest in obtaining the rescheduling terms that have so far been reserved for low-income countries, including the possibility of a debt stock restructuring.

The United Kingdom stated that a concessional rescheduling would be appropriate for Nigeria if such relief was essential for external viability, if there was an appropriate arrangement with the Fund, and if a track record of economic performance and payments was established. Other creditors, however, stressed that they had substantial arrears outstanding with Nigeria and urged that the authorities resume payments to Paris Club creditors before an agreement is reached with the Fund. Some of these creditors noted the potential cost of obtaining a rescheduling on enhanced concessions including its negative impact on access to international capital markets. Nigeria was urged to consider carefully the costs and benefits before requesting a concessional rescheduling.

2. Forthcoming reschedulings

Benin and Guyana were scheduled for the next Paris Club meeting in early May. In both cases, the last tranche of the current multiyear consolidation period through end-July 1993 has become effective, following recent Fund Board approval of the required annual arrangements under the ESAF.

Peru was also placed on the agenda for early May. In my intervention, I emphasized that at the 1992 Article IV Consultation with Peru (3/17/93) Executive Directors expressed hope that official bilateral creditors will be forthcoming with a rescheduling that will facilitate the completion of the program's financing arrangements and that Peru would require continued exceptional financial support from the international community. Creditors noted the shortfall in the financing from the support group fell short of what had been assumed in the program. They stated that the terms of the 1991 rescheduling were exceptional (including the deferral of both moratorium interest and post-cutoff date debt) and that it was difficult to have similar terms in the next rescheduling. In particular, there was resistance to a deferral of already deferred payments on post-cutoff date debt. The possibility was raised that donors might come forward with additional financing after the Paris Club rescheduling or that, in any case, the remaining residual gap should be filled through the generosity of donors. It was noted, however, that the Paris Club would need to make a special effort and the question of "special treatment" of Peru's debt was raised.

On Costa Rica, creditors reported arrears both on post-cutoff date debt and moratorium interest, with some creditors not receiving payments since December 1991. Creditors decided to place Costa Rica on the agenda for the meeting in late May contingent on Executive Directors' assessment of the situation at the Board meeting scheduled for April 19. Costa Rica would also be discussed by Paris Club creditors at the next tour d'horizon to determine whether required payments have been made.

Creditors welcomed the intention of the Philippines authorities to begin making full payments to Paris Club creditors following the end of the consolidation period on March 31, which had been extended in line with the stand-by arrangement. It is expected that the Philippines will come back to the Paris Club on the basis of a new arrangement with the Fund but that coverage would decline as the Philippines moves toward graduating from Paris Club reschedulings.

3. Other country matters

The second stage of Egypt's Paris Club debt reduction was contingent on completion of the second review of the current Fund arrangement and approval of a successor arrangement before end-December

1992. In December, creditors had granted an extension of this deadline to March 1, 1993 in line with the extension of the stand-by arrangement. Creditors indicated that they were now willing to extend this deadline to May 31, 1993 following completion of the second review of the arrangement by the Board on March 18, 1993 and the extension of the arrangement through end-May 1993. However, creditors decided to stress to the authorities that the second stage of debt reduction would be put in jeopardy if an appropriate successor arrangement with the Fund was not concluded by that date.

Iran was discussed by creditors in the wake of substantial arrears on short-term debt. It was reported that the Iranian authorities have approached several creditors on a bilateral basis with a request to rollover these arrears and current maturities through end-1993. Iran had stated that it faces a liquidity problem and that making the required payments would reduce their ability to finance its investment program. In turn, these creditors noted that Iran should regularize their payments situation either through payments or through a multilateral approach.

On the basis of preliminary information most creditors reported short-term external arrears (including US$0.8 billion with Germany, US$0.5 billion with Japan, and US$100 million with France). Creditors concluded that these arrears would not be refinanced on a bilateral basis, that information gathered by the Fund and Bank would be important to understand the extent of this problem, and an effort would be made by the Secretariat to collect updated information on Iran's external arrears. This information would be discussed at the next tour d'horizon.

Creditors expressed concern that the signing of bilateral agreements on Bulgaria's new Paris Club rescheduling of December 1992 was proceeding slowly; one creditor indicated that delays continue in the implementation of the 1990 rescheduling agreement. The Chair asked that the Fund staff communicate these concerns.

The Chair mentioned that a delegation from Gabon had just finished a tour of capitals where it indicated that the Fund's balance of payments projections were incorrect and Gabon was not able to make scheduled payments to Paris Club creditors. Creditors had previously declared Gabon's 1991 rescheduling agreement null and void.

Creditors decided to send a message to Tanzania that payments on post-cutoff date arrears need to be paid by end-April in order for the second tranche of the 1991 multiyear rescheduling agreement to become effective.

Creditors will send a message to Brazil to convey their concern about the large accumulation of arrears starting on February 1, 1993, including on post-cutoff date and short-term claims following the passing of the December 31, 1992 deadline for the completion of the review of Brazil's stand-by arrangement with the Fund, which would have triggered effectiveness of the second tranche of the rescheduling agreement. Creditors decided, however, to postpone the deadline to May 31, 1992, and the second tranche will become effective if before that date either the review is completed or a new arrangement with the Fund is in place.

Creditors complained that the Dominican Republic's payment record under its rescheduling agreement remains poor, including on post-cutoff date debt. This would affect creditors' attitude toward any future request for a rescheduling.

Some creditors noted that they had recently received a request from the Venezuelan Government requesting on a bilateral basis the deferral of principal payments falling due between April 1, 1992 and December 31, 1993 on nonrestructured promissory notes. Venezuela will be placed on the next tour d'horizon to discuss more fully creditors experiences in this regard.

4. Future meetings

May 3-7, 1993	Benin, Burkina Faso, Guyana, and Peru
May 24-28, 1993	Possibly Costa Rica and Ecuador
June 21-25, 1993	Open

cc: Heads of Departments: AFR, CTA, EUR I, EUR II, PDR
EXR, LEG, MAE, MED, PAR, RES,
SEA, SEC, TRE, WHD✓

Ms. Saunders

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

Brazil

Ted,

This is a suggested paragraph to be included in the speech of Minister Yeda Crucius, our Governor of the IADB.

Do you see any problems? I am afraid we would need your comments by tomorrow.

With the Compliments of

Alexandre Kafka

Executive Director

STB
FUB
JF

28. Retomamos, também, nas ultimas semanas, os entendimentos com o Fundo Monetário Internacional sobre o arranjo "stand-by" aprovado em janeiro de 1992. Uma missão do Fundo esteve recentemente no Brasil avaliando o comportamento da economia brasileira no quadro das consultas do Artigo IV dos Estatutos do FMI e deverá retornar ao país em abril já para, em caráter negociador, acertar a regularização do nosso arranjo "stand by".

BANCO CENTRAL DO BRASIL

TRANSMISSÃO DE TELECÓPIAS

GABINETE DO DR. PEDRO MALAN

DE: DR. PEDRO SAMPAIO MALAN

FAX Nº: 029/93

PARA: DR. ALEXANDRE KAFKA

DATA: 23/MAR/93

EMPRESA: INTERNATIONAL MONETARY FUND

TELEFONE: (202) 623-4994

Telefone para confirmação:
(061) 223-3038

Telefax nº (061) 224-5360

Nº de páginas:
(incluindo esta capa) 5

DRAFT
March 23, 1993

TELEX

TO: The International Financial Community

FROM: Republica Federativa do Brasil

RE: Republica Federativa do Brasil
1992 Financing Plan

The Federative Republic of Brazil ("Brazil") is pleased to announce that by the close of business on March 15, 1993, more than ninety-five percent (95%) of the MYDFA Banks had responded favorably to the 1992 Financing Plan substantially in the form of Commitment Telex set forth in Annex B thereto, thereby achieving the Critical Mass Commitment Date by the suggested date. (All capitalized terms herein are used as defined in the 1992 Financing Plan of Brazil.)

The distribution of committed Eligible Debt among the six available options at the close of business on March 15, 1993 was as follows:

Par Bonds:

Option A:	57.59 Percent
Option B:	6.35 Percent

Discount Bonds:

Option A:	17.08 Percent
Option B:	1.19 Percent

FLIRBs:	5.67 Percent
Capitalization Bonds	8.29 Percent
Restructuring Option	0.06 Percent
New Money Option	3.77 Percent

As stated in Brazil's communication accompanying the 1992 Financing Plan, Brazil expects that collateral will come from five sources: new money from the banks, Brazil's international reserves, and amounts available to Brazil for debt- and debt-service reduction transactions from the International Monetary Fund, the World Bank and the Interamerican Development Bank. Based on information available to Brazil at this time, the situation with respect to the collateral is as follows.

In accordance with the commitments received as of March 15, 1993, the banks have elected to provide at least U.S. dollars 230 million in new money disbursements.

An International Monetary Fund mission was in Brazil from March 1 through March 22, 1993 preparing a report on Brazil's economic performance and continuing conversations with Brazil on an economic program that could be supported by the Fund. As approved by the Fund's Board of Executive Directors, the current SDR 1.5 billion (approximately U.S. dollars 2.0 billion) standby arrangement contemplates the set-aside of up to twenty-five percent (25%) of the amount available thereunder for debt- and debt-service reduction.

Brazil expects that the World Bank and the Interamerican Development Bank will support debt- and debt-service reduction for Brazil to the extent permitted by the existing guidelines established by their respective Executive Boards.

Brazil has always envisioned the 1992 Financing Plan as part of a cooperative effort among itself, its creditors and multilateral institutions. Representatives of each of the three multilateral institutions have recently participated in information meetings with Brazil's creditors worldwide and provided creditors an indication of their institutions' support for Brazil's 1992 Financing Plan. Brazil continues to be confident that each of the sources of enhancements will contribute to Brazil's collateral requirements and that, unless waived, the amount of Initial Collateral available on the Exchange Date will be not less than U.S. dollars 3.2 billion.

As stated in Brazil's communication accompanying the Financing Plan, the cost of collateral is of utmost importance to the Brazilian economic authorities, the Federal Senate and Brazilian society as a whole. The amount of up-front debt-stock reduction achieved by the

1992 Financing Plan is also important for Brazil. Both the amount of debt-stock reduction and the cost of collateral are dependent upon the distribution of creditors' selections among the available options. It is for this reason that Brazil places so much emphasis on achieving a reasonable balance among the options-- both in terms of the balance between the defeased and nondefeased options and the balance between the two defeased options.

Creditors are reminded of the provision in the 1992 Financing Plan that permits each Lender committing Old Debt for Par Bonds under Option A to reallocate all or a portion of such Old Debt, to one or more alternative Principal Options (which shall become such Lender's selections for such Old Debt) within two weeks after the date hereof.

Brazil remains confident that, continuing the spirit of dialogue that has characterized the negotiations from their inception, Brazil and its creditors can implement the 1992 Financing Plan for the mutual benefit of all concerned.

Eliseu Resende
Minister of Finance

STB

F

Office Memorandum

To: The Deputy Managing Director
Mr. van Houten
Mr. Cisse

March 23, 1993

From: S. T. Beza

Subject: Brazil--Message of Minister of Finance to Bank Advisory Committee on Financing Package

We have just received, through Mr. Kafka, the attached revised version of the draft message. Two important points were dropped from the original draft: (1) the notion that the multilateral institutions were willing to "discharge their responsibilities" in the debt package and (2) the idea of "reinvigoration" of the current stand-by. However, most of the changes suggested by the Fund staff, intended to avoid misleading the banks regarding the Fund's involvement in the financing of the enhancements, were not incorporated.

For ease of reference, I am attaching a copy of the previous version of the message and our comments. Please let me have your reactions as quickly as possible.

Attachments

cc: The Managing Director
Mr. Saunders

BANCO CENTRAL DO BRASIL

TRANSMISSÃO DE TELECÓPIAS

GABINETE DO DR. PEDRO MALAN

DE: DR. PEDRO SAMPAIO MALAN | FAX Nº: 029/93

PARA: DR. ALEXANDRE KAFKA | DATA: 23/MAR/93

EMPRESA: INTERNATIONAL MONETARY FUND | TELEFONE: (202) 623-4994

Telefone para confirmação:
(061) 223-3038

Telefax nº (061) 224-5360

Nº de páginas:
(incluindo esta capa) 5

DRAFT
March 23, 1993

TELEX

TO: The International Financial Community

FROM: Republica Federativa do Brasil

RE: Republica Federativa do Brasil
1992 Financing Plan

The Federative Republic of Brazil ("Brazil") is pleased to announce that by the close of business on March 15, 1993, more than ninety-five percent (95%) of the MYDFA Banks had responded favorably to the 1992 Financing Plan substantially in the form of Commitment Telex set forth in Annex B thereto, thereby achieving the Critical Mass Commitment Date by the suggested date. (All capitalized terms herein are used as defined in the 1992 Financing Plan of Brazil.)

The distribution of committed Eligible Debt among the six available options at the close of business on March 15, 1993 was as follows:

Par Bonds:

Option A:	57.59 Percent
Option B:	6.35 Percent

Discount Bonds:

Option A:	17.08 Percent
Option B:	1.19 Percent

FLIRBs:	5.67 Percent
Capitalization Bonds	8.29 Percent
Restructuring Option	0.06 Percent
New Money Option	3.77 Percent

As stated in Brazil's communication accompanying the 1992 Financing Plan, Brazil expects that collateral will come from five sources: new money from the banks, Brazil's international reserves, and amounts available to Brazil for debt- and debt-service reduction transactions from the International Monetary Fund, the World Bank and the Interamerican Development Bank. Based on information available to Brazil at this time, the situation with respect to the collateral is as follows.

In accordance with the commitments received as of March 15, 1993, the banks have elected to provide at least U.S. dollars 230 million in new money disbursements.

An International Monetary Fund mission was in Brazil from March 1 through March 22, 1993 preparing a report on Brazil's economic performance and continuing conversations with Brazil on an economic program that could be supported by the Fund. As approved by the Fund's Board of Executive Directors, the current SDR 1.5 billion (approximately U.S. dollars 2.0 billion) standby arrangement contemplates the set-aside of up to twenty-five percent (25%) of the amount available thereunder for debt- and debt-service reduction.

Brazil expects that the World Bank and the Interamerican Development Bank will support debt- and debt-service reduction for Brazil to the extent permitted by the existing guidelines established by their respective Executive Boards.

Brazil has always envisioned the 1992 Financing Plan as part of a cooperative effort among itself, its creditors and multilateral institutions. Representatives of each of the three multilateral institutions have recently participated in information meetings with Brazil's creditors worldwide and provided creditors an indication of their institutions' support for Brazil's 1992 Financing Plan. Brazil continues to be confident that each of the sources of enhancements will contribute to Brazil's collateral requirements and that, unless waived, the amount of Initial Collateral available on the Exchange Date will be not less than U.S. dollars 3.2 billion.

As stated in Brazil's communication accompanying the Financing Plan, the cost of collateral is of utmost importance to the Brazilian economic authorities, the Federal Senate and Brazilian society as a whole. The amount of up-front debt-stock reduction achieved by the

1992 Financing Plan is also important for Brazil. Both the amount of debt-stock reduction and the cost of collateral are dependent upon the distribution of creditors' selections among the available options. It is for this reason that Brazil places so much emphasis on achieving a reasonable balance among the options-- both in terms of the balance between the defeased and nondefeased options and the balance between the two defeased options.

Creditors are reminded of the provision in the 1992 Financing Plan that permits each Lender committing Old Debt for Par Bonds under Option A to reallocate all or a portion of such Old Debt, to one or more alternative Principal Options (which shall become such Lender's selections for such Old Debt) within two weeks after the date hereof.

Brazil remains confident that, continuing the spirit of dialogue that has characterized the negotiations from their inception, Brazil and its creditors can implement the 1992 Financing Plan for the mutual benefit of all concerned.

Eliseu Resende
Minister of Finance

Office Memorandum

To: The Deputy Managing Director
Mr. van Houten
Mr. Cisse

March 22, 1993

From: S. T. Beza

Subject: Brazil--Message of Minister of Finance to Bank Advisory Committee on Financing Package

Mr. Fajgenbaum has sent to me from Brasilia the attached draft message that the Brazilian authorities wish to send the Bank Advisory Committee on the financing package.

Mr. Fajgenbaum has sent two versions of pages 2 and 3 of the message, the first showing the Brazilian version and the second showing the way Mr. Fajgenbaum has suggested that the text be revised.

Please let me have your reactions as quickly as possible because the Brazilian authorities wish to send the message today (Brazil is two hours ahead of Washington time).

Attachment

cc: The Managing Director
Ms. Saunders

1

DRAFT
March 19, 1993

TELEX

TO: The International Financial Community

FROM: Republica Federativa do Brasil

RE: Republica Federativa do Brasil
1992 Financing Plan

The Federative Republic of Brazil ("Brazil") is pleased to announce that by the close of business on March 15, 1993, more than ninety-five percent (95%) of the MYDFA Banks had responded favorably to the 1992 Financing Plan substantially in the form of Commitment Telex set forth in Annex B thereto, thereby achieving the Critical Mass Commitment Date by the suggested date. (All capitalized terms herein are used as defined in the 1992 Financing Plan of Brazil.)

The distribution of committed Eligible Debt among the six available options currently stands as follows:

Par Bonds:

Option A: _____ Percent

Option B: _____ Percent

Discount Bonds:

Option A: _____ Percent

Option B: _____ Percent

FLIRBs:	_____ Percent
Capitalization Bonds	_____ Percent
Restructuring Option	_____ Percent
New Money Option	_____ Percent

As stated in Brazil's communication accompanying the 1992 Financing Plan, Brazil expects that collateral will come from several specified sources: new money from the banks, Brazil's international reserves, and amounts available to Brazil for debt- and debt-service reduction transactions from the International Monetary Fund, the World Bank and the Interamerican Development Bank. Based on the best information available to Brazil at this time, the situation with respect to the collateral is as follows.

In accordance with the commitments received as of March 15, 1993, the banks have elected to provide at least U.S. dollars 230 million in new money disbursements.

Representatives of each of the three multilateral institutions have recently participated in information meetings with Brazil's creditors worldwide and provided creditors an indication of their institutions' willingness to discharge their responsibilities in the debt- and debt-service reduction strategy as it applies to Brazil.

