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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 00/116

3:00 p.m., November 27, 2000

Contents

Executive Board Attendance

H. Köhler, Chairman
S. Fischer, First Deputy Managing Director

Executive Directors

S.M. Al-Turki

M.J. Callaghan

R. Faini
K.-T. Hetrakul

J.-C. Milleron
A. Mirakhor

H. Oyarzábal
S. Pickford
M. Portugal
C.D.R. Rustomjee
A.S. Shaalan
Wei Benhua
J. de Beaufort Wijnholds

Alternate Executive Directors

D. Ondo Mañe
J. Nelmes, Temporary

S. Bonomo, Temporary
W.-D. Donecker

R.A. Jayatissa
J. Prader
Å. Törnqvist
J. Abbott, Temporary

L. Palei, Temporary

M. Junguito
I. Usman

H. Toyama
G.R. Le Fort

A.S. Linde, Acting Secretary
N. Hairfield, Assistant

Also Present
IBRD: S. Bery, Latin American and Caribbean Regional Office. African Department: R. Sharer. External Relations Department: F. Baker Meio Filho, J. Starrels. Fiscal Affairs Department: I. Coelho. Middle Eastern Department: S. Eken. Policy Development and Review Department: M. Rossi, J. Seade. Research Department: R. Baqir, G.M. Milesi-Ferreti. Secretary's Department: S. Bhatia. Western Hemisphere Department: C.M. Loser, Director; M.E. Bonangelino, Deputy Director; D. Goldsbrough, Deputy Director; T.M. Ter-Minassian, Deputy Director; G. Mackenzie, C.A. Paiva, G.J. Schwartz. Office of the Managing Director: S.B. Brown, D.A. Citrin. Advisors to Executive Directors: M.P. Bhatta, J.A. Costa, V de los Santos, S.S. Farid, A. Fidjestøl, A.R. Ismael, I. Mateos y Lago, H. Mori, R. Villavicencio. Assistants to Executive Directors: J.G. Borpujari, R. Burgess, V. Dhanpaul, F. Haupt, S. Hinata, I.C. Ioannou, A. Kapteijn, T. Koranchelian, P. Lathouly, Liu Z., A. Maciá, D. Nardelli, E. Nyambal, K. Ongley, M. Pérez dos Santos, D. Vogel.

1. BRAZIL—2000 ARTICLE IV CONSULTATION; AND REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 2000 Article IV consultation with Brazil and the sixth review under the Stand-By Arrangement for Brazil (EBS/00/223, 11/8/01; and Sup. 1, 11/16/00). They also had before them a staff paper on selected issues and a statistical appendix (SM/00/251, 11/10/00).

The staff representative from the Western Hemisphere Department made the following statement:

> The following information has become available since the "Staff Report for the 2000 Article IV Consultation and Sixth Review Under the Stand-By Arrangement" (EBS/00/223) was issued. It does not change the thrust of the staff appraisal.
>
> Brazil's economy recovery continued in the third quarter, with real GDP growing at a seasonally adjusted rate of 1.2 percent relative to the second quarter; in the first three quarters, real GDP grew by 3.9 percent relative to the first three quarters of 1999. The staff's forecast for average economic growth in 2000 remains unchanged at 4 percent.
>
> The unemployment rate (seven-day measurement period) continued to fall moderately, to 6.8 percent in October 2000 compared to 7.5 percent in October 1999. Average real wages declined by about 1.1 percent in the first nine months of 2000, compared with the same period of 1999, with significant variations across sectors and regions.
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> Consumer price inflation (IPCA) slowed further to 0.14 percent in October, compared to 0.23 percent in September. On a 12-month basis, IPCA inflation declined to 6.7 percent, down from 7.8 percent in September 2000. General price inflation also slowed, with the IGP-DI index increasing by 0.37 percent in October (compared to 0.69 percent in September), and by 12.7 percent on a 12-month basis.
>
> The trade balance for October showed a seasonal deficit of US $523 million. For January-October 2000, the trade balance surplus amounted to US $194 million, compared to a deficit of US $1,213 million for the same period in 1999. During the same period, services and transfers (net) showed a deficit of US $19.6 billion, largely reflecting interest payments. Brazil's current account deficit amounted to US $19.4 billion for January-October 2000 (3.9 percent of GDP), compared to US $19.7 billion (4.5 percent of GDP) for the same period in 1999.
>
> Net inflows of foreign direct investment remained strong in October, reaching US $1.7 billion for the month, and US $23.0 billion during January-

October, thereby continuing to more than cover the country's current account deficit. The rest of the capital account remained broadly unchanged, with net portfolio investments reaching US $2.4 billion during January-October 2000 (compared to US $2.5 billion during January-September 2000), and net inflows of medium-and short-term debt reaching US $5.8 billion during the same period (compared to US $6.0 billion during January-September 2000).

Gross international reserves stood at US $32.3 billion on November 27; net international reserves amounted to US $31.0 billion on the same day, US $6 billion above the proposed program floor for the second half of 2000.

On November 21, the government announced an increase in domestic fuel prices. Ex-refinery prices for gasoline, diesel, cooking gas (GLP), and kerosene were increased by 11 percent as of November 23, 2000, which is expected to raise pump prices by 8 percent (5 percent for GLP). As a result, consumer prices (IPCA) are expected to increase by about 0.45 percent. With this latest price increase, domestic ex-refinery prices for gasoline have been raised by a cumulative 74 percent since January 1999. In addition, the government announced that, in preparation of the planned liberalization of the domestic oil market in 2002, an automatic quarterly adjustment mechanism for domestic fuel prices will be implemented starting in the second quarter of 2001. Accordingly, differences between the world market price of oil (expressed in Reais) and the fixed reference price of R $55 per barrel will be passed to domestic prices. If the world market price were to drop below the fixed reference price, the government is committed to lower domestic fuel prices, as called for by the quarterly adjustment rule, except for subsidized products.

The government also announced that the oil account is now projected to show a surplus of R $3.5 billion to R $4.5 billion in 2001, below the R $6.5billion assumed in the budget proposal now before congress. However, the state oil monopoly, Petrobrás is also expected to post a higher primary surplus than originally projected for 2001, thereby largely compensating lower revenues in the oil account. During the course of 2001, the government should recognize/pay the small deficit that is projected for the oil account this year.

The central bank (BCB) continued its cautious conduct of monetary policy, with the monetary policy committee (COPOM), in its November 21-22 meeting, deciding to leave the overnight (SELIC) interest rate unchanged despite the slowdown in inflation.

On November 20, the government successfully sold 60 percent of BANESPA's voting shares to Banco Santander Central Hispano (BSCH) of Spain, for R $7.05 billion (about US $3.7 billion), which represented a premium of 281 percent over the minimum asking price. With the acquisition, BSCH will become the third largest private bank in Brazil, and the largest foreign-owned bank. The outcome bodes well for increasing competition in the banking sector as it creates a new strong player in the domestic market. The proceeds from the sale will be entirely used to retire public debt.

Mr. Portugal and Mr. Mori submitted the following statement:

Brazil's economic program has achieved its main macroeconomic objectives in 2000—namely, a steady economic recovery, a reduction in unemployment, a further decline in inflation, and the maintenance of external viability. These achievements may be attributed to the significant shift in fiscal stance since 1999 as indicated by large primary surpluses, the successful implementation of the new monetary policy framework of inflation targeting, and the effects of wide and important structural reforms that have been implemented since the early 1990s. Real GDP is expected to accelerate to near 4.0 percent for the year as a whole from 0.8 percent in 1999. The unemployment rate declined to 6.7 percent in September 2000 from 7.4 percent in September 1999 in a context of a strong reentry into the labor market. Despite supply shocks, inflation remained subdued, with the 12-month rate to October declining to 6.7 percent from 8.9 at end-1999, and a further decline in the inflation rate is expected by year-end to a level close to the central target of 6 percent. Macroeconomic stability and satisfactory GDP growth have been allowing the government to continue its policies to reduce poverty, improve income distribution, and diminish regional disparities.

The recovery in economic activity led by the industrial sector (which grew by 6.5 percent in January-September 2000 compared to the same period in 1999) has been broad-based. A marked rebound in the consumption of durable goods and exports, and a more moderate recovery of consumption of non-durable goods and investment has been observed.

The current account deficit is projected to remain at about the same level as last year in nominal terms, US $25.3 billion (4.2 percent of GDP). Exports continued to improve fast, rising in volume terms by 14.4 percent during the first nine months of 2000, compared to the same period in 1999. But the terms of trade improved only modestly by 2.5 percent. Imports are also expanding, reflecting the marked rebound in industrial output, especially imports of intermediate goods that rose by 30 percent in volume in the first nine months of 2000, more than offsetting the continued decline in most of the other import categories. Net FDI flows have continued to show strength, reaching US $23.8 billion in the first eleven months of the year, up to November 20. For 2000 as a whole, net FDI is projected at around US $26 billion, once again exceeding the expected current account deficit. The authorities have successfully implemented debt exchanges totaling some US $6.1 billion during this year. The total external debt declined to US $232.4 billion (40.2 percent of GDP) at end-August 2000, from US $241.5 billion (45.6 percent of GDP) at end-1999. Only 11.8 percent of the external debt has maturity of less than one year. Net international reserves were at US $29 billion on November 17, US $4 billion above the program floor. Brazil's long-term credit rating has been recently upgraded by Moody's.

The Central Bank has continued its cautious conduct of monetary policy within the inflation-targeting framework. Improvements in domestic and external conditions have allowed the overnight rate to be reduced in gradual steps from 19 percent in April to 16.5 percent in July. Since then, however, the rate has been kept unchanged, first in the light of the temporary pickup in inflation during July-August and, more recently, due to renewed uncertainty in international financial markets. The central bank has also reduced in steps the reserve requirements on bank deposits to 45 percent for sight deposits from 65 percent in October 1999.

Staff notes that credit to households has been growing relatively fast. This reflects both the decline in bank spreads (from 52.7 percent to 32.1 percent in the 12-months to October 2000) and the fact that the better economic prospects have led supply and demand for credit to be restored from the very low levels observed in the recent past, which reflected the existing uncertainties in the economy. It is also important to note that overall credit has increased by a moderate 4.5 percent in the 12 months to September 2000. In addition, real incomes remained subdued and interest rates are still high such that a consumption boom does not seem likely in the short run. In any event, the central bank will continue to maintain a cautious policy and close monitoring of the economy to avoid excessive credit expansion.

