

DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

**FOR
AGENDA**

EBS/88/126
Correction 1

CONFIDENTIAL

July 8, 1988

To: Members of the Executive Board
From: The Secretary
Subject: Brazil - Stand-By Arrangement

The following corrections have been made in EBS/88/126 (7/1/88):

Note of transmittal: revised

Page 8, paragraph #22, line 1: for "For reaching reforms"
read "Far-reaching reforms"

Corrected pages are attached.

Att: (2)

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July 1, 1988

To: Members of the Executive Board

From: The Secretary

Subject: Brazil - Stand-By Arrangement - Note on the Program of
Modernization and Adjustment, 1988-89

Attached for consideration by the Executive Directors is a letter from the Brazilian authorities requesting a stand-by arrangement equivalent to SDR 1,096 million, together with a note on Brazil's economic program, and a technical memorandum of understanding. The staff paper describing and analyzing the economic program will be circulated soon.

Mr. Reichmann (ext. 8610) or Mr. Muñiz (ext. 8611) is available to answer technical or factual questions relating to this paper.

Att: (1)

8. The reduction in tax revenues results from a series of factors, including the growth of incentives and subsidies, tax evasion and fraud, and the impact of inflation on the tax revenue of all levels of Government.

9. The public sector absorbs the major share of national financial savings. Continuation of this process could make private sector access to credit more difficult or force the Federal Government to issue large amounts of currency, thus leading the country into hyperinflation.

10. Another cause for concern is the increase in the public sector's interest expenditures that has resulted from the growth in the domestic debt, which in turn, has expanded as a consequence of the problems generated by the external debt.

11. The public deficit accumulated in the past resulted in a large debt stock that burdens the entire public sector. The increased charges on this debt have not been matched and are still not matched by a corresponding growth in the resources available to the state.

12. However, reductions in the domestic debt service costs should not be sought through artificial measures that could cause a loss of confidence in public securities and, in final analysis, have an adverse impact on small savers and the workers themselves.

13. The strategy aimed at correcting these imbalances would, therefore, be concentrated on the gradual but firm reduction of the public deficit, in such a way as to further the reordering of the Government's finances, with the least possible social cost. Thus, every effort will be made to reduce the deficit from the 1987 level of 5.5 percent of GDP to 4 percent in 1988 and a maximum of 2 percent in 1989.

NORMALIZATION OF RELATIONS WITH THE INTERNATIONAL FINANCIAL COMMUNITY

14. To renew the growth process, it is vital that an adequate flow of resources from abroad be re-established. And to achieve this, it is essential that the nation's relations with the international financial community be normalized.

15. Finalization of a pluriannual and mutually satisfactory agreement with the banks--that makes it possible for the country to normalize interest payments and reduce external debt charges, while expanding maturity and grace periods--is of fundamental importance to our economy.

16. As a member of the International Monetary Fund, Brazil should make use of the alternatives the institution makes available. Thus, we will seek that institution's support for the necessary effort that the country will make to adjust its economy and renew the process

of economic and social growth. With due consideration of our needs and conveniences, this adjustment is being carried forward in a sovereign and realistic manner.

17. An arrangement from the International Monetary Fund is indispensable to the renegotiation of the Brazilian debt with the Paris Club. This will make it possible for export credit agencies of industrialized countries to reopen financing operations for Brazilian imports, particularly capital goods, which are essential to the growth and modernization of Brazilian industry.

18. Normalization of relations with the international financial community would also make it possible to regain the confidence of investors in the Brazilian economy, to obtain new resources from financial assistance programs created by governments of developed nations and to recover access to the voluntary capital markets.

MODERNIZATION OF THE ECONOMY

19. Perhaps the greatest challenge before the Government and society in these final years of the century is the redefinition of the role of the state. Preparation of the path towards a more competitive and efficient economy is a task that must be performed with courage.

20. During the course of recent decades, the state has, with undoubted success, played a role of great importance in the transformations through which this country has passed. Our solid industrial base, the sophistication of our financial and capital markets, the change in the foreign trade structure and the modernization of important segments of the agricultural sector are, without doubt, a result of the guidance provided by public authorities, particularly through the management of subsidies and fiscal and financial incentives.

21. Today, however, the growth model based on state intervention in the economy shows clear signs of exhaustion, while it has also created distortions that must be eliminated. Exaggerated growth of bureaucracy coupled with excessive controls have become the antithesis of the initial objective of the process, which was that of making accelerated economic development feasible.

22. Far-reaching reforms must be introduced with the following objectives: revitalizing the industrial sector, particularly in regard to technology and exposing it with the necessary precautions to increased competition with the international economy; reducing foreign trade controls and implementing a tariff system that is consistent with the objective of modernization, reviewing the functioning of the national financial system for the purpose of reducing the costs of financial intermediation and enhancing the system's contribution to economic and