2'

FLIRBs: _____ Percent

Capitalization Bonds _____ Percent

Restructuring Option _____ Percent

New Money Option _____ Percent

As stated in Brazil's communication accompanying the 1992 Financing Plan, Brazil expects that collateral will come from several specified sources: new money from the banks, Brazil's international reserves, and amounts available to Brazil for debt- and debt-service reduction transactions from the International Monetary Fund, the World Bank and the Interamerican Development Bank. ~~Based on the best information available to Brazil at this time, the situation with respect to the collateral is as follows.~~

B

In accordance with the commitments received as of March 15, 1993, the banks have elected to provide at least U.S. dollars 230 million in new money disbursements.

→ move to p 3'

A

Representatives of each of the three multilateral institutions have recently participated in information meetings with Brazil's creditors worldwide [and provided creditors an indication of their institutions' support for the 1992 Financing Plan.] ~~willingness to discharge their responsibilities in the debt- and debt-service reduction strategy as it applies to Brazil~~.

3

An International Monetary Fund mission was in Brazil from March 1 through March 22, 1993 preparing a report on Brazil's economic performance and continuing conversations with Brazil concerning the reinvigoration of the current SDR 1.5 billion (approximately U.S. dollars 2.0 billion) standby arrangement. As approved by the Fund's Board of Executive Directors, that standby arrangement contemplates the set-aside of up to twenty-five percent (25%) of the amount available thereunder for debt- and debt-service reduction. Brazil expects that, in addition to the Fund, the World Bank and the Interamerican Development Bank will support debt- and debt-service reduction for Brazil to the extent permitted by the existing guidelines established by their respective Executive Boards.

Brazil has always envisioned the 1992 Financing Plan as part of a cooperative effort among itself, its creditors and multilateral institutions. Brazil continues to be confident that each of the sources of enhancements will contribute to Brazil's collateral requirements and that, unless waived, the amount of Initial Collateral available on the Exchange Date will be not less than U.S. dollars 3.2 billion.

As stated in Brazil's communication accompanying the Financing Plan, the cost of collateral is of utmost importance to the Brazilian economic authorities, the

3'

As indicated in the information meetings with Brazil's creditors worldwide, ~~An~~ an International Monetary Fund mission was in Brazil from March ~~7~~ 8 through March 22, 1993 preparing a report on Brazil's economic performance and continuing conversations with Brazil on an economic program that could be supported by the Fund. ~~concerning the reinvigoration of the current SDR 1.5 billion (approximately U.S. dollars 2.0 billion) standby arrangement.~~ As approved by the Fund's Board of Executive Directors, ~~that~~ the current standby arrangement contemplate~~d~~ the set-aside of up to twenty-five percent (25%) of the amount available (SDR 1.5 billion or approximately US$2billion) thereunder for debt- and debt-service reduction. ~~Brazil expects that, in addition to the Fund, the World Bank and the Interamerican Development Bank will support debt- and debt-service reduction for Brazil to the extent permitted by the existing guidelines established by their respective Executive Boards.~~

an arrangement from

Brazil has always envisioned the 1992 Financing Plan as part of a cooperative effort among itself, its creditors and multilateral institutions. (A) Brazil continues to be confident that each of the sources of enhancements will contribute to Brazil's collateral requirements and that, unless waived, the amount of Initial Collateral available on the Exchange Date will be not less than U.S. dollars 3.2 billion. (B)

As stated in Brazil's communication accompanying the Financing Plan, the cost of collateral is of utmost importance to the Brazilian economic authorities, the

Federal Senate and Brazilian society as a whole. The amount of up-front debt-stock reduction achieved by the 1992 Financing Plan is also important for Brazil. Both the amount of debt-stock reduction and the cost of collateral are dependent upon the distribution of creditors' selections among the available options. It is for this reason that Brazil places so much emphasis on achieving a reasonable balance among the options--both in terms of the balance between the defeased and nondefeased options and the balance between the two defeased options.

Creditors are reminded of the provision in the 1992 Financing Plan that permits each Lender committing Old Debt for Par Bonds under Option A to reallocate all or a portion of such Old Debt, to one or more alternative Principal Options (which shall become such Lender's selections for such Old Debt) within two weeks after the date hereof.

Brazil remains confident that, continuing the spirit of dialogue that has characterized the negotiations from their inception, Brazil and its creditors can implement the 1992 Financing Plan for the mutual benefit of all concerned.

Eliseu Resende
Minister of Finance

STB
FvB
JFL
IO
F

Office Memorandum

To: Mr. Beza

March 22, 1993

From: Jan F. van Houten J.v.H.

Subject: Brazil--Message to Bank Advisory Committee

We agree with the mission's deletion and corrections. In addition, we propose:

(i) Dropping the first subclause on page 3 (corrected version) which reads: "As indicated... worldwide,". This is not entirely true.

(ii) Dropping the parenthesis referring to the size of the current stand-by in the first paragraph on page 3 (corrected version) as it could be interpreted as indicating the amount of support for a new economic program.

(iii) Logically, the first paragraph on page 3 (corrected version, as amended by (i) and (ii)), would be better after the second paragraph on page 3, but before insert B.

cc: The Deputy Managing Director
Mr. Cisse

Office Memorandum

STB
FvB
JFL
IO
F

To: Mr. Beza March 22, 1993

From: Hassane Cissé H.C.

Subject: Brazil -- Message of Minister of Finance to Bank Advisory Committee on Financing Package

I have reviewed the above-mentioned draft message circulated under cover of your note of March 22, 1993 and have the following comments:

1. On page 3', the phrase "an economic program that could be supported by the Fund" in the revised version of the first sentence, should instead read: "an economic program that could be supported by an arrangement from the Fund".

2. I agree with the other drafting suggestions made by Mr. Fajgenbaum.

cc: Mr. van Houten

F

Office Memorandum

To: The Deputy Managing Director
Mr. van Houten
Mr. Cisse

March 22, 1993

From: S. T. Beza

Subject: Brazil--Message of Minister of Finance to Bank Advisory Committee on Financing Package

Mr. Fajgenbaum has sent to me from Brasilia the attached draft message that the Brazilian authorities wish to send the Bank Advisory Committee on the financing package.

Mr. Fajgenbaum has sent two versions of pages 2 and 3 of the message, the first showing the Brazilian version and the second showing the way Mr. Fajgenbaum has suggested that the text be revised.

Please let me have your reactions as quickly as possible because the Brazilian authorities wish to send the message today (Brazil is two hours ahead of Washington time).

Attachment

cc: The Managing Director
Ms. Saunders

(1)

DRAFT
March 19, 1993

TELEX

TO: The International Financial Community

FROM: Republica Federativa do Brasil

RE: Republica Federativa do Brasil
1992 Financing Plan

The Federative Republic of Brazil ("Brazil") is pleased to announce that by the close of business on March 15, 1993, more than ninety-five percent (95%) of the MYDFA Banks had responded favorably to the 1992 Financing Plan substantially in the form of Commitment Telex set forth in Annex B thereto, thereby achieving the Critical Mass Commitment Date by the suggested date. (All capitalized terms herein are used as defined in the 1992 Financing Plan of Brazil.)

The distribution of committed Eligible Debt among the six available options currently stands as follows:

Par Bonds:

Option A: _____ Percent

Option B: _____ Percent

Discount Bonds:

Option A: _____ Percent

Option B: _____ Percent

2'

FLIRBs:	_____	Percent
Capitalization Bonds	_____	Percent
Restructuring Option	_____	Percent
New Money Option	_____	Percent

As stated in Brazil's communication accompanying the 1992 Financing Plan, Brazil expects that collateral will come from several specified sources: new money from the banks, Brazil's international reserves, and amounts available to Brazil for debt- and debt-service reduction transactions from the International Monetary Fund, the World Bank and the Interamerican Development Bank. ~~Based on the best information available to Brazil at this time, the situation with respect to the collateral is as follows~~.

B

In accordance with the commitments received as of March 15, 1993, the banks have elected to provide at least U.S. dollars 230 million in new money disbursements.

→ move to p 3'

A

Representatives of each of the three multilateral institutions have recently participated in information meetings with Brazil's creditors worldwide [and provided creditors an indication of their institutions' support for the 1992 Financing Plan.] ~~willingness to discharge their responsibilities in the debt- and debt-service reduction strategy as it applies to Brazil~~.

3

An International Monetary Fund mission was in Brazil from March 1 through March 22, 1993 preparing a report on Brazil's economic performance and continuing conversations with Brazil concerning the reinvigoration of the current SDR 1.5 billion (approximately U.S. dollars 2.0 billion) standby arrangement. As approved by the Fund's Board of Executive Directors, that standby arrangement contemplates the set-aside of up to twenty-five percent (25%) of the amount available thereunder for debt- and debt-service reduction. Brazil expects that, in addition to the Fund, the World Bank and the Interamerican Development Bank will support debt- and debt-service reduction for Brazil to the extent permitted by the existing guidelines established by their respective Executive Boards.

Brazil has always envisioned the 1992 Financing Plan as part of a cooperative effort among itself, its creditors and multilateral institutions. Brazil continues to be confident that each of the sources of enhancements will contribute to Brazil's collateral requirements and that, unless waived, the amount of Initial Collateral available on the Exchange Date will be not less than U.S. dollars 3.2 billion.

As stated in Brazil's communication accompanying the Financing Plan, the cost of collateral is of utmost importance to the Brazilian economic authorities, the

As indicated in the information meetings with Brazil's creditors worldwide, ~~A~~an International Monetary Fund mission was in Brazil from March ~~1~~ 8 through March 22, 1993 preparing a report on Brazil's economic performance and continuing conversations with Brazil ~~concerning the reinvigoration of the current SDR 1.5 billion (approximately U.S. dollars 2.0 billion) standby arrangement.~~ on an economic program that could be supported by the Fund. As approved by the Fund's Board of Executive Directors, ~~this~~ the current standby arrangement contemplates the set-aside of up to twenty-five percent (25%) of the amount available thereunder (SDR 1.5 billion or approximately US$ 2 billion) for debt- and debt-service reduction. ~~Brazil expects that, in addition to the Fund, the World Bank and the Interamerican Development Bank will support debt- and debt-service reduction for Brazil to the extent permitted by the existing guidelines established by their respective Executive Boards.~~

Brazil has always envisioned the 1992 Financing Plan as part of a cooperative effort among itself, its creditors and multilateral institutions. A Brazil continues to be confident that each of the sources of enhancements will contribute to Brazil's collateral requirements and that, unless waived, the amount of Initial Collateral available on the Exchange Date will be not less than U.S. dollars 3.2 billion.

B

As stated in Brazil's communication accompanying the Financing Plan, the cost of collateral is of utmost importance to the Brazilian economic authorities, the

Federal Senate and Brazilian society as a whole. The amount of up-front debt-stock reduction achieved by the 1992 Financing Plan is also important for Brazil. Both the amount of debt-stock reduction and the cost of collateral are dependent upon the distribution of creditors' selections among the available options. It is for this reason that Brazil places so much emphasis on achieving a reasonable balance among the options--both in terms of the balance between the defeased and nondefeased options and the balance between the two defeased options.

Creditors are reminded of the provision in the 1992 Financing Plan that permits each Lender committing Old Debt for Par Bonds under Option A to reallocate all or a portion of such Old Debt, to one or more alternative Principal Options (which shall become such Lender's selections for such Old Debt) within two weeks after the date hereof.

Brazil remains confident that, continuing the spirit of dialogue that has characterized the negotiations from their inception, Brazil and its creditors can implement the 1992 Financing Plan for the mutual benefit of all concerned.

Eliseu Resende
Minister of Finance

STB
FUB
JF
IO
P

Office Memorandum

March 12, 1993

MEMORANDUM FOR FILES

Subject: Brazil--Visit of Minister of Social Security

On March 10, Mrs. Ter-Minassian hosted a lunch in honor of Minister Antônio Britto and Secretary Luiz Capella, attended by Messrs. Beza, Kafka and Parente, and myself. During lunch, Mr. Britto gave an overview of the administrative improvements under way and outlined the major elements of the overhaul of the social security system envisaged in the context of the constitutional reform, to take place around October 1993. In several instances, the Minister stressed his agreement with the FAD technical assistance report and noted the consistency of his position with our recommendations. He expressed strong interest in continued assistance from the Fund; but agreed that every effort should be made to avoid duplication with assistance from the IBRD, IDB, and ILO, which are involved mainly in the conduct of seminars on social security in Brazil.

Following lunch, Minister Britto and Mr. Capella and I met for further discussions on the above issues and to explore areas in which the Fund would be requested to provide follow-up assistance. The meeting was attended also by Mr. Barbosa, Assistant to the Executive Director at the IBRD, and Mr. Coimbra from the Brazilian Embassy. Among the administrative innovations being adopted, the Minister elaborated on: the unification of existing social security identification numbers under the existing PIS-PASEP number; collection of contributions and payment of benefits by Banco do Brasil and its branches on behalf of INSS, with on line connection to DATAPREV; change of management at DATAPREV, placed under a newly appointed general director, acting as an "interventor;" close cooperation between INSS and DATAPREV, including a new management contract that links financial transfers to performance; cancellation and suspension of thousands of fraudulent benefits, notably disability benefits. These and other measures have led to a sizable cut (about one third) in administrative expenses and an increase in efficiency.

Minister Britto highlighted the intended changes in the structure of contributions and benefits, predicated on a clear-cut functional separation among social insurance, social assistance and health care, along the lines suggested in the report. As regards the pension system, the Minister discarded the Chilean approach and stressed that the reform measures should include: phaseout of length-of-service pensions; increase in retirement age for women to that of men (65 years); imposition of contribution liability on agricultural sector and soccer clubs; and abolition of special regimes. A novel approach under consideration is the gradual introduction of a rule of 95 (i.e., sum of age and years of service), as a way of eliminating special and length-of-service benefits in a politically acceptable manner. A major question involves the determination of an appropriate ceiling on the contribution base, as a multiple of the minimum wage, and the possible redefinition of the minimum wage itself.

I questioned the rationale for setting such a ceiling in the event of a reduction in the contribution rate, as a reduced rate would still permit supplementary voluntary contributions to employer-based private pension funds. The Minister acknowledged that the ceiling would be raised and eventually lifted as cost-cutting measures permit significant payroll tax rate reductions. The authorities intend to cut the payroll tax rate to a level that is sufficient for financing a sustainable PAYG system.

Against this background, Minister Britto identified at least two areas of possible Fund assistance, building on the analysis in last year's report. First, technical assistance in sorting out the appropriate form and estimating the required level of financing for each of the three major types of social security programs (pensions, assistance, health). Second, technical assistance in determining ceilings on the contribution base and on pension benefits, consistent with the above reform measures (phase-in of the rule of 95, elimination of length-of-service benefits, reduction of contribution rates to moderate levels, etc.), within a financially sustainable scheme and allowing explicitly for transition costs. These and additional areas of interest would be discussed internally at the Ministry and a request would be transmitted in the next few weeks for a mission to take place sometime after April. In the meantime, the necessary statistical information will be sent to us to develop and apply a suitable quantitative approach. I would be in contact with Mr. Capella for this purpose. Also, Mr. Barbosa offered to help coordinate assistance with the Bank.

GK.

George Kopits

cc: Mr. Beza
Mr. Tait (o/r)
Mrs. Ter-Minassian
Mr. Fajgenbaum (o/r)
Mr. Hagemann
TAMU

3/10

Brazil

INTERNATIONAL MONETARY FUND STB FUB JFC F

March 8, 1993

Mr. Beza:

As background for the March 10 lunch, attached are the biographical notes on Minister Britto and Mr. Capella and the schedule for their Washington visit.

GK.

Attachments

George Kopits

ANTÔNIO BRITTO FILHO

Antônio Britto Filho, tem 40 anos e é natural de Sant'Ana do Livramento, fronteira com o Uruguai. Formou-se em jornalismo pela Universidade Federal do Rio Grande do Sul (UFRGS) em 1975 e foi professor da disciplina de rádio na Universidade do Vale dos Sinos (UNISINOS). Em Porto Alegre, chefiou o jornalismo das duas mais importantes rádios do Estado, a Gaúcha e a Guaíba. Foi ainda chefe do jornalismo da RBS/TV-Porto Alegre até transferir-se para a Capital Federal. Em Brasília, atuou como repórter de TV, passando depois a chefiar a sucursal da Rede Globo, até ser convidado, em 1985, pelo ex-Presidente Tancredo Neves para assumir a Secretaria de Imprensa do primeiro governo da Nova República. Demitiu-se no dia da posse do Presidente José Sarney.

Em 1986, com apenas 34 anos, Britto se elegeu com 305 mil votos para a Câmara Federal. Foi reeleito em 1990. Desde o seu primeiro mandato, a atuação de Antônio Britto tem sido marcada por projetos na área social. Em 1989, conseguiu a aprovação da Lei de sua autoria que reformulou o FGTS, estabelecendo uma série de medidas importantes, como a correção adequada dos saldos, obrigatoriedade de fornecimento de extratos mensais aos trabalhadores, criação do Conselho Curador, entre outros. Foi, por dois anos consecutivos, presidente da Comissão de Ciência e Tecnologia, Comunicacão e Informática da Câmara dos Deputados (1990-1991).

Em 1991, Britto foi o relator da Lei de Custeio da Previdência Social (nº 8.212) que determinou várias modificações e benefícios a aposentados e trabalhadores urbanos e rurais. A Lei foi sancionada em 27.07.91, pelo então Presidente Collor. Em fevereiro de 1992, foi escolhido relator da Comissão Especial de Reforma da Previdência Social do Congresso Nacional. O relatório, elogiado por todos os setores do Legislativo, foi encaminhado à Presidência da República. Todos esses trabalhos, fizeram de Antônio Britto, um dos maiores especialistas na matéria dentro do Congresso NAcional.

- * * -

THE INTERNATIONAL MONETARY FUND ARCHIVES

RECORD CLOSURE NOTICE

The item identified below has been closed in accordance with the International Monetary Fund's IMF's Open Archives Policy (Decision No. 14498 – (09/126), adopted 2009-12-17 and effective 2010-03-17, as amended. This policy can be found on the International Monetary Fund website.