Strict fiscal discipline has been maintained at all levels of government. The primary surplus of the consolidated public sector reached R $35.3 billion in the first nine months of 2000, or R $6.3 billion above the target in the program for end-September. The improvement at the central government level reflected mainly expenditure containment efforts, while preserving core social assistance programs. The favorable performance of the Social Security System, with a deficit in the first nine months that is 7.4 percent lower than last year, reflects the initial effects of the reform of 1998, as well as improvements in the administration of contributions and pension benefits.

Also deserving special mention is the good financial performance of the states and municipalities, reflecting the effects of the debt restructuring agreements, the government's tight control of access to new financing, and the continued strength in state revenues. Current projections put the consolidated primary surplus of these governments at around 0.5 percent of GDP in 2000. The federal government concluded last May debt-restructuring agreements with about 180 municipalities (including those of São Paulo and Rio de Janeiro), which should henceforth help to improve fiscal discipline at this level of government too, similarly to what is happening with the states. The fiscal performance of the public enterprises is also expected to remain strong, with a projected primary surplus of around 0.7 percent of GDP for the year.

Large primary surpluses, lower interest rates, and favorable exchange rate developments allowed the overall deficit of the public sector (PSBR) to fall markedly. PSBR is projected at 4.6 percent of GDP by year-end compared with 10 percent of GDP in 1999 as a whole.

As staff explained in Box 1, the latest published national account figures for 1999, indicate both a small reduction in real growth in that year (from 1.1 to 0.8 percent) and a more significant (5 percent) drop in nominal GDP, compared to the previous working assumption for the program that were projected using the general price index (IGP) rather than the GDP deflator. The large exchange rate depreciation and terms of trade deterioration in 1999 led to substantial increases in import and export prices and to a GDP deflator considerably lower than the price index used in the earlier GDP projections. As staff pointed out, the correction of the nominal GDP figure for 1999 implied a higher primary surplus as a percentage of GDP and also a higher debt to GDP ratio in that year. Also, it implies a lower nominal projected GDP for 2000. While the thrust of the fiscal stance remains unchanged, a lower nominal GDP for 2000 means an upward revision of the ratio of the net public debt to GDP, now expected not to exceed 50 percent of GDP. Also, in view of the revision of nominal GDP for 2000, the target for the primary surplus of the consolidated public sector of R $36.7 billion will also now be a higher proportion of GDP, around 3.4 percent of GDP (as compared to 3.25 percent of GDP previously targeted in the program for this year).

The government will continue to follow in 2001 the prudent fiscal management it has been pursuing, and has submitted to Congress a budget targeting a primary surplus of the federal government of R $28.1 billion which, given the expected primary surplus of the states and municipalities and the public enterprises, is consistent with the consolidated public sector primary surplus of 3 percent of GDP agreed in the program.

The government continues to carefully monitor developments in international oil prices in order to minimize the deterioration of the fiscal surplus of the petroleum account, while also avoiding undue pressure on inflation. In addition to two increases in domestic gasoline and diesel prices this year, the last one of 15 percent in July, the government announced today a further increase of 11 percent. The government has also defined a parametric formula for quarterly changes in oil products prices to be implemented from the second quarter of next year linking these changes to changes in the international oil prices and in the exchange rate. With these measures the net revenue of the petroleum account for next year is estimated to be between R $3.5 billion to R $4.5 billion , which together with the improved operational result of PETROBRAS, would be consistent with the fiscal targets defined for 2001.

Further steps have been taken in the structural fiscal front to ensure the medium-term fiscal sustainability. In June, the Senate approved the Multi-Year Plan for 2000-03 (PPA), which outlines the government's strategy for allocating federal budget resources among spending programs over the period, and aims at enhancing predictability, accountability, and efficiency in federal budgetary spending. A number of bills have been proposed to Congress this year to broaden the tax bases, to unify income tax rates and to improve tax enforcement, including a bill modifying the existing bank secrecy legislation; a new tax code limiting the scope for tax avoidance and excessive tax litigation; and a bill transforming the rural property tax into a special contribution to finance land reform. On the reform of indirect taxation, the government has achieved substantial progress in securing agreement by the states on the unification across the country of the base and rate structure of the state level VAT. Negotiations continue between the Government and the House of Representatives on what became a main obstacle to move ahead with the tax reform, namely the intention of some law-makers to include in the constitutional text a provision on non-cumulativity of tax which is objected by the government as this might lead to future legal disputes. The government has also submitted to Congress a proposed constitutional amendment establishing an explicit tax on fuel products to complement the scheduled full liberalization of the domestic oil market by end-2001. An important complement to the Fiscal Responsibility Law has been the enactment last October of the Fiscal Crimes Law, which defines a series of fiscal crimes in connection with the Fiscal Responsibility Law, punishable with prison sentences of up to four years.

The National Treasury has continued in its efforts to improve public debt management and the secondary market for public debt. Strengthened market confidence and declining inflationary expectations have allowed the government to increase the average maturity of total domestic securitized federal debt outstanding in the market to 29.3 months at end-August 2000. At the same time, the share of fixed-rate securities has risen from 9.2 percent at end-1999 to 15.7 percent at end-September 2000. The government is also extending the duration, smoothing the amortization profile and diversifying the currency mix of external public debt.

While the position of the Brazilian financial sector is sound, a key policy priority of the authorities has been to continue strengthening the financial sector and improving its efficiency, especially in the segment of public banks. The regulatory prudential framework has continued to be reinforced, particularly through the implementation of a forward looking loan classification system and of a new system of capital charges related to interest rate risk. The Central Bank has further strengthened banking supervision, including through the creation of separate departments for onsite and offsite supervision, and the hiring and training of new staff. It is also setting up a real-time gross settlements system to improve payments arrangements and significantly reduce default risks. It will continue its efforts to further strengthen banking supervision, in cooperation with the various supervisory authorities, to improve the functioning of domestic financial and capital markets and to further enhance transparency of its own operations. The government is currently considering the options with regard to restructuring federal banks, an important step to preserve the health of the financial system. A report prepared by Booz-Allen & Hamilton and the Economic Research Institute of the University of São Paulo (FIPE) proposing alternative approaches for a possible strategy with respect to these banks is now in process of public consultation. The report has been posted in the Internet and has been accessed 76,000 times and generated 52,000 e-mail returns. Meanwhile, the Central Bank is concluding an extensive auditing of these banks. Intensified supervision has already increased transparency of financial statements of federal banks.

The government continued to implement its ambitious privatization program. This effort has been consistently sustained for a decade now, generating nearly US $92 billion in revenues, privatizing 128 companies in a wide range of sectors and enacting concessions to the private sector. As outlined in Box 3, the fiscal and efficiency gains of privatization have been significant. The fiscal result of the state-owned enterprises shifted from a deficit to a surplus and the Treasury subsidies have been eliminated.

Since the last review, the privatization effort involved the selling of energy companies (CELPE, CEMAR), a gas company (Gás Sul), a sanitation company (Manaus Saneamento), and the bank of Paraná, generating total receipts of R $4.7 billion. In addition, substantial private sector involvement in the energy sector is already being achieved through joint ventures, with minority participation of Petrobrás and Eletrobrás, for the new thermoelectric power plants and electricity transmission lines. Also, the government carried out the sale of a large non-controlling stake of Petrobrás, for a price of R $7.2 billion. In a public auction last November 20, the government successfully privatized BANESPA, which used to be the country's largest state bank, to Banco Santander Central Hispanico, of Spain, for R $7.05 billion (about US $3.7 billion), with a premium of 281 percent over the bid's minimum price. In addition to the positive balance of payments and fiscal effects of this sale, whose proceeds will be entirely used to retire public debt, the acquisition of BANESPA will substantially increase competition in the Brazilian banking industry, as the new bank will be the third largest private bank in Brazil.

While eventual delays in such a major effort as the privatization program are inevitable due mainly factors outside the government's control, the government credentials an-d commitment in this area are well established, and the efforts to privatize the remaining state banks and the large electricity generation companies will be maintained. In this respect, our authorities are requesting some modifications in the timetable for certain structural benchmarks of the program to reflect delays that have occurred.

Since 1990, Brazil has made major progress in trade liberalization. Average import tariffs were reduced from 31.2 percent in 1990 to 12.5 percent in 1996 and all non-tariff barriers have been removed. A temporary 3 percentage points surcharge introduced by the Mercosur Council in 1997 and scheduled to be removed in 2001, increased the average tariff to 13.7 percent. The government places high priority in working towards an open, multilateral, rules-based trade system and has been working at this endeavor both at the regional and multilateral fronts. Within Mercosur, new sectors have been added, 500 new items have been incorporated into the Common Nomenclature since 1997 (which now comprises 9.372 tariff lines), the list of exceptions has been reduced, efforts are being pursued to expand the agreement to Chile, Bolivia, and the Andean Pact countries, and negotiations are under way with the European Union to improve trade relations between both trade blocs. At the hemispheric level, negotiations are under way among 34 nations to establish a Free Trade Area of the Americas by 2005. At the multilateral level, the government is committed to the WTO rules and the Uruguay Round Agreement, whose implementation has revealed persistent imbalances. While Brazil has enhanced its legislation and enforcement of intellectual property rights and the service sectors, the country's trade potential continues to be undermined by unjustifiable barriers to agricultural products and protectionist use anti-dumping measures for manufactured goods, a situation that considerably reduces the government's political latitude in the area of trade liberalization.

Many other structural reform initiatives have been taken by the government to improve medium-term economic prospects through measures envisaging gains in efficiency and increased productivity. Since 1997, the government has proposed several measures and laws seeking to increase flexibility of the labor market, allow collective bargaining at plant level, reduce severance costs, and reduce judicial interference in labor dispute. Temporary work contracts have been made easier, and the minimum wage has been differentiated by geographical regions and de-linked from public sector wages.