This record ☒ or file ☐ has been closed as it belongs to one of the following exemptions:

☐ **Legal records and other material that are protected by attorney client privilege**

☒ **Personnel files, medical information, or other records containing personal information**

☐ **Records and proceedings of the Grievance Committee**

☐ **Records acquired by the Fund by Third Parties, including Member Countries, with security classifications of 'CONFIDENTIAL' or above.** **(Declassification can be requested)**

☐ **Other sensitive nature:** N/A

Archival Ref No.:	588175
File Title & Dates:	Brazil January-December, 1993
Fonds:	Western Hemisphere Department Records, 1946-2003
Sous-fonds	Western Hemisphere Department Immediate Office Records, 1949-2000
Series:	WHDAI Country Files, 1971-1995
Box Number:	A588018-192
File Number:	5
Date Reviewed:	2024-04-25

DETAILS OF WITHDRAWN MATERIAL

DATE	1993
TYPE	Curriculum Vitae
TO	N/A
FROM	Luis Carlos De Almeida Capella
SUBJECT/TITLE	Personal
NO. OF PAGES	1
AUTHORITY	N/A
LANGUAGE	Portuguese

MINISTÉRIO DA PREVIDÊNCIA SOCIAL

SECRETARIA DE PREVIDÊNCIA SOCIAL

COORDENAÇÃO-GERAL DE ASSUNTOS INTERNACIONAIS

PERÍODO: 09/03 A 11/03/93
LOCAL: Washington - D.C.- E.U.A.

A G E N D A

Terça-Feira, 9 de março de 1993:

08:30 hs - Embarque no vôo UA 182, que parte de San Diego com destino a Washington, com chegada prevista para as 16:00 hs no Aeroporto Internacional (IAD - Dulles);

17:00 hs - Translado Aeroporto-Hotel Embassy Row
End.: 2015, Massachusetts Avenue N.W.
Telefone: (202) 265-1600
Fax: (202) 328-7526
Códigos de reserva: Min. Antonio Britto: 465666
Dr. Luis Capella: 465782

19:30 hs - Jantar com o Dr. Paulo Renato, Gerente de Operações para o Brasil do Banco Interamericano de Desenvolvimento (BID)

Quarta-Feira, 10 de março de 1993:

09:15 hs - Audiência com o Doutor Shahid Hussein, Vice-Presidente do Banco Mundial para a América Latina e o Caribe.
Local: Sala I-8000, Edifício "I" do Banco Mundial.
End.: 1850, Eye Street N.W.
Telefone para contato: (202) 458-0096/458-0085 (Escritório do Doutor Pedro Mallan)
Fax: (202) 477-2966

09:45 hs - Audiência com o Doutor Rainer Steckhan, Diretor do Departamento para o Brasil do Banco Mundial.
Local: Sala I-7015, Edifício "I" do Banco Mundial.
End.: 1850, Eye Street N.W.
Telefone para contato: (202) 458-0096/458-0085 (Escritório do Doutor Pedro Mallan)
Fax: (202) 477-2966

Quarta-Feira, 10 de março de 1993 (continuação):

10:30 hs - Audiência com o Doutor Pedro Mallan, Diretor Executivo para o Brasil do Banco Mundial.
Local: Sala D-1346, Edifício "D" do Banco Mundial.
End.: 1818, H Street N.W.
Telefone para contato: (202) 458-0096/458-0085
Fax: (202) 477-2966

12:30 hs - Almoço oferecido pelo Doutor George Kopits, Chefe da Divisão de Operações Fiscais-II do FMI.
Local: Edifício-Sede do FMI
End.: 700, 19th. Street N.W.
Telefone para contato: (202) 623-8836
Fax: (202) 623 7348

15:00 hs - Reunião de Trabalho no FMI
Local: Edifício-Sede do FMI
End.: 700, 19th. Street N.W.
Telefone para contato: (202) 623-8836
Fax: (202) 623 7348

20:00 hs - Jantar oferecido pelo Embaixador Rubens Ricúpero em homenagem ao Ministro Antonio Britto.
Local: Residência do Embaixador do Brasil
End.: 3000, Massachusetts Av. N.W.
Tel.: (202) 745-2840

Quinta-Feira, 11 de março de 1993:

09:00 hs - Coletiva de Imprensa
Local: Embaixada do Brasil
End.: 3006, Massachusetts Av. N.W.
Tel.: (202) 745 2700/2740/2749/2753
Fax: (202) 745 2827

10:30 hs - Audiência com o Doutor Henrique Iglesias, Presidente do BID
Local: Edifício-Sede do BID
End.: 1300, New York Av. N.W.
Telefone para contato: (202) 623-1002
Fax: (202) 623 3616

11:00 hs - Reunião de trabalho no Gabinete do Diretor Executivo para o Brasil no BID, Doutor Paulo Cesar Ximenes.
Tema: Seminário sobre a reforma do sistema previdenciário - a experiência latino-americana.
Local: Edifício-Sede do BID
End.: 1300, New York Av. N.W.
Telefone para contato: (202) 623-1002
Fax: (202) 623 3616

Quinta-Feira, 11 de março de 1993 (continuação):

12:00 hs - Reunião de trabalho com o Doutor Paulo Renato de Souza, Gerente de Operações do BID.
Tema: Gerenciamento do sistema previdenciário.
Local: Edifício-Sede do BID
End.: 1300, New York Av. N.W.
Telefone para contato: (202) 623-1460
Fax: (202) 623 1291

13:00 hs - Almoço oferecido pelo Doutor Paulo Cesar Ximenes, Diretor Executivo para o Brasil no BID
Local: Edifício-=Sede do BID
End.: 1300, New York Av. N.W.
Telefone para contato: (202) 623-1002
Fax: (202) 623 3616

17:10 hs - Embarque no Aeroporto Doméstico (DCA) , no vôo TW 700, com destino à Nova York-JFK, com chegada prevista para as 18:26 hs.

20:00 hs - Conexão no vôo RG 861, que parte de Nova York-JFK com destino ao Rio de Janeiro, com chegada prevista para as 07:20 hs do dia 12/03/93.

Sexta-Feira, 12 de março de 1993:

07:20 hs - Chegada no Rio de Janeiro no vôo RG 861, procedente de Nova York-JFK.

09:15 hs - Conexão no vôo RG 204, com destino à Brasília, com chegada prevista para as 11:00 hs.

03/12/93 10:15 ☎ 2241162 DEORI/GABIN 02

STB
FVB
JF
IO
F

BANCO CENTRAL DO BRASIL

RECEIVED
IMF FAX CENTER

03271U

1993 MAR 12 AM 8:36

FROM: BANCO CENTRAL DO BRASIL - BRASILIA
TO: INTERFUND - WASHINGTON

ORIG: SEC(MRS.LONG)
CC: MD
DMD
MR. KAFKA
WHD
SEC
MAE
MRS. DJEDDAOUI
MS. R. SAUNDERS

ATTN.: MR. LEO VAN HOUTVEN
SECRETARY

DEORI/GABIN-93/ 079 BRASILIA, MARCH 12 , 1993

I AM PLEASED TO INFORM YOU THAT HIS EXCELLENCY THE PRESIDENT OF THE REPUBLIC HAS DESIGNATED MR. ELISEU RESENDE, MINISTER OF FINANCE, TO ACT AS GOVERNOR FOR BRAZIL IN THE BOARD OF GOVERNORS OF THE INTERNATIONAL MONETARY FUND.

SINCERELY YOURS

Newton Faria

NEWTON NELSON DE FARIA
ACTING HEAD OF THE DEPARTMENT FOR INTERNATIONAL ORGANIZATIONS AND AGREEMENTS (DEORI)

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.
1993 MAR 15 AM 11:42

500003-3

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT
1993 MAR -2 PM 5:24
OFFICE OF THE DEPUTY MANAGING DIRECTOR

STB
FUB
JF
IO
F

To: The Acting Managing Director

March 2, 1993

From: S.T. Beza

Subject: Brazil--Briefing for Mission

Attached is the briefing for the mission that is to conduct the 1993 Article IV consultation and continue discussions on an economic program with Brazil. The mission also will be guided by the Country Strategy Brief for Brazil of November 1992.

There is an obvious question as to how far the discussions on a program can proceed, particularly since the Minister of Finance and President of the Central Bank will be just assuming their positions. Moreover, the fiscal plan under consideration by the authorities who just left office fell far short of what we consider necessary to produce a lasting and meaningful reduction of inflation.

Should the mission find that the new authorities are developing a program that could be supported by the Fund, the mission will make the point that any financial arrangement ought to be of a precautionary nature, given Brazil's relatively strong external position. For the same reason, augmentation would not seem warranted. However, purchases of the set asides might be made if needed to mobilize resources to finance the enhancements for the debt restructuring package with commercial bank creditors. An acceleration of disbursements of set asides would require at least two consecutive quarters of satisfactory performance.

In our discussions with the authorities, including most recently in the second week of February, we had accepted the possibility of an extension and rephasing of the current stand-by arrangement, which expires in August 1993. However, it is obvious that passage of time will render this possibility increasingly inappropriate.

The briefing has been reviewed by the following departments:

FAD - Mr. Tanzi	RES - Mr. Calvo
LEG - Mr. Cissé	STA - Mr. Di Calogero
MAE - Mr. Guitián	TRE - Mr. Gupta
PDR - Mr. van Houten	WHD - Mr. van Beek and myself

The briefing also has been reviewed by the IBRD.

An advance team is already in Brasilia, but the new Minister of Finance may request a delay of Mr. Fajgenbaum's departure (scheduled for March 6).

Attachment

cc: The Managing Director (o/r)
Ms. Saunders

~~John Hicklin~~ Mr Erb.
Did PDR see this note before being sent and did it receive a copy?

I spoke to Mr Fajgenbaum about this. J.H. 3/12.

Contributors:
Jose Fajgenbaum
Saul Lizondo

Summary

1. Mission headed by Mr. J. Fajgenbaum, beginning March 8, 1993 to conduct the 1993 Article IV consultation and continue discussions on a program that could be supported by a stand-by arrangement from the Fund.

2. Recent Developments: Brazil made only one purchase under the 19-month stand-by arrangement approved in early 1992 as fiscal performance criteria were not met and the mid-term review could not be completed. The primary fiscal surplus is estimated by the staff to have been at 1 1/2 percent of GDP in 1992 compared with a program aim of 3 percent of GDP; inflation surged after a brief decline; and real interest rates remained high through most of the year. A larger-than-projected trade surplus and substantial capital inflows raised gross international reserves by US$15 billion to US$23 billion by end-1992.

3. Issues for Discussion: The authorities who have just left office intended to request Fund support for their economic program, preferably in the form of an extension through the end of 1994 and rephasing of the current stand-by arrangement. They had not yet formulated the specifics of the program, but stressed that it would aim at reducing inflation markedly, including through the implementation of "nonconventional" policies. The staff had questions about the adequacy of fiscal policy as outlined by the authorities in recent discussions. The trade liberalization and privatization programs would continue, and a comprehensive fiscal reform would be introduced in the context of the Constitutional revision in late 1993.

The mission will ascertain from the new authorities their plans. For its part, the mission will take the view that a significant and lasting reduction of inflation requires an operational fiscal surplus of around 1 1/2-2 percent of GDP (and therefore a primary surplus of around 6 percent of GDP) in the first year of the program, irrespective of the approach (orthodox or heterodox) adopted to reduce inflation. Fiscal measures beyond those described to the staff recently would seem necessary to achieve such objectives, and these measures would need to be consistent with the envisaged fiscal reform. In the areas of monetary, exchange rate, and incomes policies the mission will be guided by the Country Strategy Brief of November 20, 1992, as these policies depend on the stabilization approach being adopted.

The mission will assess the progress on the debt restructuring agreement with commercial bank (now under consideration of individual banks) and seek the authorities' views on the use of international reserves for enhancements. The rescheduling of maturities falling due to Paris Club creditors in February-August 1993 is unsettled as it was contingent upon the completion of the mid-term review under the stand-by arrangement by end-1992. The mission will urge the authorities to comply with Brazil's debt service obligations if creditors do not agree to make effective the second tranche of the consolidation period.

The mission will encourage the authorities to accept Article VIII status and to remove the few remaining restrictions subject to approval under Article VIII.

F

Office Memorandum

To: The Acting Managing Director March 2, 1993

From: S.T. Beza MB

Subject: Brazil--Briefing for Mission

Attached is the briefing for the mission that is to conduct the 1993 Article IV consultation and continue discussions on an economic program with Brazil. The mission also will be guided by the Country Strategy Brief for Brazil of November 1992.

There is an obvious question as to how far the discussions on a program can proceed, particularly since the Minister of Finance and President of the Central Bank will be just assuming their positions. Moreover, the fiscal plan under consideration by the authorities who just left office fell far short of what we consider necessary to produce a lasting and meaningful reduction of inflation.

Should the mission find that the new authorities are developing a program that could be supported by the Fund, the mission will make the point that any financial arrangement ought to be of a precautionary nature, given Brazil's relatively strong external position. For the same reason, augmentation would not seem warranted. However, purchases of the set asides might be made if needed to mobilize resources to finance the enhancements for the debt restructuring package with commercial bank creditors. An acceleration of disbursements of set asides would require at least two consecutive quarters of satisfactory performance.

In our discussions with the authorities, including most recently in the second week of February, we had accepted the possibility of an extension and rephasing of the current stand-by arrangement, which expires in August 1993. However, it is obvious that passage of time will render this possibility increasingly inappropriate.

The briefing has been reviewed by the following departments:

FAD -	Mr. Tanzi	RES -	Mr. Calvo
LEG -	Mr. Cissé	STA -	Mr. Di Calogero
MAE -	Mr. Guitián	TRE -	Mr. Gupta
PDR -	Mr. van Houten	WHD -	Mr. van Beek and myself

The briefing also has been reviewed by the IBRD.

An advance team is already in Brasilia, but the new Minister of Finance may request a delay of Mr. Fajgenbaum's departure (scheduled for March 6).

Attachment

cc: The Managing Director (o/r)
Ms. Saunders

Contributors:
Jose Fajgenbaum
Saul Lizondo

Summary

1. Mission headed by Mr. J. Fajgenbaum, beginning March 8, 1993 to conduct the 1993 Article IV consultation and continue discussions on a program that could be supported by a stand-by arrangement from the Fund.

2. Recent Developments: Brazil made only one purchase under the 19-month stand-by arrangement approved in early 1992 as fiscal performance criteria were not met and the mid-term review could not be completed. The primary fiscal surplus is estimated by the staff to have been at 1 1/2 percent of GDP in 1992 compared with a program aim of 3 percent of GDP; inflation surged after a brief decline; and real interest rates remained high through most of the year. A larger-than-projected trade surplus and substantial capital inflows raised gross international reserves by US$15 billion to US$23 billion by end-1992.

3. Issues for Discussion: The authorities who have just left office intended to request Fund support for their economic program, preferably in the form of an extension through the end of 1994 and rephasing of the current stand-by arrangement. They had not yet formulated the specifics of the program, but stressed that it would aim at reducing inflation markedly, including through the implementation of "nonconventional" policies. The staff had questions about the adequacy of fiscal policy as outlined by the authorities in recent discussions. The trade liberalization and privatization programs would continue, and a comprehensive fiscal reform would be introduced in the context of the Constitutional revision in late 1993.

The mission will ascertain from the new authorities their plans. For its part, the mission will take the view that a significant and lasting reduction of inflation requires an operational fiscal surplus of around 1 1/2-2 percent of GDP (and therefore a primary surplus of around 6 percent of GDP) in the first year of the program, irrespective of the approach (orthodox or heterodox) adopted to reduce inflation. Fiscal measures beyond those described to the staff recently would seem necessary to achieve such objectives, and these measures would need to be consistent with the envisaged fiscal reform. In the areas of monetary, exchange rate, and incomes policies the mission will be guided by the Country Strategy Brief of November 20, 1992, as these policies depend on the stabilization approach being adopted.

The mission will assess the progress on the debt restructuring agreement with commercial bank (now under consideration of individual banks) and seek the authorities' views on the use of international reserves for enhancements. The rescheduling of maturities falling due to Paris Club creditors in February-August 1993 is unsettled as it was contingent upon the completion of the mid-term review under the stand-by arrangement by end-1992. The mission will urge the authorities to comply with Brazil's debt service obligations if creditors do not agree to make effective the second tranche of the consolidation period.

The mission will encourage the authorities to accept Article VIII status and to remove the few remaining restrictions subject to approval under Article VIII.

INTERNATIONAL MONETARY FUND

Briefing for Mission to Brazil

Prepared by the Western Hemisphere Depa tment

(In consultation with the Fiscal Affairs, Legal, Monetary and Exchange Affairs, Policy Development and Review, Research, Statistics, and Treasurer's Departments)

Approved by S.T. Beza and J.F. van Houten JvH

MA

March 2, 1993

A staff mission comprising Messrs. Fajgenbaum (Head), Lizondo, Traa (all WHD), Garcia (FAD), and Szymczak (PDR), and Ms. Silman (Assistant-ADM) will visit Brasilia for about two to three weeks beginning March 8, 1993 to conduct the 1993 Article IV consultation discussions and to continue discussions on an economic program that could be supported by an arrangement from the Fund. An advance team will start work on March 1. In addition to this brief, the mission will be guided by the Country Strategy Brief for Brazil of November 20, 1992. There is an obvious question as to how far the discussions on a program can proceed, particularly since the Minister of Finance and President of the Central Bank will be just assuming their positions. The last Article IV consultation was completed by the Executive Board on October 4, 1991 (EBM/91/139-140). 1/

On January 29, 1992, the Executive Board approved a 19-month stand-by arrangement for Brazil for SDR 1.5 billion (102.7 percent of the old quota). Upon approval, Brazil made a purchase of SDR 127.5 million and SDR 42.5 million was set aside. Subsequent purchases were not made as the fiscal performance criteria were not met, and the mid-term review was not completed because the authorities could not frame economic policies for the remainder of the year in the prevailing political circumstances. As of January 31, 1993 total Fund credit to Brazil was SDR 581.8 million (26.8 percent of the new quota).

I. Background

The program for 1992-93 aimed at a gradual but sustained reduction of inflation. To this end, credit policy was to remain very tight while the public finances were being strengthened. The primary fiscal surplus was to increase from an estimated 1 percent of GDP in 1991 to 3 percent of GDP in 1992 and to at least 4 percent of GDP in 1993. Exchange rate policy was to maintain the real value of the cruzeiro, following a 13 percent devaluation in late September 1991. The program also envisaged the continued implementation of structural reforms, including the reduction of import duties and the

---

1/ Brazil's relations with the Fund are presented in Attachment I.

the elimination of nontariff barriers to imports, the privatization of public enterprises, and a comprehensive fiscal reform.

In the event, monthly inflation remained very high in 1992. After declining from 27 percent in January to 19 percent in April, inflation rose again to 27 percent in September. A fiscal policy that fell short of the program and adverse expectations associated with the political difficulties that led to the eventual removal of the President were factors in the failure to reduce inflation as planned. The rate of price increase slowed to around 24 percent a month in the last quarter of 1992, mainly because the authorities limited the adjustment of public sector prices, but rose again to around 30 percent in January 1993.

Economic activity slowed in 1992, with real GDP estimated to have declined by 1.4 percent, as a large drop in industrial output more than offset a strong increase in agricultural output. Industrial employment in the Sao Paulo area (the main manufacturing region) is estimated to have fallen by about 9 percent in 1992.

Fiscal policy during 1992 was weaker than programmed, with preliminary staff estimates indicating a primary fiscal surplus of around 1 1/2 percent of GDP, compared with a program target of 3 percent of GDP. 1/ There was a large revenue shortfall resulting from the failure to implement an agreed increase in petroleum import duties and from lower revenue from the states' value added taxes (due to lower domestic activity). Because of legal disputes, a social security tax (FINSOCIAL) and the corporate income tax yielded less than had been projected. Efforts at reducing capital and non-interest current expenditure were not sufficient to offset the revenue shortfall and a large increase in social security benefits ruled by the Supreme Court which started to be paid late in the year. Also, the financial position of the public enterprises is estimated to have been weaker than originally projected, as public prices declined sharply in real terms in the last quarter of the year.

The pursuit of a tight credit policy in the context of a weak fiscal stance caused real interest rates to be higher than projected through most of the year. For 1992 as a whole the real interest rate in the overnight market for government securities was around 30 percent whereas the program had been based on an average real interest rate of about 25 percent. High domestic interest rates attracted substantial capital inflows that were sterilized to a large extent in an effort to limit the increase in base money and maintain the real external value of the currency.

Performance of the external sector in 1992 was strong. The surplus in the trade balance reached US$15.7 billion, up from US$10.6 billion in 1991,

---

1/ Preliminary official estimates that suggest a primary fiscal surplus of 2 1/2 percent of GDP seem to be based on optimistic assumptions for performance during the fourth quarter of 1992.

reflecting a sharp expansion of exports, helped by improved competitiveness and the drive to export resulting from weak domestic markets, and stagnant imports resulting from weak domestic demand. This, together with a large surplus in the capital account, resulted in an increase in gross international reserves to about US$23 billion by end-1992, more than one year of merchandise imports.

An agreement with the Bank Advisory Committee on a comprehensive debt restructuring package was reached in July 1992, and is now under the consideration of individual banks. Following the agreement, Brazil issued bonds for US$7.1 billion in payment of interest arrears accumulated during 1989-90 and raised its current interest payments to banks from 30 percent to 50 percent of interest accruing. The package includes six options, some of which involve debt or debt service reduction. Banks are to submit their initial choice of options by March 15, 1993. As Brazil requires a "balanced" set of choices, banks may be asked to modify their choices. The exchange of debt instruments has been scheduled for end-July 1993. 1/

An agreement with Paris Club creditors was reached in February 1992, covering the January 1992-August 1993 period. Seven bilateral agreements have been signed, and progress is being made in the negotiation of the remaining six. However, the rescheduling of maturities falling due during February-August 1993 (about US$700 million) was made contingent upon the completion of the mid-term review under the stand-by arrangement by December 1992. Because this condition was not met, the authorities have requested Paris Club creditors to postpone to a later date the deadline for the completion of the review under the stand-by arrangement.

Trade liberalization continued faster than scheduled, with import tariff reductions in January and October and the elimination of nontariff restrictions on computer products in October. The privatization program proceeded as planned for most of 1992, but it was interrupted recently to revise the rules. Under the new rules, the President will decide on a case-by-case basis, among other things, the fraction of the price that must be paid in cash and the extent of possible participation by foreign investors. The privatization program is scheduled to resume in March 1993. Price liberalization was completed in early 1992, but recently attempts have been made at constraining the increase in prices of pharmaceutical products.

1/ Depending on the interest rate structure and the final allocation by banks among options, required enhancements range from US$4.5 billion to US$7 billion, of which US$3.2 billion should be made available at the exchange date and the remainder in four semi-annual installments.

II. Issues for Discussion

In recent discussions with the Managing Director and the staff, the authorities who have just left office stated their intention to request Fund support for their economic program, preferably in the form of an extension and rephasing of the current stand-by arrangement through the end of 1994. As they had not yet completed the formulation of the economic program, they could not provide details about specific targets and policies to be implemented, but stressed that the program would aim at reducing inflation markedly and achieving a modest recovery in economic activity. The authorities had said that "nonconventional" means of bringing down inflation quickly could be considered, although they ruled out price and wage freezes, debt confiscations, and "dollarization." However, in a departure from Brazil's traditional policy, the staff perceived that the authorities were considering shifting the role of exchange rate policy from maintaining international competitiveness to using the rate as an anchor for the price level.

The authorities also stated that structural reforms, such as the trade liberalization and the privatization program, 1/ would continue to be implemented and that a comprehensive fiscal reform would be introduced in the context of the constitutional revision scheduled for October 1993. Also, they indicated their intention to reform the financial system for which they wish to receive technical assistance from MAE.

The mission will ascertain from the new authorities their plans. For its part, the mission will take the view that a significant reduction of inflation on a lasting basis would require a fiscal policy that is sustainable and credible and that leads to a noticeable reduction of public debt (particularly domestic debt) in relation to GDP because this would be an important factor in reversing inflationary expectations. As explained in the Country Strategy Brief, such a reduction of debt would call for an operational fiscal surplus of around 1 1/2-2 percent of GDP in the first year of the program, irrespective of the approach (orthodox or heterodox) adopted to reduce inflation. Such debt reduction would seem to require a primary fiscal surplus of around 6 percent of GDP for the year, compared with the estimated surplus of 1 1/2 percent of GDP in 1992. 2/ In addition to the fiscal measures described to the staff recently (see below), the mission will discuss with the authorities the possibility of implementing further measures to achieve such objectives. These measures should be

---

1/ Recently tariffs on certain basic goods (mainly food items and medicines) were lowered to induce a reduction in the cost of living.

2/ As indicated in the cover memorandum to the Country Strategy Brief, a phased approach, involving a weaker fiscal stance in the first year, is not likely to succeed in reducing inflation meaningfully. However, a somewhat smaller primary surplus than 6 percent of GDP may be consistent with the above-mentioned operational surplus if it were possible to reduce real interest rates on government securities through improved debt management.

consistent with the fiscal reform proposed by an FAD technical assistance mission, as well as other measures listed in Attachment III. 1/ 2/

Revenue measures already adopted or being discussed by Congress are estimated officially to yield about 4 percentage points of GDP in 1993. They include: (1) a modification of the corporate income tax regime estimated to yield US$5.4 billion (1.3 percent of GDP). Because nearly half of this yield is to be transferred to state and municipal governments and therefore spent, the authorities intend to reduce nonmandatory transfers to these governments by the same amount; (2) a tax on bank debits, now before Congress, 3/ estimated to yield around US$5 billion in 1993 (1.2 percent of GDP), 38 percent of which is earmarked for spending on housing and education. The estimated yield of this tax may be overstated in view of the experience with this type of tax in other countries and the various exemptions now being considered; (3) an increase in petroleum import duties and the introduction of social security taxes in the agricultural sector are expected to yield 0.1 percent of GDP each; (4) the recent presidential decree repealing Law 8200, which granted tax credits roughly equivalent to 1 percent of GDP a year to corporations for overpayment of taxes in 1990 (however, Congress may overrule the decree); and (5) efforts at improving tax administration expected to raise collections by about 0.7 percent of GDP. 4/ The mission will assess the likely increase in revenue resulting from these measures, as well as the progress in implementing the recommendations of FAD technical assistance in the area of tax administration.

The authorities noted that they had little room to compress expenditure from the already reduced levels of 1992. Moreover, they had to face increases in the wage bill of the Federal Government and in social security benefits. Preliminary estimates suggest that the equalization of wage scales among different government sectors may increase the Government's wage bill by about 1.3 percentage points of GDP in 1993. The authorities intend to link public sector wages to tax receipts, and thus contain this increase to just under 1 percent; the mission will discuss with the authorities the mechanism for implementing this policy.

The financial position of the social security system is expected to deteriorate by about 0.4 percentage point of GDP in 1993 as a result of a recent intensification of indexation of the minimum wage, to which most

---

1/ This list was presented as Appendix I of the Country Strategy Brief.

2/ Consistent with the recommendations made by a recent FAD technical assistance mission, the mission will refrain from suggesting increases in social security contribution rates and instead emphasize the need to introduce administrative and adjustment measures on the benefits side, enforce existing contributions, and expand their coverage.

3/ This tax is proposed as a temporary measure until a comprehensive fiscal reform is in place.

4/ FAD staff who assisted the authorities in this effort during 1992 consider this estimate highly optimistic.

social security benefits are tied, and the effect of the retroactive payment of the increase in benefits that was referred to above.

In addition, the mission will examine the fiscal impact of a number of proposals that have emerged recently. They include the provision of tax incentives to selected sectors of the economy (agriculture, automobiles, construction) and the reimbursement of involuntary loans to the Government ("emprestimos compulsorios") dating from 1986. The latter have been reported to amount to US$900 million (0.2 percent of GDP).

In an attempt to improve control over the finances of state and municipal governments, Congress is considering a constitutional amendment that would prevent these governments from issuing new bonded debt. In addition, the authorities plan to refinance the state and municipal government existing bonded debts and debts to the federal financial institutions; in principle no subsidy from the Federal Government is involved in this refinancing. The mission also will discuss with the authorities other possible instruments to improve control over the lower levels of government.

The authorities indicated their intention to raise public sector prices in real terms to the levels of September 1992 (an increase of around 14 percent) by mid-year. In particular, they plan to raise telecommunication tariffs by 40 percent in real terms and to allow differentiated electricity rates, according to costs. The mission will explore with the authorities means to ensure that enterprises do not spend the increased revenue.

In the areas of monetary, exchange rate, and incomes policies the mission will be guided by the Country Strategy Brief, as these policies would depend on the stabilization approach adopted by the authorities. With respect to monetary policy in particular, the mission will emphasize that fiscal policy needs to be supported with tight credit to turn inflationary pressures and expectations around, and that real interest rates are likely to be high for some time under any ambitious inflation reduction program. In this context, the mission will urge the authorities to avoid giving the market confusing signals on interest rates, as has occurred in recent months.

The authorities noted their intention to prepare a comprehensive proposal for fiscal reform to be discussed in the context of the revision of the Constitution scheduled for October 1993. The mission will enquire about the objectives and likely content of this proposal, and will attempt to quantify its impact on the public finances. The mission also will discuss with the authorities their plans for the reform of the social security system, and ascertain the authorities' plans regarding further technical assistance from FAD in both areas.

The mission will review the authorities' objectives for the planned financial system reform, and enquire about the type of changes being envisaged, the timing for implementation, and the likely effects of those changes on the public finances. It will emphasize that this reform also should establish an appropriate framework for the conduct of monetary policy. The mission will ascertain the timing of the possible technical assistance from MAE, stressing that if such assistance is to be effective it should take place in the early stages of the design of the reform.

The mission will examine the implications of the new rules governing the privatization of public enterprises, and stress the need for clear signals about the Government's commitment to streamline the public sector. Similarly, the mission will encourage the authorities to continue implementing the trade liberalization program, and will note the advantages of reducing tariff protection further, including in the context of MERCOSUL.

The mission will assess the progress made on the debt restructuring agreement with commercial bank creditors, and seek the authorities' views on the use of Brazil's international reserves for enhancements if an agreement with the Fund can not be reached by the time of the debt exchange. Also, the mission will ascertain the authorities' position regarding the restructuring of debts to Paris Club creditors falling due during February-August 1993. In this context, the mission will encourage the authorities to expedite the negotiation of the remaining six bilateral agreements, and urge them to comply with Brazil's debt service obligations if creditors do not agree to make effective the second tranche of the consolidation period.

Should the mission find that the new authorities are developing an economic program that could be supported by the Fund, the mission will make the point that any financial arrangement (a new one or the current one appropriately extended and rephased) should be of a precautionary nature given Brazil's relatively strong balance of payments and high reserves. For the same reasons, augmentation of access would not seem warranted. However, purchases of the set aside portions could be made if needed to mobilize resources from other international financial institutions to help finance Brazil's debt agreement with commercial bank creditors. 1/ Acceleration of the disbursement of set asides would require at least two consecutive quarters of satisfactory performance under the program. If Fund support were to take the form of a new stand-by arrangement, access on an annual basis in SDR terms would be the same as that under the current arrangement. The mission will stress that fiscal measures requiring legislative action and other key policy measures, depending on the stabilization approach being adopted, would need to be in place before Executive Board consideration of the program.

1/ Given Brazil's excellent record in servicing its debt to the Fund, its high international reserves, its external medium-term outlook (described in the Country Strategy Brief) and the relatively low Fund exposure to Brazil, there is no question that Brazil's use of Fund resources is consistent with the need to safeguard the revolving character of these resources.

The mission will encourage the authorities to accept Article VIII status, as Brazil does not maintain restrictions under Article XIV, and will recommend the elimination of the few remaining restrictions subject to approval under Article VIII (described in EBS/91/205, Sup. 1). 1/ The mission will discuss with the authorities statistical issues and currentness, as presented in Attachment IV, and ascertain whether data in the fiscal accounts, balance of payments, and external debt on military transactions are comprehensive and transparent. The mission will propose that the next Article IV consultation be held on the standard 12-month cycle.

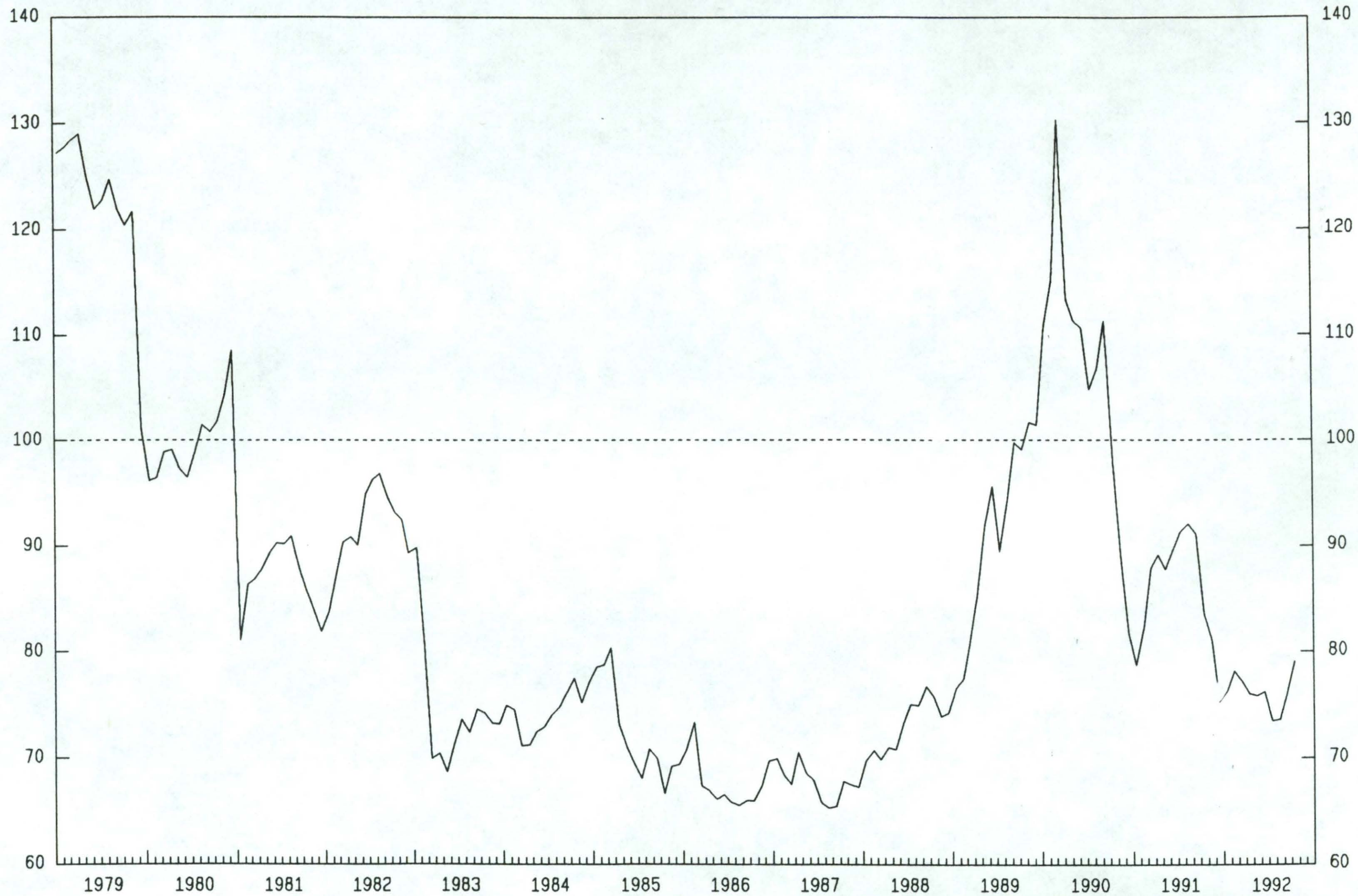
cc: AFR
CTA
EURI
EURII
FAD
INS
LEG
MAE
MED
PDR
RES
SEA
SEC
STA
TRE
WHD
IBRD

1/ The report on Recent Economic Developments is expected to have a summarized section on recent developments and a number of appendices on specific issues, including poverty and social safety net.