In concluding, Brazil has continued to implement successfully its economic program and to display a strong macroeconomic performance into this second year of its arrangement with the Fund. Since the program revision in early 1999, all quantitative performance criteria, nearly all indicative target and numerous structural benchmarks have been met. But a challenging policy agenda remains ahead and the external environment remains considerably unsettled. The authorities remain fully committed to the program targets and objectives, determined to preserve domestic and external macroeconomic stability, pursue sustainable economic growth, and prepared to respond swiftly and appropriately to domestic or external adverse developments.

Ourselves and our Brazilian authorities would like once again to express our appreciation for the continued high quality dialogue with staff and Management and thank them for their support, as well as that of the international community to Brazil's economic program.

Mr. Shaalan and Ms. Farid submitted the following statement:

The Brazilian economy has continued to perform well due, in no small measure, to the sustained implementation of macroeconomic adjustment and structural reform following the crisis of 1998. The authorities' commendable management of the reform effort has paid off, as reflected in the strengthening of the economic recovery with subdued inflation, declining unemployment, and an improvement in the external accounts. The free float of the real has been maintained and has been supported by a well-balanced financial policy mix. While the currency has appreciated somewhat, competitiveness does not seem to have suffered, as evidenced by the continued growth in export volumes and in import substitution in 2000. Most importantly, progress on fiscal consolidation has continued at all levels of government, and has included a significant improvement in the fiscal position of the states, attesting to the success of the authorities' strategy of strictly enforcing debt refinancing contracts between the states and the federal government and of upholding strict borrowing limits for the states. Fiscal discipline has facilitated the conduct of monetary policy, allowing the central bank to cautiously reduce the SELIC interbank rate during the year while taking important measures that helped reduce bank spreads significantly to stimulate increased lending operations. Continued market confidence in the authorities' policies is reflected in the strength of capital inflows, particularly in the form of foreign direct investments. In view of Brazil's strong performance under the program, we support the completion of the sixth review.

On fiscal policy, the achievement of primary surpluses in the consolidated public sector continues to be necessary to maintain the downward trend in net public debt to GDP. Strict expenditure discipline will be required in the remaining months of this year to assure the achievement of the primary fiscal targets for 2000, particularly by the federal government and its enterprises, in view of the persistence of high international oil prices and the expectation that no further increases in domestic fuel prices will be effected before year-end. Looking forward to 2001, achievement of the authorities' primary fiscal targets, which appear to be broadly appropriate, will most likely require timely increases in domestic oil prices. Staff note, in particular, that the proposed 2001 federal budget assumes a surplus in the petroleum account based on an optimistic projection of a decline in international oil prices to under $25 a barrel. The budget also assumes a more pronounced decline in interest rates than assumed by staff as well as a significant appreciation of the average exchange rate from its current level, which also may not materialize. Other uncertainties surrounding budget projections are related to (a) the passage of the constitutional amendment instituting a social security contribution for retired civil servants, (b) the assumption of no real increase in the minimum wage and minimum pension benefits, both of which are under considerable debate in congress, and (c) the possibility that a recent Supreme Court decision could result in a retroactive 12 percent wage increase to the judiciary. These factors would call for close monitoring of the budgetary accounts so that corrective measures are taken, if needed, in a timely manner.

On structural fiscal reforms, it is heartening to see that the Social Security System reforms put into effect have begun to bear fruit, as reflected in the marked improvement in the finances of the social security system for private sector workers in 2000. These reforms helped strengthen revenues by closing legal loopholes, enlarging the base of contributions, and allowing for a sizable recovery of contribution arrears. The reforms also appear to have led to a containment in benefit expenditures which remained below the nominal expansion of GDP. Combined with the managerial and operational improvements that have also been introduced, the system now appears to be on a sustainably viable path. As noted by staff, the authorities should now turn to the reform of the pension system for public sector workers where problems still remain. The introduction of the social security contribution for public retirees assumed in the 2001 budget would be a first step in this direction. The authorities' intention to introduce reforms to allow the recruitment of new civil servants under the same labor and pension regimes as private employees would also help ameliorate the problems in the system for public retirees. Still on structural fiscal reforms, the implementation of the fiscal responsibility law is also expected to strengthen the institutional base of budget discipline at the state and local government levels and thereby contribute to a sustained improvement in the public finances. Looking beyond 2001, it will be important to continue to strengthen structural fiscal reform efforts particularly in the areas of social security and the tax system, in order to ensure the maintenance of primary surpluses in the consolidated sector to allow continued declines in the ratio of net public sector debt to GDP.

On monetary policy, the authorities should be commended for their skillful conduct of monetary policy which has successfully contained inflation within its tolerance band despite unanticipated supply shocks. While we agree with staff that the indications of a pick-up in demand in recent months, coupled with the narrowing of spare capacity in some important industries and the growth of consumer credit, call for close monitoring, we are confident that no premature loosening of monetary policy is imminent. The very cautious decline in interest rates so far attests to the high degree of prudence that has characterized the management of monetary policy by the central bank up till now.

We are pleased with staff's assessment that the health and resilience of the Brazilian financial system remains relatively strong. We welcome the progress that has been made in bank supervision and regulation, particularly the implementation of the new loan classification system and other measures strengthening the regulatory framework for financial institutions. Also noteworthy is the progress being made in strengthening domestic capital markets, including the expected consideration by congress before year-end of a proposed law on corporate governance substantially strengthening safeguards for minority shareholders. We also take note of the authorities' intention to present to congress, in the first half of 2001, legislation strengthening the independence of the central bank. The restructuring and privatization of the remaining state-owned banks also seems to be proceeding broadly as scheduled. The recent privatization of the Bank of Sao Paolo (BANESPA), the country's largest state bank, is an important milestone in this process. As noted by Mr. Portugal in his helpful statement, this acquisition will substantially increase competition in the Brazilian banking industry, and will also have substantial positive effects on the balance of payments and the fiscal accounts.

Given the Brazilian authorities' continued implementation of strong domestic policies, we agree with staff that the risks to sustained high noninflationary growth appear to stem primarily from possible negative developments in the external environment. The most salient concern, in our view, lies in the possible emergence of a crisis of market confidence vis-à-vis other important countries in the region, which could quickly adversely affect the flow of foreign financing to Brazil and other emerging markets. Given Brazil's relatively high current account deficit and its overall relatively large gross financial requirements and external debt, an external shock could impact the country strongly and, as staff rightly note, would require a prompt and forceful tightening of financial policies.

To conclude, notwithstanding the real risk that an external shock could complicate the outlook for Brazil in the near to medium term, we fully expect that the continued steadfast implementation by the Brazilian authorities of their sound and prudent macroeconomic policies and structural reform program will ensure that the economy remains on a path of sustained noninflationary growth. We commend the authorities for their achievements under the Fund–supported program thus far, and wish them every success as they face the challenges in the period ahead.

Mr. Tornqvist and Mr. Fidjestol submitted the following statement:

Again this chair commends the Brazilian authorities for their achievements. In view of the fact that only slightly more than two years have passed since the country was hit by a serious crisis the results are impressive. GDP continues to grow on a broadly based, sustainable path, employment has rebounded while inflation has remained subdued. In addition, fiscal policy performance has been strong at all levels. Despite the very positive developments mentioned above, there are, nevertheless, significant vulnerabilities that should be considered.

As pointed out by staff the most important vulnerabilities stem from a possible deterioration of the external environment. This vulnerability is mainly due to the relatively high level of the current account deficit and the high level of external debt, which create large overall gross financing requirements. Moreover, although Brazil's market credibility has improved markedly over the last couple of years, it is still rather fragile as evidenced by the high spread on its foreign debt.

In these circumstances a hard landing in the United States, with effects on world trade and the flow of foreign financing to emerging markets, higher oil prices, or a crisis of market confidence vis-à-vis other markets, could have serious consequences for the performance of the Brazilian economy. In particular, Brazil is dependent on a continued stream of foreign direct investment.

Economic policies during the last couple of years have, however, reduced the vulnerabilities. Fiscal policy is particularly important in this regard. The enactment of the Fiscal Responsibilities Law in May provides a basis for a sustainable fiscal policy. Implementing such a policy is particularly challenging for a federal state. Comments from staff on the implementation of this legislation would be welcome.

It is particularly encouraging that fiscal policy performance this year improved not only at the federal level but also at the state level. Given present economic prospects, continued adherence to the present fiscal policy stance is a necessary condition for a continued sustainable development. If external conditions were to deteriorate or domestic demand were to develop stronger than envisaged, the authorities should be ready to tighten the fiscal stance. In this connection, I would appreciate comments from the staff on recent public sector wage developments.

As described in Box 5 of the staff report, the Federal Treasury has recognized substantial amounts of contingent liabilities. The recognized contingent liabilities since 1996 even exceed proceeds from privatization during the same period. The existence of such liabilities and the fact that protracted legal processes have been necessary in order to settle the issues involved are sources of concern, since they represent impediments to fiscal transparency and rational policymaking. I appreciate the efforts to settle these issues, but I would like staff to elaborate on whether new contingent liabilities are likely to occur, and on what has been done to avoid the creation of new such liabilities.

During this year significant progress has been made in improving the structure of the public debt. The share of domestic federal debt placed as fixed rates has increased while the share linked to the overnight rate and the share of foreign exchange-indexed debt have decreased. This process should be continued in order to reduce the vulnerability from changes in interest and exchange rates.

The adoption of a formal inflation targeting framework in mid-1999 seems to have served the country well, despite a small excess over the inflation threshold in September. I agree with staff that the room for maneuver to reduce interest rates during the coming year seems quite limited.

Nevertheless, there seems to be a significant potential for reducing the cost of bank credit, since bank spreads were 37 percentage points in September 2000, despite a major reduction since October 2000. At the same time bank funding cost was 16 percent. I assume it is possible to obtain some kind of financing, for instance mortgage credit, on more favorable terms. It would be interesting to hear staff's view on the reasons for the high spreads, other than the high reserve requirements, and the effects of the high spreads on the economy. Moreover, do the large margins indicate a large scope for efficiency gains, are they due to lack of competition, or do they reflect a need for large provisions for losses?

The authorities have a major task ahead in deciding the future role of the federal banks, which account for 40 percent of the country's banking system. These federal banks have been burdened with a number of quasi-fiscal operations which have had an adverse effect on the transparency, efficiency and competitiveness of these institutions. There is therefore an urgent need for reform and for making a clear decision as to what functions, if any, these banks should have in the future. I encourage the authorities to participate in the FSAP program once their strategy for the federal banks is in place, as mentioned in the staff report.