BRAZIL

Real Effective Exchange Rate

1980=100



Source: International Monetary Fund, Information Notice System

Brazil: Fund Relations
(As of January 31, 1993)

I. Membership Status: Joined 12/27/45; Article XIV

II. General Resources Account:	SDR Million	% Quota
Quota	2,170.80	100.0
Fund holdings of currency	2,752.61	126.8

III. SDR Department:	SDR Million	% Allocation
Net cumulative allocation	358.67	100.0
Holdings	15.03	4.2

IV. Outstanding Purchases and Loans:	SDR Million	% Quota
Stand-by arrangements	264.49	12.2
Extended arrangements	316.91	14.6

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	1/29/92	8/31/93	1,500.00	127.50
Stand-by	8/23/88	2/28/90	1,096.00	365.30
Extended	3/01/83	2/28/86	4,239.38	2,743.13

VI. Projected Obligations to Fund (SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue 1/31/93	Forthcoming 1993	1994	1995	1996	1997
Principal		360.4	93.5	32.3	48.2	23.7
Charges/interest		48.6	30.9	26.3	23.4	20.8
Total		409.0	124.4	58.6	71.6	44.5

Nonfinancial Relations

VII. Exchange Rate Arrangement

For most of the period since 1968, Brazil followed a flexible exchange rate policy under which the exchange rate for the cruzeiro was adjusted at relatively short intervals in terms of its intervention currency, the U.S. dollar. In mid-March 1990, Brazil introduced a floating rate system, in which the Central Bank has intervened to attain its targets for international reserves. Beginning in May 1991 central bank intervention has aimed at maintaining external competitiveness. Brazil no longer maintains restrictions under the transitional regime of Article XIV, Section 2, but maintains a number of exchange measures subject to approval under Article VIII, Sections 2 and 3.

VIII. Last Article IV Consultation

The last Article IV consultation with Brazil was concluded by the Executive Board on October 4, 1992 (EBM/91/139 and EBM/91/140). Brazil is on the standard 12-month cycle.

IX. Technical Assistance

The Fiscal Affairs Department has recently provided technical assistance to Brazil in the areas of tax policy, tax administration and the social security system. This includes a mission in September 1990 to assess the data processing system plan for the Federal Revenue Department (DpRF), and missions in December 1991 and March 1992, with follow-up missions in June and September 1992, to review tax administration procedures (including the activities of the DpRF and the Government Attorney's Office for National Finance (PGFN)) and to assist the authorities in designing a taxpayer control system. Missions in February and May 1992 presented proposals for a comprehensive tax reform, and a mission in June 1992 prepared proposals to reform the financial position of the social security system.

Brazil: Selected Economic Indicators

	1989	1990	Prel. 1991	Est. 1992
		(percent change)		
National accounts				
Real gross domestic product	3.3	-4.0	1.2	-1.4
Real domestic demand	3.5	-2.6	1.5	-3.5
		(percent of GDP)		
Gross national savings 1/	17.0	15.7	15.6	16.5
Gross domestic investment 1/	16.7	16.0	15.9	15.7
Prices		(percent change)		
Consumer prices (annual averages)	1,320.1	2,740.0	414.7	991.4
Balance of payments		(billions of US$)		
Merchandise exports	34.4	31.4	31.6	36.2
Merchandise imports	18.3	20.4	21.0	20.5
Investment income (net) 2/	-12.6	-11.6	-9.7	-9.5
Current account balance	1.0	-3.8	-1.4	3.0
Overall balance	-3.3	-8.8	-4.7	20.2
Net foreign reserves (end of period)	3.6	9.0	4.7	-20.2
External payments arrears (end of year)	4.0	13.9	19.6	12.9
		(percent of merchandise exports)		
Current account balance	2.9	-12.1	-4.4	8.3
		(percent change)		
Terms of trade (decrease -)	-9.7	-8.0	3.6	0.3
Real effective exchange rate (depreciation -)	24.8	17.3	-19.7	7.8
Total external debt		(percent of merchandise exports)		
Total debt (end of year)	327.5	381.3	387.7	352.3
Debt service ratio 3/	46.1	51.8	50.8	53.1
Interest payments 3/	28.2	29.4	30.4	24.2
Fiscal data		(percent of GDP)		
Public sector noninterest revenue	26.2	31.7	28.7	26.4
Public sector noninterest expenditure	26.7	29.4	26.0	24.9
Public sector net interest expenditure	6.4	0.9	3.6	4.0
Public sector operational balance (deficit -)	-6.9	1.3	-0.9	-2.6
Public sector primary balance (deficit -)	-0.5	2.2	2.7	1.5
Money and credit		(percent)		
Real Interest rate 4/	31.7	25.4	17.0	30.2
		(percent change)		
Money and quasi-money	1,406.8	1,157.4	695.2	1,654.7
Net domestic credit 5/	3,362.5	3,354.2	922.7	2,233.4
Credit to public sector	1,616.1	1,953.1	500.2	1,223.7
Credit to private sector	1,746.3	1,401.1	422.5	1,009.6

1/ In constant prices.
2/ Includes reinvested earnings.
3/ Scheduled payments.
4/ Monthly overnight rate on treasury securities, annual average.
5/ As percent of liabilities to the private sector at beginning of the period.

Brazil--Measures to Strengthen the Public Finances

This note presents a list of possible measures to strengthen the public finances on the assumption that the proposed fiscal reform will not be approved before year-end.

I. Revenue Measures	Budget Impact (In percent of GDP)
1. Impose tax on gross corporate assets	2.0
2. Increase petroleum taxes and tariffs on electricity	1.0
3. Convert IPI into federal value-added tax	0.4 1/
4. Impose or increase excises on cars, beverages, tobacco	0.3 1/
5. Reform individual income tax	0.4 1/
6. Widen coverage of tax on financial operations (IOF)	1.0
7. Raise social security contributions	0.7
8. Continue to strengthen tax and social security administration	0.2 1/
Total	6.0
II. Expenditure measures	
1. Reduce nonwage, noninterest expenditure	0.2
2. Reduce fiscal incentives and tax expenditure	1.0-2.0
3. Reduce credit subsidies (O2C)	0.2
4. Eliminate "phantom" social security benefits	0.2
5. Reduce personnel costs, starting with a hiring freeze	0.1
6. Reduce transfers to universities, the Federal District of Brasilia, and state and municipal governments under "convenios"	0.5
Total	2.2-3.2

III. Other measures

1. Accelerate the privatization program
2. Reduce lending by the Federal Financial institutions to public enterprises, states, and municipalities
3. Raise public sector prices in real terms, if necessary

1/ Impact on the financial position of the Federal Government, i.e., net of tax-sharing requirements.

4. Reform the property tax (to offset the effects of measures II.6 and III.2 on the states and municipalities)
5. Target social welfare expenditures to the poor.

IV. Description of measures

1. Revenue measures

(1) The proposed tax on gross corporate assets is an alternative tax under the corporate income tax (IRPJ), intended to combat evasion of the latter. The revenue estimates given in the table are based on an assumed tax rate of 2 percent. 1/

(2) The increase in petroleum taxation and electricity tariffs entails the imposition of a federal excise tax or an equivalent import duty in the case of petroleum, and an increase in electricity tariffs of around 50 percent in real terms with respect to the levels achieved in December 1991. (In August 1992, prices in real terms for electrical energy were about 8 percent above their level of December 1991.)

(3) The proposal to convert IPI into a federal value added tax assumes a flat tax rate of 6.5 percent. Constitutional scrutiny of this proposal may arise as it would involve taxing some services provided to industrial enterprises. At the present time, the federal government only taxes "industrial products".

(4) The federal excises on cars, beverages, and tobacco are assumed at rates somewhat below the 6.5 percent rate of the VAT replacing the IPI. The excises themselves would enter the base of the proposed VAT (item 3).

(5) The reform of the individual income tax incorporates four components, including elements proposed by the Fiscal Reform Commission, Secretary Wellish, and the Tanzi mission: (a) reducing the exemption level from 2.4 times per capita GDP to 1.6 times; (b) a reduction in deductions (not including family allowances) to one-third of their 1991 levels; (c) institution of a rate structure involving rates of 10, 20, and 30 percent; and (d) taxation of fringe benefits.

(6) The widening of the tax on financial operations proposes to extend the present IOF to cover financial system credit operations. The Fiscal Reform Commission had suggested that the tax on financial operations

---

1/ While Article 153 of the Constitution appears to allow federal imposition of this tax (inasmuch as the Constitution does not reserve its base for the states or municipalities), the authorities told the Tanzi mission that the Constitutional status of this proposal is ambiguous. Also, there is a question about double taxation of real estate. The Fiscal Reform Commission proposed a similar tax earlier this year and stipulated an explicit amendment to Article 153.

be replaced by a tax on financial transactions, but the latter has been criticized because of its distortionary effects and its potential to induce disintermediation.

(7) The proposal to raise social security contributions includes extending the coverage to public employees in the base of the social security payroll tax and increasing contribution rates on existing contributors to finance the arrears on the 147 percent increase in benefits. This would be followed by a reform of the Social Security System.

2. Expenditure measures

(1) The proposal to reduce nonwage, noninterest expenditure is based on a further compression of "other current and investment" expenditure of the Federal Government. The limited impact of the reduction in this expenditure category reflects cutbacks that already have taken place (from 4.5 percent of GDP in 1990 to 2.5 percent of GDP in 1992).

(2) Fiscal incentives and tax expenditure comprise regional and sectoral subsidies, concessions on corporate income and IPI taxes and on import duties. The total value of these incentives in 1992 is estimated at nearly 2 percent of GDP.

(3) Credit budget subsidies comprise agricultural buffer stock arrangements and agricultural and export credit facilities at below market interest rates. Total cost of these programs amounts to some 0.4-0.5 percent of GDP.

(4) Administrative problems with the social security records have given rise to unwarranted payments of benefits. The authorities had estimated that a careful review of the files would reduce the payments of benefits by 5-7 percent. In 1992, social security benefits are estimated at some 4 percent of GDP.

(5) Attrition of personnel is assumed at about 3 percent a year. The federal government wage bill in 1992 is approximately 3.6 percent of GDP.

(6) Transfers to lower levels of government and institutions outside of the scope of constitutionally mandated revenue sharing are often effected through negotiated assistance programs (convenios). They account for about 1 point of GDP and involve transfers to universities; transfers to the Federal District of Brasilia to support fire brigades, the police, personnel costs in the public health area and selected civil services; and mostly project related transfers to states and other municipalities. Convenios have been reduced from a peak of 1.5 percent of GDP in 1988 on account of the graduated increase in constitutionally mandated revenue sharing transfers. The reduction of transfers to the universities could be offset by the introduction of a system of fees.

Brazil--Statistical Issues

1. Outstanding statistical issues

a. Monetary accounts

Consolidated data on money and banking statistics have major problems: the latest complete IFS data for the monetary survey and banking survey relate to 1988 and 1985, respectively. On September 1992, STA received quarterly information for the Deposit Money Banks (DMB) and Other Banking Institutions (OBI) for the period December 1988 through June 1991, and monthly data from July 1991 through May 1992. These data are being evaluated by STA, before the DMB and OBI data can be published in IFS. However, this work cannot be completed without extensive technical discussions with the authorities. A STA technical assistance mission has been under consideration for some time. As a result of recent discussions with the authorities, it has been agreed that a mission should take place in May 1993.

b. Interest rates

Data on interest rates for bank deposits and discount rate are being currently reported. However, data on bank lending and treasury bill rates have not been reported since 1989.

c. Balance of payments

Although the authorities prepare quarterly balance of payments statistics, these are not furnished to STA on a timely basis. The latest data, which were sent to STA in September 1992, relate to the fourth quarter of 1990. It would be useful if the mission could discuss with the authorities possible ways to reduce the delay in sending balance of payments data and ask them to send quarterly data as they are compiled.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Brazil in the March 1993 issue of IFS. The data are based on reports sent to the Fund's Statistics Department by the Central Bank of Brazil which, during the past year, have been provided on an irregular basis.

Status of IFS Data

Sector	Series	Latest Data in March 1993 IFS
Real Sector	- National Accounts	1990
	- Prices: WPI	November 1992
	CPI	November 1992
	- Production	n.a.
	- Employment	n.a.
	- Earnings	
Government finance	- Deficit/surplus	November 1992
	- Financing	1986
	- Debt	1986
Monetary accounts	- Monetary authorities	November 1992
	- Deposit money banks	1987 1/
	- Other banking institutions	1987 2/
Interest rates	- Bank rate	December 1992
	- Bank deposit rate	December 1992
	- Bank lending rate	n.a.
	- Treasury bill rate	December 1989
External Sector	- Merchandise Trade:	
	Values:	
	Exports	November 1992
	Imports	November 1992
	Volumes	1986 3/
	Prices	1987 3/
	- Balance of payments	Q4 1990
	- International reserves	November 1992
	- Exchange rates	January 1993

1/ Last available information, June 1988.
2/ Last available information (partial) March 1988.
3/ Volume and price indices for selected export goods are available through November 1992.

Brazil: Tentative Work Program

1. UFR/Article IV missions and Executive Board meetings 1/

a.	Article IV consultation discussios and discussions on a possible program	March 1993 (3 weeks)
b.	Conclusion of SBA negotiations	Mid-May 1993 (10-days)
c.	Executive Board discussion on Article IV consultation and SBA	Late June 1993
d.	Staff visit to review performance	Late August 1993 (10 days)
e.	First review of SBA and initial discussion on economic program for 1994	Early November 1993 (10 days)
f.	Conclusion of negotiation of economic program for 1994	Mid-December 1993 (10 days)
g.	Executive Board discussion on first review	Late December 1993

2. Technical assistance mission

FAD -- Follow-up assistance on tax reform (1 mission), tax administration (3 missions), and social security reform (1 mission)	To be scheduled 2/
MAE -- Assistance in financial system reform (2 missions)	To be scheduled 2/
STA -- Assistance in National Accounts and Monetary statistics (2 missions)	To be scheduled 2/

3. Training Course in Brasilia

INS -- Financial Programming Course	June 1993

1/ Some of these contacts might be held at headquarters.
2/ Awaiting authorities' specific request.

STB
FvB
JF
IO
F

Office Memorandum

To: Mr. Fajgenbaum February 25, 1993

From: Jan F. van Houten JvH.

Subject: Brazil--Briefing Paper

We have no major difficulties with this brief as it broadly corresponds to the Country Strategy Brief. We agree that any new arrangement should be precautionary. Nonetheless, it should have the same emphasis on prior actions and front loading of measures, as set-asides may well be available from the outset. A short update on the current political situation is desirable in view of the importance of a strong commitment for the successful implementation of an adjustment program.

We would like you to address the following specific concerns.

Fiscal policy

A sustainable and credible fiscal policy is clearly essential to support a meaningful reduction in inflation in Brazil. The brief should therefore emphasize the importance of the quality of the fiscal adjustment, avoiding stop-gap measures which would lack the credibility critical to bringing down inflation. While the 1993 fiscal targets in this brief are in line with the targets noted in the Country Strategy Brief, it is not clear that the measures discussed are sufficient to achieve them. Although the revenue measures are officially estimated to yield most of the required improvement in the primary balance, the brief appears to doubt this estimate for a variety of reasons. The brief is also reticent about the staff's views regarding the supposedly limited possibilities for expenditure reduction. The mission should investigate the possibilities for implementing the measures listed in Attachment III and, if these are limited, should seek specific proposals from the authorities for achieving an acceptable fiscal adjustment. The mission should also assess the progress made in implementing the recommendations of the FAD technical assistance team on the reform of the social security system.

Monetary and exchange rate policy

We are puzzled by the characterization of monetary policy. The first paragraph of page 4 seems to imply that capital inflows were successfully sterilized. The discussion on credit policy in the last paragraph of page 10, on the other hand, notes that "the mission will urge the authorities to avoid giving the market confusing signals on this policy stance, as has occurred in recent months." This raises the question as to what the stance of monetary policy has been and whether capital inflows have in fact been successfully sterilized. The brief should also spell out the staff's view on the effectiveness of sterilization as well as its quasi-fiscal costs.

The mission should ascertain more clearly what the authorities have in mind as a "nonconventional" means of reducing inflation quickly which would use the exchange rate as an anchor while ruling out an incomes policy (page 6). (The Country Strategy Brief envisages transitory wage-price controls and a tight fiscal stance in the scenario where the exchange rate is used as an anchor.) We would stress that in the absence of an incomes policy, the widespread use of formal and informal backward-looking indexation mechanisms in the context of high inflation is likely to undermine the credibility of a nominal exchange rate anchor, even with a tight fiscal stance.

Exchange system

The brief should note the mission's intention to evaluate the recent changes in exchange measures subject to approval under Article VIII. It would also be of interest to have a preliminary evaluation of the progress that could be made in eliminating these restrictions in the context of a possible Fund arrangement. We would hope that any such arrangement would seem to reduce the "dependence" on restrictions. Finally, given that Brazil no longer maintains any restrictions under the transitional regime of Article XIV, the mission should explore the possibilities of Brazil moving to Article VIII status in conjunction with the elimination of these restrictions subject to Article VIII.

Trade issues

We think the staff should take a stronger stance on trade liberalization in Brazil and deepen reforms rather than continue as envisaged (p. 11). Our comments on the strategy brief are, therefore, relevant and are attached.

MERCOSUL members recently agreed on a common external tariff of 20 percent (after January 1, 1995) with possible exceptions allowing tariffs up to 35 percent for some products which are to be phased out over a six year period. The mission should urge the authorities to accelerate tariff reductions for these exceptions.

External debt issues

Given the strong balance of payments outlook and the comfortable foreign reserves position, we would agree with the stance proposed by the mission of encouraging the authorities to service the scheduled debt service payments from February 1, 1993 onwards, should the Paris Club not agree to the authorities' request to extend the end-December 1992 deadline for the effectiveness of the second tranche of the consolidation. In this connection, we would suggest that "extend the consolidation period" at the end of the first paragraph on page 12 be redrafted to read "agree to make effective the second tranche of the consolidation period." The authorities should be dissuaded from further recourse to Paris Club reschedulings in the context of a future arrangement given the strength of the external position.

While we understand that the Paris Club has not yet responded to the authorities' request for an extension of the deadline, the mission should ascertain whether Brazil has been making debt service payments to the Club since February 1, 1993 (the start of the second tranche). If the Club does not agree to an extension (which is possible given the reserves position), Brazil could be accumulating new arrears, which would be a breach of a performance criterion. In any case, since not all of the bilaterals under the 1992 Agreed Minute have been signed, Brazil could require an approval from the Fund of exchange restrictions evidenced by external arrears.

Regarding commercial bank debt and the debt service reduction operation, it would be helpful for the brief to give some indication of the likely cost of the package based on a judgement of the final outcome of bank's choices from the menu. Presumably Brazil will still--despite the very high level of reserves--insist on multilateral support and phasing in of enhancements.

Use of Fund resources

The authorities should be made aware that there are strong views in certain quarters in the Fund against the appropriateness of extending and rephazing the present stand-by arrangement. The current arrangement has not been operational for quite some time, and any new program would follow a substantially different strategy from the previous one. The mission should ascertain the authorities' reasons for wanting an extension so that these views can be adequately considered in coming to a judgment.

While a precautionary program would not impede disbursing set-asides to catalyze support from other IFIs, it should be emphasized that any Fund support, including for a DDSR operation, would have to be justified on the basis of a demonstration of "balance of payments need," taking into account the cost of the package and the availability of other sources of financing. Given Brazil's present balance of payments strength, we would suggest that a commitment at this time to all drawings of set-asides for debt reduction should not be made. This point was raised by PDR at the time of the Country Strategy Brief, and could have important repercussions from the standpoint of uniformity of treatment. Also, we would seriously doubt that conditions would be satisfied for providing augmentation resources. This should be made explicit in the brief.

Several formal and procedural remarks

The mission should state its intentions with regard to form and coverage of reporting to the Board (e.g., RED, statistical appendix, special study) as stipulated in Mr. Erb's memorandum of July 3, 1991.

The brief should include a summary work program appendix as stipulated in Mr. Boorman's memorandum of July 22, 1992.

Poverty and social safety net issues should be dwelled on perhaps through cross-referencing if warranted.

The brief should include a medium term balance of payments projection as well as the standard REER chart.

The latest data available in the Government Finance Statistics about military expenditures corresponds to 1989. Even though the share of military spending over GDP is historically lower than 2 percent, this share was increasing until 1990 according to the Stockholm International Peace Research Institute. It would, therefore, be useful if a line item on defense expenditure could be included in one of the fiscal tables. The mission should also seek to ascertain whether data related to military transactions within fiscal accounts, balance of payments and external debt are comprehensive and transparent.

Attachment

cc: FAD, LEG, MAE, RES, STA, TRE, WHD

*Part of memo from J. Ferran to Mr. Fajgenbaum on the Strategy Brief for Brazil, dated 11/16/92

Other Comments

Trade policy

We agree that Brazil is to be commended for the trade reform undertaken in the last two years, eliminating almost all non-tariff barriers and moving to a mostly tariff based policy. However, the country strategy brief is overly complacent about future trade policy strategy. We disagree with the staff position that endorses a strategy of proceeding as planned (p. 34, 2nd full para, first sentence). We would recommend a strong pitch to accelerate and deepen a reform process for the reasons below.

First, even after the current tariff reduction program will have been completed in July 1993, there remains ample scope for further lowering tariff protection and improving economic efficiency. Brazil is among the more advanced developing countries but its average tariff level by 1993 will still be three times higher than the average of industrial countries. Due to considerable tariff dispersion, effective rates of protection for some sectors such as the motor vehicle industry will still exceed 60 percent.

Second, there continue to be a host of regulations, laws, and decrees that deter trade and have not allowed the liberalization undertaken in recent years to be fully effective. This points to the need for further streamlining, hence we support the Government's intentions to consolidate existing regulations into a single basic foreign trade law. The country strategy brief could mention this and encourage an early enactment of the new legislation.

Third, we are concerned about the increased frequency of use of anti-dumping and countervailing duties on imports since 1991. There is a risk that with the reduction in quantitative import controls, Brazil is being tempted to rely on contingent protection. This may be a case of following the bad example set by major industrial countries such as the U.S. and the EC.

Fourth, by all indications Brazil is taking a less liberal approach than its regional trading partners in Mercosul. Brazil's maximum tariff (scheduled to decline to 35 percent by July 1993) is higher than that of Argentina and Uruguay. In recent Mercosul discussions, Brazil proposed a maximum common external tariff of 35 percent; Argentina and Uruguay favor a maximum rate of 20 percent.

Fifth, the brief accepts without explanation that regional integration a la Mercosul is the right strategy for Brazil to pursue. What is the basis of such a judgment? A country like Brazil--a major advanced developing country with a leadership role among developing countries in the GATT--has to be actively pushing toward an open multilateral system both in words and actions. (Also, it is in Brazil's interest to do so, as the major part of its trade is outside

Mercosul.) Thus, we would like to see Brazil take a leadership role in pushing Mercosul toward even a more liberal stance consistent with multilateral liberalization. The brief could make this point.

Sixth, the brief seems too willing to shift responsibility on the design of future trade policy on other institutions (IDB, IBRD). Granted that these institutions have an important role to play, this does not absolve the Fund's strategy brief from featuring the desirable major elements of trade policy strategy and its sequencing.

Finally, in the structural area, we suggest that it would be a reasonable medium-term goal for Brazil to liberalize its exchange system completely as regards current international payments (and move to Article VIII), side by side with the proposed further liberalization of the trade system.

Drafting Comments

The draft should state more clearly that average real and nominal interest rates can diverge from marginal rates (e.g., in the interbank market). For example, when comparing the primary and operational fiscal balance, it is the average real rate that is important. However, the marginal real rate is likely to be more important for questions of the effect of policy on overall economic activity.

The statistical presentation would be improved through the inclusion of data on the real effective exchange rate and a monetary survey. The monetary survey would allow examination of what is meant by the statement that inflows during the first half of 1992 were "largely sterilized," in the context of the projected 1,470 percent increase in net domestic credit for 1992.

Bottom of page 4. The sentence "in the course of 1983 monthly inflation rose from an average of 6 percent to over 10 percent" is confusing. Is this the monthly rate or the six-month moving average of the price index reported in chart 3?

Page 8 (line 2). It would be useful to have a footnote defining M-4 which is being referred to for the first time.

Page 8 (line 9). The sentence "The abrupt reduction in liquidity ..." could be changed to "The abrupt reduction in liquidity, together with the general price freeze ...".

Page 9 (line 5). The sentence "An agreement on settling the arrears ..." seems to be truncated.

Office Memorandum

ACTION {STB FVB JF
IO
F

To: Mr. Beza February 25, 1993

From: Vito Tanzi Vito Tanzi

Subject: Brazil--Draft Brief for Article IV Consultation

We agree with the overall approach outlined in this draft brief, based largely on the earlier strategy paper. We have just a few observations to offer.

1. To reiterate the observation I had made in my memorandum of November 12 regarding the strategy paper, the draft brief lacks a coherent fiscal package that would generate the target primary surplus equivalent to 6 percent of GDP. Again, the measures shown in Attachment III seem like a shopping list rather than the elements of a sequenced and structurally sound package. They include uncritically on the same footing desirable and objectionable measures, in some instances with little regard to recommendations of technical assistance missions. 1/ Thus, we continue to take exception, for example, to the self-defeating proposal for raising social security contribution rates; instead, every effort should be made toward introducing corrective design and administrative measures on the benefit side, as well as enforcing the existing contributions and expanding their coverage.

2. Several fiscal measures--in particular, the linkage of public sector wages to tax performance--taken or considered by the authorities seem rather obscure, as described in the draft brief. We would, of course, welcome any additional explanation either in the brief or in the future staff report.

Contributor: George Kopits

cc: LEG
MAE
PDR
RES
STA
TRE
Mr. Fajgenbaum

1/ The measures listed in Attachment III are virtually identical to those listed in Appendix I of the draft strategy paper of November 6, 1992, notwithstanding my comment on the latter.

STB
FVB
IO
F

To: Mr. Fajgenbaum February 25, 1993

From: Guillermo Calvo (Signature on file)

Subject: Comments on Brazil--Strategy Brief

The apparent change in the focus of economic policy toward domestic price stabilization is certainly a welcome development. As we indicated in our comments on the strategy brief, we believe that domestic price stabilization will require a discontinuation of the real exchange rate targeting policy. Therefore, the use of an exchange rate anchor being considered by the authorities may be an appropriate instrument, provided that financial policies are consistent with it. The strong balance of payments position and the arguably undervalued currency imply the existence of some room to withstand the real appreciation that will likely take place in the transitional phase.

An important issue for the stabilization plan will be to avoid high real interest costs on domestic debt which could impose too high a burden on the government finances. To the extent that high (ex-post) real interest rates result from credibility problems, debt management could help to mitigate this cost. Credibility problems could arise from depreciation risk or from persistent high-inflation expectations. Thus, newly-issued domestic government debt could be dollar-denominated or indexed to the domestic price level. If high interest rates on government securities derive from default risk, consideration could be given to using some international reserves as collateral. Privatization may also offer the opportunity to repurchase domestic debt in favorable terms.

Contributor: E. Borensztein

cc: Mr. Mussa
Mr. Khan
Mr. Tanzi
Mr. Gianviti
Mr. Zulu
Mr. Boorman
Mr. McLenaghan
Mr. Williams
Mr. Beza

WHD 10-100
STB
FvB
JF
IO
F

Office Memorandum

To: Mr. Fajgenbaum **February 25, 1993**

From: Robert Di Calogero RDC

Subject: **Brazil--Draft Briefing Paper**

I refer to your memorandum of February 25, 1993 on the above subject. We found the draft briefing paper to be well written and concise while addressing the main policy issues. We endorse the overall thrust of the approach described in the paper. We agree that major fiscal adjustment is absolutely essential to deal with the problem of inflation and restore internal balance largely by breaking the indexation cycle. In our view, the mission will face a difficult task in agreeing with the authorities on a fiscal package that provides the basis for a program, especially given the authorities' statement that there is little room to compress expenditure from their 1992 level; moreover, the authorities may be faced with increases in Federal Government wages and social security benefits. In this connection, the recommendation of using the exchange rate as an anchor (p.6) rather than pursuing a real exchange target might have to be reconsidered.

Regarding financial issues, it is not clear that substantial capital inflows were sterilized to a large extent in 1992 (p.4, 1st paragraph) in view of the 2,233 percent increase recorded in net domestic credit as shown in the table on selected economic indicators (Attachment II). In this regard, some explanation would be helpful. In addition, it would be useful to clarify whether the interest rates shown in the table are in nominal or real terms; the first paragraph on page 4 would indicate that they are real rates.

We did not notice any reference to statistical issues in the brief. We would like to suggest that the mission discuss with the authorities any major data shortcomings hindering economic analysis and policy discussions, and that the outcome of the mission's discussions be used to update the statistical inventory prepared in 1990 (attached).

02/25/93 CY - G:\WHD\BRA\TAS\ESS932.CMT

Finally, we are attaching a statement of outstanding statistical issues together with a list of the Statistics Department's correspondents. It would be helpful if the mission would discuss with the authorities the problems set out in the statement and the currentness of the list of correspondents.

Attachments

cc: Mr. McLenaghan
FAD
LEG
PDR
RES
TRE
WHD

Contributor:
Elizabeth Sumar

Brazil--Statistical Issues

1. Outstanding statistical issues

a. Monetary accounts

Consolidated data on money and banking statistics have major problems: the latest complete IFS data for the monetary survey and banking survey relate to 1988 and 1985, respectively. On September 1992, STA received quarterly information for the Deposit Money Banks (DMB) and Other Banking Institutions (OBI) for the period December 1988 through June 1991, and monthly data from July 1991 through May 1992. These data are being evaluated by STA, before the DMB and OBI data can be published in IFS. However, this work cannot be completed without extensive technical discussions with the authorities. A STA technical assistance mission has been under consideration for some time. As a result of recent discussions with the authorities, it has been agreed that a mission should take place in May 1993.

b. Interest rates

Data on interest rates for bank deposits and discount rate are being currently reported. However, data on bank lending and treasury bill rates have not been reported since 1989.

c. Balance of payments

Although the authorities prepare quarterly balance of payments statistics, these are not furnished to STA on a timely basis. The latest data, which were sent to STA in September 1992, relate to the fourth quarter of 1990. It would be useful if the mission could discuss with the authorities possible ways to reduce the delay in sending balance of payments data and ask them to send quarterly data as they are compiled.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Brazil in the March 1993 issue of IFS. The data are based on reports sent to the Fund's Statistics Department by the Central Bank of Brazil which, during the past year, have been provided on an irregular basis.

Status of IFS Data

Sector	Series	Latest Data in March 1993 IFS
Real Sector	- National Accounts	1990
	- Prices: WPI	November 1992
	CPI	November 1992
	- Production	n.a.
	- Employment	n.a.
	- Earnings	
Government finance	- Deficit/surplus	November 92
	- Financing	1986
	- Debt	1986
Monetary accounts	- Monetary authorities	November 1992
	- Deposit money banks	1987 1/
	- Other banking institutions	1987 2/
Interest rates	- Bank rate	December 1992
	- Bank deposit rate	December 1992
	- Bank lending rate	n.a.
	- Treasury bill rate	December 1989
External Sector	- Merchandise Trade:	
	Values:	
	Exports	November 1992
	Imports	November 1992
	Volumes	1986 3/
	Prices	1987 3/
	- Balance of payments	Q4 1990
	- International reserves	November 1992
	- Exchange rates	January 1993

1/ Last available information, June 1988.
2/ Last available information (partial) March 1988.
3/ Volume and price indices for selected export goods are available through November 1992.

3. Technical assistance missions in statistics (1988-present)

Subject	Staff Member	Date
Money and banking statistics	Ms. Ruth Lituma	April 22-May 13, 1987

BRAZIL

BOP

Sr. Altamir Lopes, Chefe de Divisao
Divisao de Balanço de Pagamentos - DIBAP
Departamento Econômico - DEPEC
Banco Central do Brasil
SBS - Edif. Sede do Banco Central
11º andar
70074 Brasilia, DF, Brazil

DOT--Exports

Banco do Brazil, S.A.
CACEX/DEPEC/ANEDI/SEDEC
Avenida Rio Branco, No.65 -Sala 605
20090 - Rio de Janeiro, (RJ)
Brazil

DOT--Imports

Sr. Jose Antonio Schontag
Chefe da Divisao de Processamento
de Dados; Coordenacao de
Informacoes Economico-Fiscais
Secretaria da Receita Federal
Ministerio da Fazenda
Bloco P, Anexo, Ala "A", 3º andar
Brasilia - DF, Brazil

IFS

Chefe do Departamento Economico
do Banco Central do Brasil
Banco Central do Brasil
SBS - Edif. Sede do Banco Central
11º andar
70074 Brasilia, DF, Brazil

GFS

Sr. Silvio Rodrigues Alves
Chefe do Departamento Economico
do Banco Central do Brasil
SBS - Edif. Sede do Banco Central
11º andar
70074 Brasilia, DF, Brazil

GFSCC

Sr. Federico Augusto Barros
Secretario de Orçamento e Finanças
Esplanada dos Ministérios
Bloco 7, Brasilia - DF, Brazil

GFS

Mr. Moacyr Antonio Fioravante
Fundacao Getulio Vargas
Praia de Botafogo, 190S/S. 1101
Rio de Janeiro, Brazil

GFSCC

cc:
Sr. Federico Augusto Barros
Secretario de Orçamento e Finanças
Esplanada dos Ministérios
Bloco 7, Brasilia - DF, Brazil

Bsne

Atlantic Division: Statistical Inventories

Brazil: Statistical Inventory

1. National accounts

The problems in this area are not major. Data on changes in inventories are not gathered, creating distortions in measuring consumption and investment. There appears to be some problems with the deflation of data on nominal investment.

2. Public finances

The major problem is the lack of timely information that would allow the preparation of consolidated public sector accounts above the line. Information on the revenues and expenditures of state and local governments is available only with a considerable lag. No information is available on the operations of public enterprises owned by state and local governments. For enterprises owned by the federal government the information available is not very reliable. Except for the central government, dependable statistics for the public sector are available only on an annual basis, which complicates the implementation of fiscal policy.

3. Monetary accounts

Money and banking statistics have major problems and the authorities and the staff have discussed technical assistance in this area. It is hoped that a joint BUR/WHD technical assistance mission could take place in the near future. The authorities have expressed general agreement with this idea but have not yet issued a formal request. At present the authorities are introducing a new data collection system for the banking system. Because of lags in the implementation of the new system reliable data for the consolidated banking system are only available through June 1988.

4. Balance of payments and external debt

There are no major problems in this area.

5. Prices, employment, and wages

Price statistics are good. Employment and wage indicators could be improved.

STB
FuB
M. Fajgenbaum
IO
F/

Office Memorandum

February 17, 1993

MEMORANDUM FOR FILES

Subject: Brazil--Visit by Minister of Social Security

I was contacted today by Mr. L. Alves, International Affairs Advisor to the Minister of Social Security. Mr. Alves called to transmit Minister Britto's regrets for having to cancel his trip to Washington last week at the request of President Franco. He also informed me that the Minister would like to reschedule the visit for March 10 (after his participation at a conference in La Jolla, California, on March 7-9) and to meet with us on that day. I told Mr. Alves that we would be delighted to see him and to hold discussions on social security reform. We agreed tentatively that following a morning meeting at the Interamerican Development Bank, we would host a lunch for Minister Britto and then meet with him in the afternoon. The Minister will be accompanied by Secretary Luiz Capella.

GK.
George Kopits

cc: Mr. Tait
Mrs. Ter-Minassian (o/r)
Mr. Fajgenbaum

Office Memorandum

STB
FJG
JF
F

To: The Managing Director
The Deputy Managing Director

February 9, 1993

From: S. T. Beza MB

Subject: Brazil--Meeting with Authorities on February 8, 1993

Meetings were held with Minister Haddad and his team yesterday.

The Minister said that he needed to show results in getting the economy out of recession and to bring inflation down relatively quickly, but he did not want to get into much detail. He kept saying that these matters would need to be examined by the mission that will start work on March 1 in Brasilia.