I note that the authorities have been successful in addressing the problems of the state-owned banks, that also have had some quasi-fiscal functions. The largest of these, Banespa, is now being privatized following a court decision. In general, progress in privatization has fallen somewhat short of expectations. Noting the gains from privatization referred to in Box 3, I fully support the staff in urging the authorities to avoid any further slippages on this front.

With these remarks I fully support the completion of the sixth review.

Mr. Barro Chambrier submitted the following statement:

I thank the staff for this excellent report. As Mr. Portugal indicates in his comprehensive and helpful statement, the Brazilian economy has continued to perform well under the Fund- supported Stand-By-Arrangement. Performance has exceeded expectations for most performance criteria and benchmarks. Macroeconomic indicators are encouraging. GDP growth is satisfactory, unemployment is declining, inflation has been kept under control, fiscal discipline has been maintained and the current account position has improved. The improved economic outlook has enabled the Government to devote more resources for poverty alleviation, as evidenced by significant progress made in a number of social indicators. The authorities should be commended for their commitment to reforms and poverty alleviation.

Thanks to the authorities' effective policy mix based on prudent monetary and fiscal policies, flexible exchange rates and structural reforms, growth prospects remain good and continued progress is expected on the inflation front. However, although Brazil is better prepared than before the 1998 crisis to withstand substantial shocks, the economy faces significant vulnerabilities that can hamper the continuation of sustained and noninflationary growth path. The main risks on the external front have been clearly pointed out by the staff. On the domestic front, the combination of accelerated domestic demand growth and short term supply constraints could result in inflationary pressures. Thus, we encourage the authorities to watch closely the domestic imbalances. As regards the management of external shocks, we concur with the staff that if the external environment were to deteriorate, priority should be given to the tightening of fiscal policy in order to avoid placing an undue burden on monetary policy. Failure to do so would have adverse consequences on investment and the public sector deficit and debt. The overall outcome of a deteriorated economic environment would depend on the authorities' ability to conduct a prompt and forceful policy response.

The authorities have taken action to restore fiscal discipline at all levels of Government, through the containment of expenditures of the central Government and limits imposed on the states' expenditure. As a result, the primary surplus of the consolidated public sector have improved and the overall deficit has declined. Looking ahead, it is expected that the Fiscal Responsibility Law will reinforce this trend.

On the monetary front, we commend the authorities' continued cautious conduct of monetary policy to achieve the inflation objective. Despite unexpected supply shocks and the floating of the Real, inflation has remained within the tolerable limits and the lending rates of banks have been reduced, contributing to encourage investment. The banking sector as a whole appears sound thanks to structural reforms undertaken in the aftermath of the financial crisis. However, the authorities need to address the remaining weaknesses with regard to the federal banks. To this end, we welcome their efforts to participate in the Financial Sector Assessment Program (FSAP).

Substantial progress has been made as regards the structural reforms and the authorities have enacted the Fiscal Responsibility Law. Reforms are underway to reduce the deficits of social security and a number of bills have been submitted to Congress to broaden the tax base, improve the enforcement of existing legislation and rationalize taxation as to reduce the proliferation of exemptions and evasion. However, the authorities need to speed up a number of structural reforms regarding indirect taxation, the development of domestic capital markets, the labor market legislation, further reduction of trade barriers and accelerate privatization of public enterprises to enhance productivity and competitiveness.

Concerning the medium-term prospects of external accounts, the current account deficit is projected to improve and increased exports will generate a rising trade surplus. Net capital inflows will reduce external debt borrowing requirements and the coverage of the short term debt by gross international reserves will increase. In order to reap the benefits of external markets, Brazil will need to foster regional integration within Mercosur to enlarge its export markets while speeding up the pace of trade liberalization, especially for capital goods to facilitate the upgrading of domestic capacity and promote efficiency gains. We concur with Mr. Portugal that the opening up of industrial countries to Brazilian exports, especially for agricultural goods could facilitate the efforts of the authorities.

On the social front, we appreciate the Government's commitment to promoting equity and tackling poverty. Significant progress has already been made in a number of social indicators. We welcome the authorities' efforts to improve the efficiency and level of spending in social sectors as to help poor regions and groups to catch up.

In light of Brazil's remarkable and robust performance, we agree with the completion of the Sixth Review under the SBA. We are convinced that the Brazilian Government's commitment to reforms will reinforce the sustainable, noninflationary growth path of the economy and result in lasting benefit to the population. We wish the Brazilian authorities every success in their continuing effort.

Mr. Mirakhor submitted the following statement:

We thank the staff for a clear and well-written report and Mr. Portugal and Mr. Mori for their comprehensive statement. The Brazilian economy continues to perform remarkably well. Output is growing strongly, employment has rebounded, and core inflation remains subdued. This positive overall picture is underpinned by a stellar fiscal performance and a skillfully implemented monetary policy. Noteworthy progress has also been made with the implementation of key structural reforms. The staff is right to note that Brazil appears to be reaping the fruits of the strong adjustment and reform measures that were undertaken in late-1998-early 1999. While Brazil's economic performance and success in meeting program objectives is, first and foremost, a tribute to the authorities' skill and determination in implementing sound policies, it is also a good illustration of the Fund working at its best.

Notwithstanding the high praise the authorities deserve for their accomplishments, challenges and vulnerabilities remain. The external environment harbors many risks which could have an impact on the growth of world trade and the flow of financing to emerging markets. Domestically, the main risk seems to be the brisk forward momentum of the economy which could push against the economy's short-term supply potential and lead to pressures on prices and/or the external position. While there are no clear signs at present of pressure points or emerging difficulties, the authorities will need to monitor developments closely in the months ahead and stand ready to take prompt and forceful corrective action if warranted.

Mr. Portugal and Mr. Mori indicate the Government's continued commitment to prudent fiscal management in 2001 which, based on the budget submitted to Congress and envisaged performance at all levels of government, is expected to yield a consolidated public sector primary surplus that would imply no fiscal stimulus. In the absence of shocks to the economy, the proposed fiscal stance would seem to be appropriate. The budget envisages a fairly ambitious increase in revenues relative to GDP, especially in respect of the petroleum account. However, the decision by the government today to effect a further increase in domestic petroleum prices and to commit to a formula for quarterly changes in oil product prices should allay staff concerns of a revenue shortfall from the petroleum account. We are somewhat concerned by the build-up of pressures for higher spending and join staff in urging the authorities to resist these pressures or insist on offsetting cuts elsewhere so as to safeguard the targeted primary surplus in 2001. The authorities' ability to impart greater budget discipline at the subnational government level—due in large part to the strictures contained in the fiscal responsibility law—is commendable. We welcome the significant progress that has been made to improve social indicators, especially education and poverty alleviation, which reflects the Government's success with protecting key social sector programs from the rigors of fiscal consolidation.

Looking forward, it is clear that achieving fiscal sustainability and favorable debt dynamics will hinge on making durable progress with the implementation of the wide-ranging agenda of structural fiscal reforms. Mr. Portugal and Mr. Mori note the number of bills that have been proposed to Congress this year to broaden the tax base and improve enforcement. It will be important that these bills—and other reform initiatives in the area of social security and management of public spending and debt—are passed and implemented convincingly so as to dispel lingering market concerns that contribute to the still relatively high spreads for Brazilian debt.

We commend the steps that have been taken to strengthen the regulatory framework in the banking sector. While this sector is "fundamentally sound," we join staff in encouraging the authorities to articulate a strategy to address the vulnerabilities of the federal banks and to begin implementing corrective measures next year. Given the magnitude and complexity of Brazil's privatization effort, delays are inevitable and we can support the authorities' request for some modifications to the timetable for certain structural benchmarks.

In short, Brazil's performance to date under the stand-by arrangement with the Fund has been exemplary and the authorities' commitment to the program targets and objectives is unwavering. Accordingly, we have no hesitation in agreeing to staff recommendation to complete the sixth review.

Mr. Kelkar submitted the following statement:

We wish to commend the staff for a comprehensive set of documents which, along with a helpful statement from Mr. Portugal, provide a rich fare on recent economic developments in Brazil.

The Brazilian authorities deserve to be complimented for the continued impressive performance of the economy emanating from the strong macroeconomic adjustment and structural reform efforts initiated by the authorities in the aftermath of the crisis of late 1998 and early 1999.

The Brazilian economy has responded well to the sustained policy efforts undertaken with the well-designed IMF program. With GDP growth of 4 per cent for the first time since 1995, subdued core inflation, steadily declining unemployment and strong fiscal performance, it is hardly surprising that the Brazilian economy is meeting all the quantitative performance criteria to date. Most indicative targets and structural benchmarks under the Stand-By Arrangement have also been met.

We fully agree with the staff assessment that the overall stance of macroeconomic policies remains appropriate. Like many other emerging market economies, the main risk to the continuation of sustained, noninflationary growth in Brazil arises mainly from the external environment – especially a hard landing of the US economy with adverse implications for world trade expansion and flow of foreign financing as well as a further escalation of oil prices. Domestically, the emergence of excess demand pressures against the backdrop of domestic short term supply constraints could rekindle inflationary tendencies and exert pressure on balance of payments.

As noted by the staff report, the Brazilian economy is certainly more resilient today than before the 1998 crisis to withstand these potential risks. Nevertheless, should these risks materialize, much would depend on the swiftness of policy response. Given the recent track record of policy authorities in Brazil, like the staff, we feel assured that a prompt and forceful policy response would be forthcoming.

Brazil's efforts in inculcating fiscal discipline at the sub-national government level are truly impressive. Yet, formidable tasks lie ahead. Given the imperatives of fiscal sustainability, Brazil will need substantial primary surpluses of the consolidated public sector beyond 2001. This calls for sustained fiscal reform efforts, especially in the areas of social security, tax system, management of public spending and public debt.

While the banking sector in Brazil appears to be quite sound, there is no room for complacency. We are encouraged by the efforts to put in place a strategy to deal with significant weaknesses in some federal banks. We join the staff in recommending a full FSAP for Brazil at an early date.

It is true that the privatization program in Brazil has slowed down somewhat in recent months. But, to an extent, as noted by the staff, the slow down is for reasons beyond the control of the authorities. Under the circumstances, we fully support the authorities' request to reschedule the unobserved benchmarks and urge the authorities to speed up the implementation of their structural reform and privatization programs.

With these comments, we recommend the completion of the Sixth Review Under the Stand-By Arrangement and wish the authorities every success in their policy endeavors.

Mr. Oyarzabal and Mr. Beauregard submitted the following statement:

As we did in May at the fifth review under the Stand-by-Arrangement, we commend the Brazilian authorities for pursuing an adequate economic policy mix. As a result, despite the adverse external environment (due to high oil prices and uncertainties with regard to the future economic developments in the US economy and in the region), the Brazilian economy maintained an extraordinarily good economic record and price stability. Furthermore, even though there was an increase in the labor supply due to more job opportunities in the economy, the unemployment rate continued its declining trend. We also share the authorities view that more efforts should be done to improve the burden of the economic recovery process and the income distribution of the economy.

With regard to the program with the IMF, Brazil continued to perform strong. All targets were achieved and, in some cases, with wide margins. This of course is the result of the perseverance showed by the authorities in applying the correct fiscal and monetary policies.

As always, as Mr. Portugal and Mr. Mori stated in their excellent statement, a challenging policy agenda to consolidate what has been achieved until know lies ahead. We would like to comment on some issues we consider important to pursue this consolidation process.

The Brazilian authorities have improved their fiscal management in a very important way. Valuable reforms had been promoted, not only at the federal but also at the state level. The government has been able to generate the much-needed primary surplus to reduce the stock of public debt. These efforts, however, should continue.

The increase in the primary surplus has come mainly from expenditure reductions. On the income side, much remains to be done. The increasing demands that the government is facing to boost its social expenditure, which in our opinion should be confronted by a reform on the way social spending is carried out, rather than by an increase in the resources to fund already existing programs, and the authorities desire to distribute in a more equitable way among the poorest segment of the population the benefits of the current economic growth, will require a more self-sufficient public sector.

Therefore, it is important to continue with structural reforms in this sector to broaden and make more efficient the income side of the equation, and to reform the social security system, especially in relation to the public sector workers.

We support the staff's recommendation to institutionalize the fiscal stance by announcing for the subsequent (three) years the primary fiscal and debt targets. We think the Multi-Year Plan for the period 2000-2003 approved by the Senate last June confirms how committed the authorities are with medium-term fiscal sustainability. We expect that these efforts will at the end materialize in a less vulnerable economy to external shocks.

We also welcome the government's debt-restructuring agreements with the municipalities and Mr. Portugal and Mr. Mori assurances that the government will continue to follow in 2001 a prudent fiscal management.

The Brazilian authorities have been able to manage their monetary policy successfully. After the devaluation, many expected a very high and fast pass through process, especially in an economy that had experienced painful (hyper) inflationary processes in the past. The evidence, however, surprised more than one. Evidently, this result can only be explained by considering all the economic policy measures the authorities adopted to stabilize the economy after the adoption of the flexible exchange rate regime.

The staff presented us a paper with the analysis of the determinants of the pass through process in Brazil. It is important to underline that the factors the staff notes as the main causes of a lack of a fast pass through process are not present today. In particular, the current business cycle is precisely the opposite one that the Brazilian economy had in 1999. Therefore, authorities should be vigilant and ready to act on this front, should a depreciation of the currency occur. Even though Brazil remains one of the least trade dependant countries, this factor did not appear in the staff's analysis as one of the variables to explain the lack of a fast pass trough process. Staff comments are welcome.

Staff reports that in 2001 the authorities will take actions to strengthen the independence of the central bank. We welcome these efforts, which should increase the confidence in the monetary authorities in pursuing its inflation target policy. We would welcome a more detail explanation by the staff with regard to these actions.

The authorities' efforts to reduce lending spreads are welcomed. By reducing this intermediation cost, a more efficient economy is being promoted.

The staff argues that the sound macroeconomic policies and the economic stability already achieved by the Brazilian authorities are, in part, the main determinants of the lending spreads. We fully agree with this argument but we are of the opinion that this is explained by the fact that the default risk as a determinant of the lending spread in the current environment is clearly less important. This argument, though, underlines the importance of having "good" financial legislation. Only so, the banking sector will be able to perform its intermediation function both during good and bad times. We therefore encourage the authorities to continue the process of developing a better legal system applicable to all financial related activities.

Even though the Brazilian financial system remains in good shape, staff reports that there are some areas where improvements may be needed. As

Mr. Portugal and Mr. Mori argue in their statement, this is an area where continuous work has been done. With respect to the reforms proposed to the Federal Banks, given their relative importance, we encourage the authorities to proceed with caution but, at the same time, in a firm way. We consider that all the progress made until know, as reported by Staff in Box 6 of their report, is a step in the right direction and demonstrates the authorities' commitment to proceed with such paramount reforms.

The international environment during the present year has not been the best for emerging markets. Nevertheless, Brazil's economic performance until know has demonstrated that its fundamentals are strong enough to cope with this kind of environment. Foreign Direct Investment flows to Brazil are a clear evidence of the confidence investors have in the authorities and in the future prospects of the economy. However, in order to strengthen the Brazilian economic growth base, a more opened economy would be more desirable.

As the main economic risks come from external sources, we think that more efforts should be carried on to increase the domestic savings in the country, as a way to reduce the current account deficit and the external financial requirements.

We encourage the authorities to continue their efforts to direct social expenditures to the most needed segments of the population. The Alvorada program is a step in the right direction. As staff suggests, the issue is not one of quantity but of the quality of the programs. Continuing efforts to reform the pension system of the public employees and a fiscal reform may contribute to achieve this goal by liberalizing resources to fund these programs.

To conclude, we would like to wish the authorities the best success in their future endeavors, and we support the completion of the sixth review of the program.

Mr. Bernes submitted the following statement:

I would like to thank the staff for a comprehensive report, and congratulate the authorities for overall good policy implementation over the course of the past year. Indeed, I agree with the staff's analysis and their policy recommendations for 2001. As the staff notes, the overall stance of macroeconomic policies appears to be broadly appropriate. Perhaps most importantly, therefore, there is a need to underline the staff's warning that significant vulnerabilities remain, and it is on this topic that I will focus most of my remarks. In particular, I have some concerns regarding vulnerabilities to international developments, particularly as they relate to fiscal policy and the current account deficit. Additionally, I have a question regarding the inflation process that reflects on the credibility of the BCB.

The authorities expect to achieve a consolidated public sector primary surplus of about 3 percent in 2001, based on projected real output growth of 4.5 percent and year-end inflation of 4 percent. However, the authorities' federal budget for 2001 is predicated on a decline in international oil prices to under US $25 per barrel, and on an average exchange rate of R $1.82. These assumptions are likely to be over-optimistic, as the staff rightly points out. Using the staff's rule of thumb (from footnote 14), and a more reasonable exchange rate assumption of R $1.90 and an international oil price assumption of US $30 per barrel, revenues would be lower than budgeted by around R $6.5 billion, or 0.5 percent of GDP. This would reduce the consolidated primary surplus to around 2.5 percent of GDP in 2001.

Furthermore, the 2001 budget proposal makes no allowance for a real increase in the minimum wage and minimum pension benefits. Nor does it address the Supreme Court's decision to grant a retroactive 12 percent wage increase to the Electoral Tribunal. These issues have significant implications, since, as the staff notes in paragraph 39, slightly higher primary surpluses than those projected by the authorities would be needed over the medium term to secure a continued gradual decline of the net public debt in relation to GDP over the rest of this decade. Given the potential for lower revenues and higher expenses than budgeted for in 2001, Brazil's debt-to-GDP ratio may not be set on a declining path. This would not be good news, the current uncertainty tainting emerging markets, and the resulting premium being placing on sound economic underpinnings, particularly as they relate to government debt burdens.

The staff's discussion of Brazil's contingent liabilities is particularly interesting given such concerns. I note that liabilities resulting from under-funding the FGTS (the workers severance payment fund) could reach R $39 billion (Box 5). As the staff notes, there is an actuarial component to this sum, and it is expected that disbursement of these funds will be scaled over 20-25 years. Nevertheless, this represents an additional liability in the near-term, though relatively small. However, when combined with the R $10 billion in liabilities expected to be recognized by the FVCS (housing/mortgage insurance/subsidy fund) in 2001, this represents a significant increase in Brazil's net debt burden. In addition, there are several other potential liabilities that, as the staff highlight, have yet to be resolved. These additional liabilities have the potential to detract from Brazil's medium-term fiscal sustainability and make Brazil more vulnerable to changes in international sentiment.

Brazil's current account deficit is expected to remain relatively high in 2000, at 4.2 percent of GDP. This is somewhat lower than the 4.7 percent deficit registered in 1999, but in line with the pre-floating outcomes of 1997 and 1998. The deficit has not, to date, been a problem because of Brazil's status as a preferred destination of foreign direct investment. The staff notes in paragraph 13 and in the Selected Issues paper, however, that three quarters of FDI inflows in 2000 have been concentrated in the communications, utilities and financial services sector. A large portion of these flows represent follow-up investments subsequent to the large-scale privatization of the last four or five years. These inflows will therefore eventually abate, as privatized enterprises become sufficiently recapitalized. The funding of Brazil's current account balance depends on these flows. Given the turmoil facing this sector in the developed economies (as witnessed by the NASDAQ's performance since March), I am concerned that this source of funds may not be as stable in the future as in the past.

The possibility of reduced FDI inflows is of concern given the sensitivity of the current account balance to alternative scenarios, such as the one presented by the staff in paragraph 54. The possibility of reduced global demand for Brazil's exports, sustained strength in oil prices, higher risk premia on emerging-market debt, and a more expansionary fiscal policy than planned all raise some red flags with respect to the vulnerability of Brazil's external financing activities over the next years.

Brazil will likely meet its year-end inflation target of 6 percent this year. As the staff notes, this has been accomplished in an environment of rising domestic demand, rising capacity utilization, lower short-term official interest rates, rapid credit growth in light of the significantly reduced consumer and business loan rates (due to the success of the BCB's efforts to reduce the cost of bank intermediation) and adverse supply shocks.