The points he made (or suggested) were the following:

--That he expected the primary fiscal balance to be some 1 1/2 percentage points of GDP stronger in 1993 than was indicated by the Brazilian officials in their visits to Washington, largely through reductions in transfers to states and municipalities (which would obtain more shared revenues) and by improved tax administration.

--That there should be an examination of nonconventional means of bringing down inflation quickly, but he ruled out price and wage freezes, controls, debt confiscation and "dollarization." It was not clear whether he ruled out real appreciation of the currency. Again, he was cautious about getting into specifics.

--That a major tax reform would be prepared to be ready by the time the general constitutional revision takes place late this year (October). (The tax on bank debits which the authorities expect will have a gross yield of 1 1/4 percent of GDP in 1993 is viewed as temporary.) Also, the social security system and the financial sector would be reformed.

--That the opening of trade (generally and under MERCOSUR) would continue as would a revised privatization program. Also, there would be an improved control over the public enterprises but their pricing policies would be based on costs. The debt management of states and municipalities would be tightened.

The Minister said that he did not expect to be able to sign off on an economic program before the middle of April (and even this date was uncertain). Time was needed to examine the situation carefully, and he expected the March mission to help him in this

process. Also, time was needed to ascertain whether, for example, the tax on bank debits would be paid or challenged, and whether the tighter controls over states and municipalities would function as expected.

The Minister said he was seeking from us an assurance that he could request an extension and rephasing of the existing arrangement through the end of 1994. I replied that this was a matter he would wish to discuss with you today. For my part I had no particular problem with this procedure provided the substance of the economic program is satisfactory.

I emphasized the message we had been transmitting to Brazil about the need to have a very strong fiscal policy to deal with the inflation problem. I went on to say that any shortcuts (a word used by the Minister) in cutting inflation required changing expectations quickly and this rested on fiscal policy being strong enough to erase doubts about the need to resort to the Central Bank to finance the public sector.

The Minister did not challenge what I said, but some of his advisors said that I was oversimplifying matters, and that there were many elements other than fiscal policy that mattered in reducing inflation.

cc: Mr. Mussa
Mr. Boorman
Mr. Tanzi
Mr. Williams
Mr. Guitian
Ms. R. Saunders

STB
FJB
JA
F

The authorities made substantial progress in implementing structural reforms and in their relations with external creditors during 1992. Prices were liberalized completely and the privatization program proceeded as planned. The trade liberalization program continued with import tariff reductions in April and October and the elimination of the domestic market reserve policy for computer products in October. In March 1992, the authorities concluded negotiations with the Paris Club for a rescheduling of obligations due and an elimination of arrears and, as noted earlier, in July they reached an agreement in principle on the rescheduling of medium-term debt to commercial banks. Approval of the term sheet by the Brazilian Senate is expected by end-November 1992.

The Administration that took office in October 1992 reduced selected interest rates and eased access to some credit facilities because of concerns about the effect of continued weakness in the economy on the social fabric. This, together with the weak fiscal position has contributed to an increase in inflation to around 26 percent a month.

Looking to 1993, the authorities have submitted to Congress a fiscal reform project that is less ambitious than the proposals that had been submitted in July 1992. 1/ Although the various political parties seem to agree on the need for fiscal adjustment and reform, there appears to be no consensus regarding the extent of this adjustment and the main elements of the fiscal reform. Moreover, there are some questions about the likelihood that a comprehensive fiscal reform would be approved by Congress before year-end. In the staff's view, delaying fiscal action at the present time would have serious consequences for the public finances in 1993 because under Brazilian law certain tax measures only become effective in the year following their approval. Similarly, there is a need to accelerate the reform of the social security system.

II. Brazil's Relations with the Fund and Capacity to Repay the Fund

During the last decade Brazil entered into three arrangements from the Fund and made three purchases under the CFF (Table 3). The arrangements were operative for shorter periods than envisaged because the authorities were unable to sustain the implementation of agreed policies, particularly in the fiscal area. Thus, Article IV consultations and lengthy discussions on how to bring agreed programs back on track have been the main vehicles for policy discussion with the authorities.

1/ This reform includes the temporary establishment of a tax on financial transactions, increases in excise taxes on specified products (e.g., petroleum derivatives and alcoholic beverages), and the elimination of certain Social Security taxes, the profit surcharge, and certain federal and state indirect taxes.

Table 3. Brazil: Transactions under Fund Arrangements

(In millions of SDRs)

	Date of Inception	Date of Expiration	Amounts Approved	Amounts Drawn
Extended Fund Facility	2/28/83	2/27/86	4,239.4	2,743.2
First credit tranche	2/28/83	--	249.4	249.4
Compensatory Financing Facility	2/28/83	--	498.7	498.7
Buffer Stock Facilty	11/22/83	--	64.5	64.5
Compensatory Financing Facility	5/9/84	--	247.9	247.9
Stand by	7/26/88	2/28/90	1,096.0	365.3 1/
Stand by	1/29/92	8/31/93	1,500.0	127.5 2/
Memorandum item				
Outstanding Fund credit (as of end-October 1992)	SDR 705 million (43.2 percent of quota)			

Source: IMF Treasurer's Department.

1/ Equivalent to Brazil's first credit tranche.
2/ Excludes set asides for SDR 42.5 million.

Brazil's performance under the EFF approved in February 1983 was mixed and a number of purchases required waivers and/or modifications (mainly related to the public finances and credit policy areas). It would seem that the Fund agreed to the waivers and modifications in view of the commitment of the authorities to the adjustment program and the systemic importance of Brazil in the context of the debt crisis. In the second half of 1984, however, the authorities shifted their policy stance and the arrangement became nonoperational.

As Brazil's balance of payments strengthened in the aftermath of the debt crisis, discussions with the authorities focussed increasingly on the policies needed to reduce inflation on a lasting basis. Thus, starting with the 1985 Article IV consultation, the staff and the Executive Board have stressed the need to tighten fiscal policy to the point of generating operational surpluses to break the momentum of inflation and provide a credible basis for putting into effect deindexation measures. Such a fiscal stance would raise domestic savings and help implement a monetary policyconsistent with a sharp reduction of inflation. While the authorities generally agreed that achieving operational surplus was a necessary condition to stabilize the economy, they noted on many occasions the lack of political backing for the required effort.

The Fund's role in the design of the heterodox stabilization programs implemented by Brazil in 1986 and 1987 was very limited. The staff and the Executive Board tacitly supported the incomes policies adopted by the authorities, but emphasized the need for reducing the public sector deficit to bring aggregate demand in line with supply (so as to lower inflationary pressures and prevent a deterioration of the external sector). The authorities were unable to strengthen the public finances promptly and the programs could not be sustained.

In July 1988 the Executive Board approved a 17-month stand-by arrangement. The economic program for 1988 was explicitly characterized as a holding operation that was to provide the basis for the deindexation of the economy in 1989. The fiscal program was significantly weaker than necessary and inflation accelerated despite the maintenance of high real interest rates. In the event Brazil did not meet the fiscal performance criteria for the second half of 1988, and the authorities could not frame an adequate program for 1989. Brazil made only the initial purchase under this arrangement.

Following the adoption of the stabilization program of March 1990, the authorities requested a stand-by arrangement to support their policies and help Brazil re-establish relations with its creditors. The letter of intent was circulated to the Executive Board in September 1990 but the request could not be presented to the Board because of insufficient progress in the negotiations with commercial bank creditors (to meet the financing assurances requirement). Soon after, the program went off track as financial policies weakened.

The program for 1992-93 aimed at a gradual and sustained reduction of inflation through the pursuit of a very tight credit policy while the public finances were being strengthened. Because of the risks associated with this strategy, the Managing Director met with the President of Brazil and his economic team to assess their commitment to the sustained implementation of the program. Convinced of the authorities' determination to carry out the policy changes that were needed to address Brazil's economic problems, management decided to support the program with the stand-by arrangement that was approved by the Executive Board in January 1992. During the Board meeting, however, a number of Directors expressed misgivings about the adequacy of the policy mix and its sustainability.

Fiscal policies turned out to be weaker than projected and the corresponding performance criteria for end-March and end-June were not observed. Because of the inability of the authorities to adopt corrective measures in the context of the political difficulties faced by the President, the mid-term review of the program could not be completed. Thus far the only purchase made by Brazil under this arrangement was upon approval.

Policy dialogue with the new authorities is expected to take place shortly. At this stage, their intentions in regard to Brazil's relations with the Fund are unclear, but it is important to note that the recent debt restructuring agreement with commercial bank creditors requires an arrangement from the Fund. The following options on a course of action can be envisaged:

1. Proceed under the current stand-by arrangement, provided that its duration is extended and the remaining purchases rephased (while preserving their backloaded structure). Despite Brazil's high level of international reserves and apparent absence of balance of payments need, disbursements under the arrangement might be required to mobilize resources from other international financial institutions to finance the enhancements necessary for the completion of the debt agreement. Nevertheless, the staff would explore with the authorities the possibility of converting this arrangement into a precautionary one, with the understanding that purchases of the set aside portions could be made, if necessary. An acceleration of the disbursement of set asides will require two-to-three quarters of satisfactory performance under the program;

Only if [illegible]

Only if measures were extremely convincing.

2. Proceed with a new stand-by arrangement. Brazil's strong external position would suggest a lower access level than under the current arrangement, but the authorities are likely to resist this view because a lower access level could signal a weaker support for the program. In these circumstances, a precautionary stand-by arrangement with the same level of access and phasing as the (rephased) current arrangement would seem an appropriate solution. As in the previous case, the staff would explore with the authorities the feasibility of such a solution, including the implications for set asides; and

3. Proceed with a monitored program while the authorities formulate an economic program that could be supported by the use of Fund resources under a follow-up stand-by arrangement.

The previous economic team intended to request an extended arrangement after the current stand-by expires. Brazil's weak performance thus far suggests the need for the establishment of a satisfactory track record under a stand-by or a monitored program before consideration could be given to an arrangement under the EFF. Thus, such an arrangement could start (at the earliest) at the beginning of 1994, and it would have to be of a precautionary nature for the reasons given above. The annual access would be 50-60 percent of quota.

Brazil always has kept current in its debt service to the Fund, although it has incurred significant arrears to certain other creditors. Fund exposure to Brazil was 48.2 percent of quota by end-October 1992 and (in the absence of new purchases) is projected to decline to 39.8 percent of quota by end-1992 and to 15.1 percent of quota by end-1993. Even assuming that all purchases under the current arrangement were made, Fund exposure at its peak would be less than 4 percent of Brazil's exports of goods and services.

In addition, Brazil's gross international reserves are projected to amount to some US$22 billion by the end of 1992, more than one year of merchandise imports, and its obligations to the Fund represent only a small share of its total external indebtedness. 1/ For these reasons, the staff believes that Brazil's use of Fund resources under the current arrangement (and possible future ones) is consistent with the need to safeguard the revolving character of these resources.

III. Medium-Term Policy Framework

1. Overview and possible stabilization strategies

The main objectives of a medium-term economic program in Brazil should be to bring inflation down to international levels on a lasting basis, and to set the stage for a recovery of investment and the resumption of economic growth. Attainment of these objectives would lower the social costs associated with high inflation, which affects more intensely the low-income population.

Achieving a sustainable decline in inflation requires a comprehensive effort on several fronts. The crucial element is a strong fiscal adjustment that eliminates the need for relying on the inflation tax and results in a significant reduction of the public debt in relation to GDP. The choice of

---

1/ Brazil's debt to all multilateral financial institutions represents 11 percent of its total debt.

Office Memorandum

① Brazil ② Travel — approval memo

To: The Deputy Managing Director
(Cleared with Administration)

February 9, 1993

From: S. T. Beza MB

Subject: Brazil--Fund Staff Participation in Meeting with Commercial Banks

The Brazilian authorities have requested that a representative of the staff participate in the presentation of the financing package for Brazil to the banking community in Toronto. This meeting, to be held on February 12, 1993, was overlooked by the authorities when they made their original request for staff participation in the meetings with the international banking community (my memorandum of January 25, 1993). To meet this request I propose that Mr. Fajgenbaum, who participated in the other road show meetings, take part in the meeting in Toronto.

cc: ADM
Mr. Elson
Mrs. Braña

Office Memorandum

To: The Managing Director
The Deputy Managing Director

February 9, 1993

From: S. T. Beza MB

Subject: Brazil--Meeting with Authorities on February 8, 1993

Meetings were held with Minister Haddad and his team yesterday.

The Minister said that he needed to show results in getting the economy out of recession and to bring inflation down relatively quickly, but he did not want to get into much detail. He kept saying that these matters would need to be examined by the mission that will start work on March 1 in Brasilia.

The points he made (or suggested) were the following:

--That he expected the primary fiscal balance to be some 1 1/2 percentage points of GDP stronger in 1993 than was indicated by the Brazilian officials in their visits to Washington, largely through reductions in transfers to states and municipalities (which would obtain more shared revenues) and by improved tax administration.

--That there should be an examination of nonconventional means of bringing down inflation quickly, but he ruled out price and wage freezes, controls, debt confiscation and "dollarization." It was not clear whether he ruled out real appreciation of the currency. Again, he was cautious about getting into specifics.

--That a major tax reform would be prepared to be ready by the time the general constitutional revision takes place late this year (October). (The tax on bank debits which the authorities expect will have a gross yield of 1 1/4 percent of GDP in 1993 is viewed as temporary.) Also, the social security system and the financial sector would be reformed.

--That the opening of trade (generally and under MERCOSUR) would continue as would a revised privatization program. Also, there would be an improved control over the public enterprises but their pricing policies would be based on costs. The debt management of states and municipalities would be tightened.

The Minister said that he did not expect to be able to sign off on an economic program before the middle of April (and even this date was uncertain). Time was needed to examine the situation carefully, and he expected the March mission to help him in this

process. Also, time was needed to ascertain whether, for example, the tax on bank debits would be paid or challenged, and whether the tighter controls over states and municipalities would function as expected.

The Minister said he was seeking from us an assurance that he could request an extension and rephasing of the existing arrangement through the end of 1994. I replied that this was a matter he would wish to discuss with you today. For my part I had no particular problem with this procedure <u>provided</u> the <u>substance</u> of the economic program is satisfactory.

I emphasized the message we had been transmitting to Brazil about the need to have a very strong fiscal policy to deal with the inflation problem. I went on to say that any <u>shortcuts</u> (a word used by the Minister) in cutting inflation required changing expectations quickly and this rested on fiscal policy being strong enough to erase doubts about the need to resort to the Central Bank to finance the public sector.

The Minister did not challenge what I said, but some of his advisors said that I was oversimplifying matters, and that there were many elements other than fiscal policy that mattered in reducing inflation.

cc: Mr. Mussa
Mr. Boorman
Mr. Tanzi
Mr. Williams
Mr. Guitian
Ms. R. Saunders

Office Memorandum

To: The Managing Director
The Deputy Managing Director

February 9, 1993

From: S. T. Beza MB

Subject: Brazil--Meeting with Authorities on February 8, 1993

Meetings were held with Minister Haddad and his team yesterday.

The Minister said that he needed to show results in getting the economy out of recession and to bring inflation down relatively quickly, but he did not want to get into much detail. He kept saying that these matters would need to be examined by the mission that will start work on March 1 in Brasilia.

The points he made (or suggested) were the following:

--That he expected the primary fiscal balance to be some 1 1/2 percentage points of GDP stronger in 1993 than was indicated by the Brazilian officials in their visits to Washington, largely through reductions in transfers to states and municipalities (which would obtain more shared revenues) and by improved tax administration.

--That there should be an examination of nonconventional means of bringing down inflation quickly, but he ruled out price and wage freezes, controls, debt confiscation and "dollarization." It was not clear whether he ruled out real appreciation of the currency. Again, he was cautious about getting into specifics.

--That a major tax reform would be prepared to be ready by the time the general constitutional revision takes place late this year (October). (The tax on bank debits which the authorities expect will have a gross yield of 1 1/4 percent of GDP in 1993 is viewed as temporary.) Also, the social security system and the financial sector would be reformed.

--That the opening of trade (generally and under MERCOSUR) would continue as would a revised privatization program. Also, there would be an improved control over the public enterprises but their pricing policies would be based on costs. The debt management of states and municipalities would be tightened.

The Minister said that he did not expect to be able to sign off on an economic program before the middle of April (and even this date was uncertain). Time was needed to examine the situation carefully, and he expected the March mission to help him in this

process. Also, time was needed to ascertain whether, for example, the tax on bank debits would be paid or challenged, and whether the tighter controls over states and municipalities would function as expected.

The Minister said he was seeking from us an assurance that he could request an extension and rephasing of the existing arrangement through the end of 1994. I replied that this was a matter he would wish to discuss with you today. For my part I had no particular problem with this procedure provided the substance of the economic program is satisfactory.

I emphasized the message we had been transmitting to Brazil about the need to have a very strong fiscal policy to deal with the inflation problem. I went on to say that any shortcuts (a word used by the Minister) in cutting inflation required changing expectations quickly and this rested on fiscal policy being strong enough to erase doubts about the need to resort to the Central Bank to finance the public sector.

The Minister did not challenge what I said, but some of his advisors said that I was oversimplifying matters, and that there were many elements other than fiscal policy that mattered in reducing inflation.

cc: Mr. Mussa
Mr. Boorman
Mr. Tanzi
Mr. Williams
Mr. Guitian
Ms. R. Saunders

INTERNATIONAL MONETARY FUND

WASHINGTON, D. C. 20431

Brazil

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

CC: WHD
MD
DMD
MR. KAFKA
MS. R. SAUNDERS

8 de fevereiro de 1993

Excelentíssima Senhora Ministra,

Permita-me felicitá-la por sua nomeação à frente da Secretaria de Administração Federal na administração do Senhor Presidente Itamar Franco.

É com prazer que me lembro do proveitoso intercâmbio de idéias que tivemos quando de minha visita a São Paulo em junho de 1992. Lembro-me de sua preocupação, bem como de seus colegas prefeitos, de que as prefeituras enfrentam problemas que são reflexo de condições e medidas político-econômica nacionais, aos quais têm pouca ou nenhuma participação. Também concordo com a Senhora de que uma participação mais ampla de todas as partes envolvidas poderia contribuir para a solução dos problemas econômicos e sociais. Em seu novo papel como Ministra da Administração Federal, sua ampla experiência como prefeita da cidade de São Paulo a coloca em posição única para ajudar os prefeitos, e também governadores e colegas ministros, a defrontar os problemas que o Brasil tem a resolver.