Not all of these developments were foreseen at the beginning of the year, as can be determined by comparing the BCB's inflation report at the start of the year with that from September. Nevertheless, the year-end inflation target appears to be within reach. I wonder, however, if and to what extent price controls may have played a role, as recent press reports have suggested? If price controls have been used to a significant degree, the central bank's credibility could suffer and distortions in the allocative process would result.

Mr. Rustomjee submitted the following statement:

The Brazilian economy has performed remarkably well in the aftermath of the 1998/99 crisis in response to the structural adjustment program. The recovery remains strong, the level of unemployment is declining, inflation is subdued, and income distribution has improved.

Prudent fiscal management has been an important pillar of the adjustment effort. This has helped not only to contain inflation but also contributed to a reduction in the public debt relative to GDP. We encourage the authorities to continue on the path of fiscal consolidation, and this will require adherence to strict expenditure controls to achieve the primary budget surplus that they have targeted. In this connection, there are uncertainties regarding some of the key budget assumptions, and the authorities should be prepared to take corrective action should it become necessary. For now, the fiscal program for 2001 appears to be broadly appropriate. It is encouraging that the progress on fiscal consolidation owes much to the success the authorities have had in building cooperation at all levels of government to adhere to the budgetary targets. This is commendable, as well as the increased transparency that has been introduced in the budgetary process. The enactment of the Fiscal Responsibility Law, which will place limits on spending and debt on all levels of government, is welcomed. Approval of additional legislation to enhance administrative reform will further strengthen Brazil's public finances.

The inflation-targeting framework seems to be working well. Staff have expressed some concern that credit is growing fast, suggesting the need for caution in the management of monetary policy. However, the authorities have given cogent reasons for not being alarmed at this stage, including the low base from which credit is growing and the still high level of interest rates which would restrain consumption. Meanwhile, we note the assurance that Mr. Portugal has given that the monetary authorities will continue to monitor developments in the economy closely so as to avoid excessive credit expansion. This should be seen against the vigilance the central bank has already demonstrated in trying to contain inflation.

The Brazilian financial markets have been relatively stable in the aftermath of the 1998/99 crisis. The banking sector has been placed on a more secured footing, with the sharp decrease in the number of non-performing loans. Moreover, the solvency and the liquidity of the banking sector have been enhanced, and the overall provisioning levels have been higher than the requirements set by the Basle Principle. We welcome the agreement by the authorities to have a full FSAP at the earliest convenience.

The government has had an impressive record of privatization which has substantially benefited the economy both in terms of efficiency gains and improvement in financial savings. Although the process slowed down somewhat in the first half of this year, we understand that this was necessary to obtain the political support to move ahead. In fact, action taken with regard to the privatization of state banks indicate that the authorities remain basically committed to the privatization program.

Brazil's external balance has improved, due to strong export performance and the positive inflow of the foreign direct investment. The latter is a good indicator of the level of private sector confidence in the economic policies of the government. The country's competitiveness, measured by real effective exchange rates, has improved markedly. We note, meanwhile, that the authorities recognize that there is room for improvement by raising productivity, reducing costs and removing distortions in the tax system.

As the biggest partner in the MERCOSUR, Brazil should take the lead in promoting regional trade. We agree with the authorities that increased access of Brazilian exports to markets in industrial countries would be helpful to the process of trade liberalization in Brazil.

The Brazilian authorities have performed admirably under the program supported by the Stand-By Arrangement. The policies that are in place seem to be appropriate to continue the process of strong growth in a non-inflationary environment. Accordingly, we support the conclusion of the sixth review, and wish the authorities success in their endeavors.

Mr. Faini and Mr. Nardelli submitted the following statement:

Mr. Chairman, let me begin by saying that we fully support the completion of the sixth review. The set of very informative papers prepared by the staff for today's discussion clearly show that Brazil is consistently maintaining a solid macroeconomic performance. This result is the product of a well designed program coupled with a strong commitment on the part of the authorities to implement the required policy measures.

The new monetary framework has allowed a progressive reduction of interest rates while keeping inflation subdued, helping the economy rebound from its downturn and achieve a robust rate of growth. After two years of hovering well above 7 percent , unemployment is now steadily declining. The fiscal performance was also very strong, with public sector deficit this year being halved respect to 1999, and it is worth noting that the improvements were posted both at the central government and state level. We think that with these credentials Brazil can look with confidence at the third year of the Stand By arrangement.

Certainly, the Brazilian recovery has benefited from a period of relative calm in the world's economy, marked in particular by the protracted strong but non-inflationary growth in the US and by the absence of large-scale financial crises. The only development of significant relevance that has occurred in the world's economy – the marked increase in oil prices – does not seem to have a particularly adverse impact on the Brazilian accounts. As the staff points out in the report, the oil company Petrobras is slated to record higher surpluses in case of higher-than-expected oil prices, which could partially offset the negative effect on the revenues of the petroleum account.

With this in mind, we agree with the staff that the main risks for growth may arise from adverse dynamics in the external environment. Of the factors highlighted by the staff, we would single out in particular a sudden change in market sentiment and a non gradual slowdown of the US economy. Brazil remains vulnerable to these developments. In order to reduce these vulnerabilities, the authorities should continue in their reform action, and in particular with a view to continuing to improve public debt management, speeding up the privatization efforts, and widening the export base.

Concerning the public debt, we would like to repeat the note of concern that we expressed in the March Board meeting, where we stressed that, although declining, the level of the public debt remains still high. This burden represents a real threat to the Brazilian economy since payments on external debt still account for a sizable amount in terms of both export and GDP. As a percentage of GDP, for example, we see from the report that debt service on external debt for 2000, although declining from last year, is still envisaged to be twice as large as its pre-crisis level. This is the product of a structure of the public debt that remains unbalanced in terms of maturity and currency composition. We can see from market reports that the significant increase in sovereign spreads that has affected Argentina since the beginning of the year is reflected, although to a lesser extent, by an increase of spreads in most of the Brazilian debt instruments. Notwithstanding the marked lengthening of the public debt maturity achieved over the last year, in particular through the successful debt exchanges, the high share of floating interest rate and currency indexed debt leaves the economy exposed to higher interest rates and currency fluctuations. The level of market confidence over the next months will be crucial in this regard: should volatility continue to increase due to concerns in the region the cost for Brazil could be substantial. However, it must be recognized that the authorities are doing everything they can to address the weaknesses in the structure of the public debt: it is because of unfavorable market conditions that the pace of adjustment cannot be faster. We would also like to make a comment on the path for debt reduction assumed under the program. We note that the figures for the level of net public debt as a percentage of GDP in the staff's baseline scenario have been significantly revised upwards since the time of the last discussion. As a result, public debt is projected at 50 percent of GDP in 2000 and thereafter to decline reaching 46.5 percent in 2005. In the May staff paper for the fifth review these levels were, respectively, 45 percent and 40.3 percent. We understand that the difference in the level of the debt ratio is due to a revision in the figure for nominal GDP. However, in the baseline scenario of today's paper, the speed of the decline of public debt over the medium term is less ambitious, as can be inferred from the above numbers. What would then be the reason for the latter change? We would appreciate staff's comments on this issue.

In the privatization area, one could have the impression that, in the wake of the outstanding fiscal performance, the government's action is being relaxed somewhat. The results presented in table 1 of the report appear poor in the structural benchmarks section. Here, many targets have not been achieved, and some of them regard the privatization program. We also see that some of the benchmarks, such as the progress in implementing the plans for the privatization of electrical and reinsurance companies, have not been included in the revised structural benchmarks. We would appreciate if staff could offer some more details on the causes of the reported slowdown in the privatization effort and the reasons why some of the missed benchmarks are not included in the program. However, we find the authorities' plan to use the oncoming privatization to contribute to the development of the capital market worthy of support.

With regard to export performance, we think that the authorities should continue to work to increase export growth to strengthen the sustainability of the current account in the long run. As noted in the staff paper, exports are limited in relation to GDP. We would add that imports have reacted very quickly to the improved economic conditions, and have also picked up significantly. For the time being, the strong inflows of FDIs should continue to more than offset the current account deficit. However, these levels cannot persist for a protracted period of time and it is also to be expected that, when the investments begin to pay off, some resources will be repatriated. It is therefore important to generate a consistent growth of exports in order to reduce the ratio of external debt to exports. The total external debt is more than 4 times exports in Brazil, much higher than in other comparable emerging economies. This factor is going to take its toll on rating and the cost of Brazilian debt.

To conclude, we believe that Brazil is well positioned to continue to benefit from sustained growth in the medium term. The authorities should be complimented for their unflinching commitment to stability and reform, but need to remain vigilant to take prompt action in case the external developments were to deteriorate. We support the staff's view that in this case spending commitments should be restricted below budgetary authorizations. We also welcome the progress that has been reported in social indicators and in the effectiveness of social spending.

Mr. Toyama submitted the following statement:

The Brazilian economy continues to recover led first by strong growth of exports and now by increased consumption, with balanced external and internal demand. The recovery may be the result of Brazil's improved competitiveness which is due mainly to the depreciation of the real and the flexibility of monetary policies. Put simply, the effectiveness of the floating foreign exchange regime has been proved in the Brazilian case. However, given the signs of a worsening global economic environment, Brazil needs to try to reduce its vulnerability to external shocks and to ensure medium-term sustainable economic growth with subdued inflation. The recent increase in the Brazilian bond spread suggests that the risk of adverse effects on Brazil of the deteriorating global economy, including the slowdown of the U.S. economy, has been taken into account. The current state of the Argentinian economy, which has close ties with that of Brazil, may have increased Brazil's risk. The bond spread could widen further if the authorities do not take appropriate actions to respond to the unfavorable environment on the assumption that the increase was due not to domestic problems but to external shocks outside their control. By contrast, if the authorities believe the bond spread provides room for maneuver to improve the structure of the economy, it could be used as leverage to facilitate economic reform. It may even be possible to reduce the bond spread to where it was before the increase. I would therefore like to urge the authorities to implement economic reforms decisively.

On the fiscal policy front, I welcome the reduction of the fiscal deficit in the consolidated public sector overall balance resulting from both increased revenues during the cyclical recovery and expenditure constraint, including a freeze on public sector wages in real terms. I also welcome the enaction in May of the Fiscal Responsibility Law, which will contribute to further fiscal consolidation over the medium term. On the other hand, when I consider the policy discussions on the 2001 budget, I have to say that the measures aimed at fiscal consolidation do not appear strong enough to improve the fiscal balance. For instance, a significant increase in revenue is envisaged based on what I believe are unduly optimistic assumptions on international oil prices as well as foreign exchange rates. If the assumptions are not realized, achievement of the targeted revenue increase will depend on whether the authorities are able to increase domestic oil prices despite political and public pressure. In addition, the outstanding government external debt is projected to decrease based on the assumption of a substantial decline in interest rates. Assumptions should be set more conservatively, at least to avoid a deterioration of the fiscal balance. In my view, market credibility could decrease if the fiscal balance were to deteriorate because of an optimistic assumption. I welcome the budgetary conditions attached to the Poverty Fund in this regard. The tax system should provide the Poverty Fund with a certain portion of revenue through specific taxes. This mechanism in the tax system would help prevent rigidity in new expenditure as well as avoid a worsening of the fiscal balance through a binding linkage between revenue and spending. (In the case of a financial transaction tax, however, I think it needs to have a neutral effect on financial markets. I would like to hear from staff on this point.) I welcome the improved government debt management in setting a ceiling when issuing bonds against current revenue. This will provide a more transparent framework for knowing whether the level of government debt is sustainable. Meanwhile, the authorities need to continue their fiscal consolidation. In this context, the tax structure should be further simplified and provide a good balance between direct and indirect taxes to ensure the stability of revenue. Instead of expenditures automatically increasing in line with increases in cyclical revenue, a cost-benefit analysis of expenditures should assure a strengthening of expenditure control. I hope the authorities will redouble their efforts in these areas.

Regarding monetary policy, according to the staff paper (EBS/00/223), the authorities explained that the small increase in inflation in September was due to the weather factor in July and August. I agree that this is so; however, two fundamental questions are raised: whether the central bank should neglect such supply shocks in conducting monetary policy to achieve price stability; and whether the framework for inflation targeting should include such supply shocks as a factor. With respect to supply shocks, it is important to minimize their contagion effects. At the same time, however, we have also learned that there is a risk of overkill. Foreign exchange rates, international commodity prices such as oil, and technological improvements—all these external factors can influence inflation. The question is how to treat these external factors in the context of an inflation targeting framework. I also wonder whether such factors should be considered on a case by case basis, in light of countries' varying situations. I would appreciate staff's comment on these two points.

On the structural reform front, the staff paper said that the delay in structural reforms had contributed to the increased bond spread. However, it is also a fact that net FDI has continued to exceed the expected current account deficit by a significant margin despite the widened bond spread. I would be interested in hearing staff's explanation on this point—in particular whether net FDI could increase further when the bond spread narrows through the smooth implementation of structural reform. If the recent widened bond spread was not influenced by the amount of structural reform, I would be interested in hearing what factors staff believe led to the widening of the spread.

On the financial sector front, it is encouraging to hear that the health and resilience of the Brazilian financial system remain relatively strong. I welcome the authorities' cooperation with the Fund and the World Bank in assessing compliance with the Basle Core Principles and their interest in participating in a full FSAP.

With these remarks, I support the proposed decision and wish the authorities further success.

Mr. Portugal, extending his remarks, said that last week the price of oil products had been increased by 11 percent, bringing the surplus of the oil account for the next year to between 3 1/2 to 4 1/2 billion reais, which was close to what was initially envisaged in the budget. The rest would be made good by the effect of that increase on the surplus of the state oil company Petrobas.

While it was true that the budget did not contemplate room for any real increase in the minimum wage, it contemplated an increase for the nominal wage, from

151 reais to 159 reais. That was something which, from a strategic point of view, the government should have done, because whatever number would have been proposed in the budget for a real increase would immediately have become a floor in the bargaining process with congress. Congress would then have pushed for a real increase in the minimum wage. However, it has been made clear that for that to happen, other expenditures would have to be cut or revenues would have to be increased.

Mr. Abbott made the following statement:

> The staff has prepared an excellent set of papers for today's review of Brazil, jam- packed with relevant information and state-of-the-art econometric analysis of the central macroeconomic issues facing Brazil. We agree with most of the analysis, so I will concentrate on a few themes.
>
> Over the past year, the Brazilian economy has achieved a greater degree of stability than at any time since the Plano Real disinflation program was launched in 1994. The dislocations following the floating of the exchange rate two years ago have been largely absorbed, and improved external competitiveness has been sustained. Rough fiscal discipline has been established. The debt/GDP ratio is stabilizing, and there is the prospect that this ratio can be gradually worked lower within the framework of existing fiscal arrangements. A more resilient monetary regime has been introduced. Freed of multiple, extraneous and conflicting objectives, the Central Bank is establishing a track record for containing inflation in the single-digit range. The flexible exchange rate regime is responsive to shifting circumstances while still delivering relative exchange rate stability at a level that supports a balance of payments position that looks to be sustainable over the medium term. Attractive internal opportunities make Brazil a prime destination for direct investment flows. Growth has strengthened, and employment has increased.
>
> The Brazilian economy looks better balanced and less accident prone than it has in a long while.
>
> Even with a framework of macro stability, however, Brazil faces a formidable range of structural and policy weakness that gnaw at the vitality of the economy. Overcoming these structural weakness is essential if Brazil is to move out on to a high growth trajectory and deliver the rising standards of living that are within its potential. The staff documents provide a partial catalog of issues that need to be addressed. These include: public sector preemption of domestic capital and credit flows, unresolved insolvencies in the large federal banking sector, a ragged and distortionary tax structure, a large and complex but poorly targeted and poorly financed social support system, and outdated labor market practices. Many embedded problems are the legacies of the high inflation period or of patchwork, second-or-third best policies adopted in an earlier atmosphere of crisis management. Now that

Brazil has secured a steadier macroeconomic footing, there is a lot of retrofitting that needs to be done. These structural issues should be moved higher up the policy agenda.

Growth is now in the four percent range and, absent deeper structural adjustments, that seems to be about the safe speed limit. The staff report worries that domestic demand may already be running at a rate that creates inflation risks. Capacity utilization is high, and higher investment and consumption of consumer durables are likely to be the near-term drivers of growth. This would be an ideal time to see a switch to a pattern of growth that was driven more strongly by domestic private sector investment. Such a pattern would reinforce the productivity gains that are already in train from privatization and strong inflows of direct investment. There are numerous obstacles to such a rosy scenario, however, and most of them relate to the still too intrusive role of the public sector.

Bank credit to the private sector is still prohibitively expensive, a point analyzed in detail in the staff report. The commercial banking system will never support economic growth as long as corporate lending rates are above 30 percent and inflation is under ten percent. Government financing costs account for a large share of the large spread of bank intermediation in Brazil. High reserve requirements, though declining, are still a source of significant captive finance for the government. High tax rates on banking transactions are a stop gap, but nevertheless important, source of government revenues. For all the progress over the past decade in cleaning up the private banking system and the state-owned banking system, over fifty percent of the banking sector is still in public—largely federal—hands. As the staff report discusses in detail, the state-owned banking system is too overburdened with inherited bad credits, latent insolvencies and policy lending to fill the commercial gaps left by the private banking sector. The job of comprehensive restructuring of the banking system is only half done. Getting the job finished ought to be a high priority. It will, inevitably, require the authorities to address the quasi-fiscal problems at the root of the public sectors' involvement in the banking sector.

We welcome the recent successful privatization of BANESPA. With BANESPA now privatized, the next largest remaining state-owned bank is Nossa Caixa-Nossa Banca, also owned by the Sao Paulo government. I wonder if there are any plans to privatize this bank.

Revitalized domestic investment will require a stronger domestic saving effort. Table 1 of the Statistical Appendix shows that gross national savings declined from 21.8 percent of GDP in 1994 to 15.7 percent in 1999. Foreign inflows picked up some of the slack but, on balance, the total savings available to the economy declined by 1.7 percentage points of GDP over this period. Stronger and faster budget consolidation would be one obvious way to achieve a stronger national saving rate. However, the material in the Selected Issues paper also suggests that more micro reforms, not just budgetary squeezing, could be a fruitful avenue for improving aggregate savings. The public sector has innumerable social programs that incentivize and mobilize individual savings. Over time, many of these programs appear to have been deflected from their original objectives with the result that resources accumulated are absorbed in current spending or fail to generate the intended saving. Just to illustrate, Table 3.1 of the Selected Papers shows that 1999 annual withdrawals from the FGTS (Fundo de Garantia por Tempo de Servico) exceed receipts by the Fund. The major withdrawals were for unfair dismissal, with payments made to 11 million individuals. Something has gone badly wrong if one-sixth of the labor force annually receives payments for unfair dismissal.

The Central Bank is doing a good job of bedding down its inflation targeting approach to monetary policy. The policy is enunciated clearly and is being executed consistently, and the markets seem to be adapting well to the new regime. The Central Bank, with a little help from Fund staff, is mobilizing all the latest in theory and econometrics to buttress its ability to predict inflation and calibrate its policy instruments to iterate toward a preset inflation trajectory. For all the fancy modeling, however, the material presented in the staff report suggests to me that inflation targeting in Brazil is still a policy that very much relies on Central Bank judgment.

At several points, the staff report suggests that inflation upticks this year have been due to transient disturbances, such as oil prices, that do not foreshadow quicker inflation. We generally share this view, but we have also been disturbed by indications that wage settlements have picked up significantly in the past couple of months. The government has agreed to some outsized pay awards for public sector employees, and industrial workers in Sao Paulo are also reported to be seeking catch up pay increases. I would be interested in staff's updated assessments of these developments.

I would like to complement the staff on the two excellent chapters on Fiscal Sustainability in the Selected Issues Paper. These are among the best treatments of this important topic that I have seen in country reports. The analysis shows that Brazil's fiscal position, though considerably improved, still remains vulnerable to shocks from either high interest rates or weak growth. Disciplined fiscal policy will need to be continued. But the analysis also shows that disciplined policy yields substantial payoffs in reduced vulnerability. Small annual increases in the primary surpluses led over time to significant improvements in the debt to GDP ratio. Whether looked at from a growth perspective or from a financial vulnerability perspective, stronger fiscal consolidation needs to be at the heart of Brazil's macroeconomic strategy.