Senhora Ministra, o Fundo Monetário Internacional continua a disposição do governo do Brasil, cooperando no que for possível.

Renovo a V. Ex.ª os protestos de minha mais alta estima e consideração.

Michel Camdessus

Excelentíssima Senhora Ministra
Luiza Erundina de Sousa
Chefe da Secretaria de Administração Federal
Esplanada dos Ministérios
Bloco C - Sexto andar
Brasília, D.F. - Brasil

BRESIL : l'ancien maire de Sao Paulo nommé au gouvernement. – Mme Luiza Erundina, ancien maire de Sao-Paulo et membre du Parti des travailleurs (PT, gauche), a accepté, vendredi 22 janvier, d'entrer dans le gouvernement de M. Itamar Franco en qualité de ministre de l'administration fédérale. Sa nomination, ainsi que celle d'une économiste, Mme Yeda Crusius, au ministère du plan, complète le cabinet de coalition mis en place par le nouveau chef de l'Etat brésilien à la suite de la condamnation de l'éviction de l'ancien président Fernando Collor de Mello. – *(AFP.)*

ORIG: WHD
CC: MD
DMD
MR. KAFKA
MS. R. SAUNDERS

Exmo. Sr.
Michel Camdessus
Diretor Gerente
Fundo Monetário Internacional

Permita-me, antes de tudo, felicitá-lo por incluir na sua agenda uma reunião com uma autoridade local. No meu caso, como Prefeita de São Paulo, sou responsável por 10 milhões de cidadãos, população superior a cerca de 100 países membros do Fundo Monetário Internacional. O orçamento municipal, da ordem de 3,5 bilhões de dólares, é superior ao produto nacional bruto de mais de 30 países. São Paulo é o maior centro industrial do Terceiro Mundo. Os interesses de São Paulo são importantes, não só para o nosso país no seu conjunto, como para a própria dinâmica econômica internacional.

Como autoridade local, somos a instância mais próxima do cidadão e dos seus problemas concretos. E como município, somos a instância mais distante do poder central. Com o forte processo de urbanização das últimas décadas e, de modo particular, com a atual recessão, os problemas urbanos tornaram-se explosivos. Para lhe dar um exemplo concreto, São Paulo tem hoje cerca de 1,2 milhões de desempregados, o que, com os dependentes, significa uma massa de vários milhões em situação de desespero. Somos a esfera que se situa na linha de frente destes problemas, e somos a instância de menor poder; jamais consultada na elaboração das políticas de reajustes macroeconômicos, e submetida a filtragens políticas e dramática morosidade na transferência dos recursos necessários para enfrentar os seus efeitos.

A importância de se ouvir as instâncias locais prende-se também às diferentes realidades que coexistem no país. Não é viável aplicar-se uma política macroeconômica global, sem levar em conta que o Brasil é São Paulo e Nordeste; riqueza e pobreza; empresa multinacional e garimpo da Amazônia. Políticas demasiado globais são assim programadas para um país "médio" que não existe. Necessitamos sem dúvida de equilíbrio macro-econômico, de reduzir a inflação e controlar o déficit público. Mas a política econômica destinada a produzir estes resultados tem de apoiar-se em políticas diferenciadas e flexíveis, partindo das necessidades concretas dos principais atores econômicos em cada região do país.

Finalmente, Senhor Diretor, queria manifestar o nosso desacordo com políticas de reajuste macroeconômico que lançam muita gente no desespero, sem que estejam previstas as ações compensatórias indispensáveis para a contenção dos efeitos negativos. Políticas deste tipo não são um "mal necessário", antes desorganizam a economia e criam condições sociais insuportáveis. O nível de governo que conhece o detalhe da situação dos diversos segmentos da atividade econômica e as necessidades sociais diferenciadas da população, podendo responder de maneira flexível e ágil, é o nível local. A esta instância de poder devem ser dados os meios necessários, pois é a instância onde melhor pode se fazer ouvir a voz da sociedade, e onde as respostas podem ser mais eficientes e mais concretas. Os prefeitos estão cansados, Senhor Diretor, de fazer um trabalho de contenção dos problemas criados por políticas sobre as quais não foram consultados, e sem os meios necessários.

Ao fazermos estas considerações, Senhor Diretor, desejamos contribuir no sentido de se criarem formas de elaboração de políticas mais participativas, modernas e eficientes.

Com os protestos da minha mais alta estima e consideração,

LUIZA ERUNDINA

Prefeita de São Paulo

São Paulo, 8 de Junho de 1992

STB
FJB
JF
F

Office Memorandum

To: The Managing Director
The Deputy Managing Director

February 8, 1993

From: S. T. Beza

Subject: Brazil--Visit of Authorities

Attached is a note prepared by the staff for your meeting tomorrow with the Minister of Finance and President of the Central Bank of Brazil. Also attached is my cover note for the Country Strategy Paper on Brazil that was sent to you in November 1992.

As is indicated in the attached note, from our meetings with Brazilian officials in recent months it is evident that the fiscal policy they envisage falls far short of the one we think necessary to provide a solid basis for an economic program to be supported by the Fund. Furthermore, some aspects of policy seem to have weakened under the Administration of President Franco--e.g., freedom in pricing, wage policy, interest rate policy, and privatization.

Because we cannot become involved in another program without an adequate fiscal base, we need to resist the suggestion of the authorities that we agree to a plan that they "can deliver." From what they have put on the table it would seem that the only plan they can deliver is one that would mean the continuation of inflation in the range of 20-30 percent a month, but such an inflation rate is highly unstable and can readily move up. In any event, we could not present such a plan to the Executive Board.

Perhaps the authorities cannot produce a stronger fiscal plan at this time and the development of a suitable plan would need to be handled in the context of the constitutional reform scheduled for later this year (October). In the meantime, we could work with the authorities to monitor the situation and to help them frame the fiscal reforms needed. This course of action will be resisted by Mr. Kafka who has been thinking of having the authorities request an extension of the present SBA which expires in August 1993. Under the approach I outlined above, the present SBA would be allowed to expire.

I will report to you tomorrow morning on today's meeting with the Minister and his team.

Attachments

cc: Ms. Saunders

Brazil--Notes for Meeting with Finance Minister Mr. Paulo Haddad
and Central Bank President Mr. Gustavo Loyola

Mr. Haddad was recently confirmed as Finance Minister after temporarily holding the posts of Planning Minister and Finance Minister. Previously he was a professor in the state of Minas Gerais. (**Mrs. Crusius** has been appointed Planning Minister.) Mr. Loyola was a Director in the Central Bank during President Collor's term and was appointed Central Bank President in November 1992.

Background

-- After declining from January to April, monthly inflation rose to around 25 percent in late 1992, and further to nearly 30 percent in January 1993.

-- Real GDP is estimated to have declined **by 1.5 percent** in 1992.

-- Preliminary official estimates suggest that the fiscal primary surplus for 1992 was around 1.9 percent of GDP (2.3 percent of GDP according to a new methodology proposed by Brazilian officials) compared with a program target of 3.3 percent of GDP (after removing the effects of inflation during the course of the year). The actual primary surplus, however, may turn out to be significantly weaker as ~~the official~~ estimate seems to be based on optimistic assumptions for the fourth quarter of 1992.

-- Domestic real interest rates were high through July, but turned lower thereafter **with negative rates in August and December, and base money growth increased sharply**.

-- Performance of the external sector was strong, reflecting a sharp expansion of exports, weak imports, and large capital inflows. By end-1992 gross international reserves reached some US$24 billion, more than one year of merchandise imports. The process towards finalizing the refinancing package with commercial bank creditors is moving forward as planned with completion of the road show last week. An agreement with Paris Club creditors was reached in February 1992; however, extension of the consolidation period to cover maturities during February-August 1993 (about US$700 million) had been tied as to the completion of the review under the stand-by arrangement by end-1992. Based on Brazil's high level of reserves and the discussions during the Paris Club meeting, obtaining such an extension would seem difficult.

-- The administration of President Franco has provided confusing signals regarding the course of economic policy: public sector **tariffs** fell [illegible]
sharply behind inflation in the last quarter of 1992, with efforts now underway to recover some of these losses; real interest rate policy has not RIR
been clearly defined, with the President complaining about interest rates being too high; some interventions in the pricing system have been observed

(pharmaceuticals); and the privatization process has been interrupted and revised.

Recent discussions

During their visits to headquarters in November and January, officials of the new economic team informed the staff about recent policy initiatives. As part of a fiscal package submitted last year, Congress approved a reform of the corporate income tax regime which is expected to yield some US$2.5 billion (0.6 percent of GDP) for the Federal Government. The lower house also approved a temporary tax on bank debits, with a projected yield for the Federal Government in 1993 of around US$3.3 billion (0.8 percent of GDP), and prohibited the issue of new bonded debt by state and local governments until the year 2000. Senate approval is still pending. Other measures originally included in the proposal were eventually dropped or rejected by Congress, including the Federal Value Added Tax and selective taxes (meant to replace other taxes), the lifting of bank secrecy provisions under special circumstances, and the extension to public enterprises of the bankruptcy rules that apply to private firms.

To strengthen the financial position of the public enterprises the authorities intend to recover tariffs in real terms to their levels of September 1992 (an increase of around 14 percent). Similarly, certain measures to strengthen administration of the Social Security System are being adopted. A new national wage law has speeded the indexation of wages, including the minimum wage, and will affect social security benefits because they are tied to the minimum wage. As a result of this law, and the process of salary equalization for public employees, the public sector wage bill is expected to increase by about 1 percentage point of GDP in 1993; the financial position of the social security system, including the effect of the retroactive payments of the 147 percent increase approved last year, would deteriorate by about 0.4 percentage point of GDP in 1993.

Assuming that all measures now before Congress are approved, the authorities project a fiscal primary surplus for 1993 in the same order of magnitude as the estimated outcome for 1992, while they consider this to be consistent with a reduction of monthly inflation to around 10 percent by end-1993, the staff questions how broad maintenance of the 1992 ~~first~~ fiscal? stance would yield a declining inflation rate. Furthermore, based on a preliminary evaluation by the staff, the official fiscal projections for 1993 seem to be optimistic, particularly as regards the financial positions of the public enterprises and of the state and municipal governments. Officials said they would continue to work on the fiscal projections.

The Brazilian delegations indicated the authorities' desire to reach an agreement on a program for 1993-94 that could be supported by the Fund. Apart from what was just said on fiscal policy, officials indicated that the trade liberalization and privatization programs would be continued and that a reform of the financial system (including a strengthening of the Federal Savings Bank) would be introduced. They also indicated that discrepancies on economic policies between the new President and the economic team had been eliminated. However, some tensions seem to have re-emerged recently regarding the appropriate stance for monetary policy.

While the measures adopted by the authorities and those in the planning stage may be seen as steps in the right direction and should be encouraged, the staff believes that a significantly stronger fiscal stance would be required for the Fund's support of an arrangement with Brazil. In the recent Country Strategy Brief for Brazil the staff concluded that a primary surplus of around 6 percent of GDP in 1993 would be needed to produce a significant reduction of inflation on a lasting basis. (This message had been communicated earlier to the authorities and was repeated to the visiting officials, who said they would transmit it to Minister Haddad.)

The Article IV consultation mission has been tentatively scheduled to start on March 1, 1993. This date needs to be confirmed. This memorandum has been reviewed by FAD and PDR.

Office Memorandum

To: The Managing Director
The Deputy Managing Director

November 20, 1992

From: S. T. Beza

Subject: Brazil--Country Strategy Paper

The attached country strategy paper has been reviewed by Messrs. Tanzi and Kopits (FAD), Ferran (PDR), Calvo (RES), Gupta (TRE), Croce (INS), Lindgren (MAE), Cisse (LEG), Wasfi (STAT), Papageorgiou (IBRD) and Mr. van Beek and myself (WHD). An executive summary and a work program for the next 12 months also are attached.

In a meeting with reviewing departments and the IBRD on the draft paper, there was a consensus that Brazil needs to implement a major strengthening of the public finances (achievement of a primary surplus of around 6 percent of GDP) irrespective of the approach adopted to reduce inflation. (Two basic approaches are presented, one supported by a flexible exchange rate policy and the other one by a fixed exchange rate and supporting incomes policies.)

It was emphasized in these discussions that the fiscal strengthening ought to be based on measures of a permanent nature to produce the change in confidence required to reduce inflation on a lasting basis. Given the staff's current estimate of fiscal prospect for 1993 before measures, achievement of a primary surplus of the magnitude just indicated would require a fiscal effort of about 7 percentage points of GDP.

There was no enthusiasm for a program based on a phased approach to fiscal strengthening and inflation reduction. The phased approach described would aim first at achieving a significant improvement in the public finances (a primary surplus of around 4 percent of GDP) and a modest decline in monthly inflation (from 25-30 percent currently to around 15 percent by December 1993) in the first year. This would be followed in the second year by one of the two basic approaches referred to above. There was skepticism whether this relatively slow pace of inflation reduction could be carried through to a successful conclusion, given the instabilities inherent in high inflation.

While a unilateral restructuring (confiscation) of domestic public debt might reinforce the fiscal effort by reducing real interest payments on public debt, such measures had important negative effects on confidence. Therefore they should not be advanced as suggestions by the staff (although the authorities might be driven to such actions).

Participants in the meeting were not in favor of a program in which a tightening of credit policy sought to compensate for inadequate fiscal adjustment, as was attempted for the first part of the present program. The conclusion was that this approach had been tried and had not worked.

It was agreed that the implementation of structural reform policies needed to be continued to raise efficiency. Efforts should be focussed on deepening the trade liberalization program, accelerating the privatization of public enterprises, and introducing comprehensive fiscal and financial system reforms. A proposal for fiscal reform was submitted recently to Congress but it is unclear whether it stood a chance of being approved before year end and whether it would be sufficient to address Brazil's fiscal problems. Further technical assistance missions would be required in the areas of tax administration, tax and social security reforms, and financial system reform.

In sum, the sense of the meeting was that we should not get involved in supporting a program unless it involves a major fiscal adjustment that is sustainable. If the authorities were to ask for support for a program that included significant fiscal actions by most standards but nevertheless fell short of the effort described above as necessary, we would need to explain to them that the chances that inflation would be reduced with such a program would be very slim. In effect, in the circumstances of Brazil, with inflation running at a very high rate, trade offs to compensate for a less than fully adequate fiscal policy do not exist.

Attachments

cc: FAD, INS, LEG, MAE, PDR, RES, STA, TRE, IBRD

Contributors:
J. Fajgenbaum
J. Lizondo
B. Traa

STB
FuB
JF
IO
F

Office Memorandum

INTERNATIONAL MONETARY FUND
WESTERN HEMISPHERE DEPT.

1993 FEB -5 PM 12: 22

To: Mr. Lizondo February 5, 1993

From: Jan F. van Houten J.H

Subject: Brazil--Draft Briefing for MD Meeting

The Managing Director should be informed early on in the briefing of the purpose of the visit. As is stands, the only indication is on page 4 (top of first full paragraph), where it is said that recent delegations have pressed for 1993 program support from the Fund.

More generally, the note fails to convey adequately the unsustainable situation the Brazilian economy finds itself in. The performance of the economy in 1992 is said to have been "uneven" (page 2). There has been "some confusion regarding the course of economic policy" (page 3). Surely, we want to sound a more acute note of warning about the situation. As a minimum, to better justify the magnitude of the fiscal adjustment the staff deems adequate, we should mention the magnitude of the PSBR in 1992 (some 50-60 percent of GDP), in addition to discussing the primary fiscal surplus. Also, while noting the recent strength of the external sector, we should indicate its precariousness as it reflects both weak domestic demand and an unsustainable policy mix.

We found the draft briefing memorandum somewhat misleading in its presentation of Brazil's relations with the Paris Club when it states that "An agreement was reached with Paris Club creditors in February 1992". While this is factually true, it is also important to mention (page 2), that the consolidation period was tranched and that the period covering February-August 1993 was to be triggered only if the Fund completed the review under the SBA by December 1992.

cc: Mr. Beza
Mr. Tanzi

Office Memorandum

① Brazil
② Travel - mission

To: Mr. Fajgenbaum February 1, 1993

From: R. A. Elson

Subject: Participation of Mr. Garcia in Mission to Brazil

Following our telephone conversation on the day before your departure for Japan, I spoke with Messrs. Tait and Duran-Downing about the possible conflict for Mr. Garcia in participating in the missions to Bolivia and Brazil. Since Mr. Garcia had already devoted significant time to preparations for the mission to Bolivia, which is now scheduled to depart on or around February 15, Mr. Tait wanted him to continue with that assignment. If necessary, Mr. Tait was prepared to ask Mr. Garcia to travel directly to Brazil upon completion of the work in Bolivia to join a mission there. He also thought that Mr. Garcia could participate in the discussions with the Brazilian authorities at headquarters next week.

Mr. Tait has requested, however, that during those discussions every effort be made to agree on a date for the mission to Brazil in the second half of March or towards the end of March in order to allow time for Mr. Garcia to return to Washington after the close of the mission to Bolivia and before he embarks on the mission to Brazil.

I think this is a reasonable request and hope you will be able to agree on such an arrangement with the Brazilian authorities on the grounds that staffing constraints require some delay in the timing of the mission.

cc. Mr. Tait
Mr. Duran-Downing

✓ ① Brazil
② Travel-approval memo

(F)

Office Memorandum

To: The Deputy Managing Director
(Cleared with Administration)

January 25, 1993

From: S. T. Beza

Subject: Brazil--Fund Staff Participation in Meetings With Commercial Banks

Mr. Kafka and the Brazilian authorities have requested that a representative of the staff participate in the presentation of the financing package for Brazil to the international banking community. Meetings will be held in New York, Tokyo, Frankfurt, Paris and London over the period January 26-February 5, 1993. To meet this request, I would like your approval for Mr. Fajgenbaum, Chief of the Atlantic Division, to participate in these meetings.

cc: ADM
Mr. Elson
Mrs. Brana