Given this, we are a little uneasy with the budget now being prepared for FY 2001. It does not aim for further improvement in the primary deficit, and it seems to rely on some optimistic assumptions such as substantial revenues from the petroleum account, lower nominal interest rates and favorable court decisions on contested payments. I would appreciate a little more discussion from staff regarding the risks that the budgetary objectives for both the primary deficit and the PSBR may be overshot and what contingency plans the authorities have to keep within the program's performance criteria.

We share the staff view that a more rapid pace in the reduction of tariffs—especially on imports of capital goods—would benefit Brazil by reducing costs and increasing productivity and export competitiveness. An important first step would be a decision by Mercosur to eliminate in 2001 the temporary 3 percent CET surcharge that was implemented in 1997. This is a measure that would also benefit Argentina, so Brazil could make a useful and timely contribution by leading such an initiative within Mercosur. I would also like to note that my authorities welcome Brazil's continuing commitment to develop and implement its trade policy in accordance with the WTO rules and agreements.

We are pleased that the authorities have made substantial progress in meeting the SDDS requirements, and we would appreciate reconfirmation that they will, in fact, be able to subscribe by the end of this year. The new quarterly national accounts being prepared by IBGE will be a welcome addition to our tool kit for understanding demand side developments in the Brazilian economy. Is there any prospect for better and more timely income account statistics?

Brazil's performance under this arrangement has been good, and we are happy to support today's proposed decision.

I assume the Selected Issues Paper will again be published as has been the practice for the past few such reports. As I indicated, we believe there is excellent material in this document that will enrich the policy debate that is already beginning in Brazil. Publication of the Article IV report could also add significantly to the transparency of Fund operations in Brazil. If Mr. Portugal has some good news for us on publication of this article IV report, it would be warmly welcomed.

Mr. Wei made the following statement:

At the outset, I would like to thank the staff for their well prepared papers and Mr. Portugal for his insightful statement. The performance of the Brazilian economy has been very impressive. The firm implementation of structural adjustment measures and a prudent macroeconomic policy have started to bear fruit as the economy moves onto a sustainable path of recovery, as witnessed by a robust GDP growth rate, increased employment, subdued inflation, a more balanced trade account, and an improved fiscal balance. All these developments point to enhanced resilience to external shocks. The Brazilian authorities should be commended for their skillful management of the economy and far-reaching reform efforts. Despite these achievements, the authorities have fully recognized their significant vulnerabilities, mainly stemming from the external environment, strengthened adjustment efforts, and deepened structural reforms. As I am in broad agreement with the staff appraisal, I would like to make some brief remarks for emphasis.

The authorities' recent success highlights the importance of their correct reform strategy over the past decade, particularly over the past two years. The gradual and well-sequenced approach embedded in the adjustment measures has struck a balance between growth, stability, and reform, which will, in turn, reinforce each other. I am of the view that such an approach is crucial in addressing some chronic and costly imbalances in an uncertain external environment while facing political and fiscal constraints on the domestic front, and will make it easier to win public and legislative support for further reforms. I fully support the authorities' stance to ensure that the benefits of the macroeconomic and structural adjustment efforts be more equitably distributed in the future.

I would like join others in commending the authorities for their remarkable progress with public enterprise reform and in fiscal consolidation at all levels of government. The primary surplus for the first nine months of this year is very encouraging, contributing to a significant decline in the ratio of net public debt to GDP. The better-than-expected fiscal performance is attributable to the enactment of the Fiscal Responsibility Law, central government expenditure constraint, buoyant revenue from certain taxes, and improved enforcement. Looking ahead and given the measures elaborated by staff and the authorities, I concur with staff's assessment of the 2001 budget. Now it is time to look at the long-term fiscal position. In view of the consolidated public sector's gradually declining primary surpluses over the next five years, staff's view that "slightly higher primary surpluses than those projected by the authorities would be needed over the medium term to secure a continued gradual decline of the net public debt in relation to GDP in the rest of this decade" may be warranted. In this regard, the authorities are encouraged to maintain fiscal discipline and resist the recently emerged pressures for a relaxation of expenditure constraint and tax cuts. The pay-as-you-go principle should be firmly upheld.

Although the inflation targeting framework for monetary policy has been operating for only a short period of time, evidence shows that the framework has been effective in containing inflation within the targeted range despite the supply shock and its gaining credibility. We note that the recent developments in terms of accelerated consumer credit and strong imports may point to a rapid recovery of domestic demand, while the overall picture is still mixed. To be on the safe side, greater caution in future monetary policy setting is justified. We have been well assured by Mr. Portugal in this regard. The ongoing efforts to reduce the relatively high bank lending rates have had a profound impact on stimulating both growth and banking activity. Meanwhile, these efforts have also had a certain expansionary impact on the current monetary environment, and the authorities might need to monitor the development of bank lending closely, being vigilant that credit expansion should not exceed reasonable levels.

The new federal bank assessment initiative and discussion of a feasible reform strategy is an important point. Given the size of the business involved in terms of GDP, as well as the whole industry's share of assets, the weakness of these banks needs to be addressed appropriately in line with efforts to further enhance their supervision framework over commercial banks. I can imagine the complexity of such a process and see that there is no easy solution. While we fully support the authorities' efforts in this regard, I associate myself with Mr. Mirakhor's view that "given the magnitude and complexity of Brazil's privatization efforts, delays are inevitable and we can support the authorities' request for some modifications to the timetable for certain structural benchmarks."

Like staff, I also welcome the authorities' firm commitment to give priority to social spending, primary education, and basic health care, in the face of tight expenditure constraints, and their continued efforts to better target such expenditures in maximizing their effectiveness. This will facilitate economic growth and stability enabling diverse groups of people and regions to benefit from this process in an evenhanded way.

In concluding, based on the authorities' sound track record under the program, I fully support the proposed decision and wish the authorities further success in their future policy endeavors.

Mr. Milleron made the following statement:

First, I would like to comment on Brazil's performance under the program to date, and then I will try to appraise the current economic situation before entering into the policy discussion.

As far as the former point is concerned, I can subscribe to Mr. Mirakhor's contention that "it is an illustration of the Fund working at its best"; it means a strong macroeconomic adjustment and structural reform program supported by large scale, short-term official financial assistance and constructive voluntary involvement of the private sector throughout. The program was well designed and skillfully implemented by the authorities. Thus, in spite of a mixed external environment, the results are unambiguously positive. GDP growth has regained steam, and unemployment and inflation are on a declining path; both the fiscal and external imbalances have been significantly reduced. The structural characteristics of the economy have also improved dramatically.

It seems to me there is a slight divergence of views between the staff and the authorities when it comes to appraising the progress of structural reform; but, to me, it boils down to the problem of the bottle being half full or half empty. My impression is that the authorities have been doing their best to advance the structural reform agenda against unfavorable odds. Politically and economically speaking, two significant moves deserve to be especially mentioned: the privatization of BANESPA and the adjustment of domestic oil prices, together with the setting up of an automatic adjustment mechanism. Both testify to the authorities' strong commitment in that respect.

This being said, as noted by previous speakers and authors of statement, there remain considerable vulnerabilities. Two, in particular, must be emphasized, namely the still high ratio of public debt to GDP and the burden of external debt. The former, public debt, in spite of the active debt management effort of the authorities, is coupled with rather unfavorable debt dynamics. Indeed, the staff's calculation shows that it would take only a small deviation from the baseline scenario to interrupt or even reverse the so far declining path of the debt-to-GDP ratio. The latter, the external debt, appears all the more hefty as it is associated with (1) a narrow, though rising, export base; (2) a significant current account deficit; and (3) a relatively small cushion of external reserves. Like Mr. Toyama, I think these vulnerabilities account for a large part of the sizable spread demanded by capital markets and for the sensitivity of the Brazilian spreads to recent developments in Argentina. Indeed, since Argentina absorbs no more than 10 percent of Brazilian exports, the real implication from the crisis should be fairly limited unless relative exchange rates are affected. Staff comments on this point would be appreciated.

Against this backdrop, and given signs which could be interpreted as indicative of emerging excess demand pressures, I was a little concerned to read that, in the best of cases, the outcome of the current budget discussion will be neutral fiscal policy aiming at a primary surplus no higher than last year: if the government is able to either resist or entirely offset the growing pressures on expenditure that it faces and if the optimistic assumption on which the budget was based regarding, in particular, oil prices, the exchange rate, and the path of decline of domestic interest rates are proven right, which would involve a substantial change from current levels. It seems to me there is a kind of conjunction of "ifs" here that has to be kept in mind in the overall macroeconomic assessment.

It is understandable in a country where there remain a lot of unsatisfied social needs, especially among the 20 percent of the population who receive only 2.6 percent of the national income, that there would be an urge to raise public expenditure as much as seemingly possible, but, at this juncture, it might be a wiser thing to do for Brazil to take advantage of the dynamics of growth to accelerate fiscal adjustment by targeting a more ambitious primary surplus. In such a case, we would have a virtuous circle that would increase the probability of Brazil's being awarded an investment grade credit rating, thus lowering the cost of debt and the PSBR, and finally allowing a faster decline of the debt-to-GDP ratio, and so on and so forth. In addition, such a policy would certainly be more likely to permit a relaxation of monetary policy than one of minimal adjustment.

Furthermore, like staff and others, I think it is essential for the credibility and sustainability of the macroeconomic adjustment effort to combine it with a resolute continuation of the structural reform effort engaged by the authorities, in particular tax and administrative reforms. It would also be helpful to develop a multi-year framework for fiscal adjustment which, ideally, for transparency and predictability purposes, would incorporate projections regarding the cost of contingent liabilities.

Finally, in my view, there is more good news than bad ones in the turnout of the trade balance for the year 2000, in particular the buoyancy of manufactured exports, which was, unfortunately, offset by the rise of the oil import bill. I am also not too preoccupied by the outlook for foreign direct investment flows in spite of the attrition of privatization opportunities. Indeed, if the willingness of the central bank to pay almost three times the minimum bid of the acquisition of BANESPA is any indication, there are sufficient profitable opportunities in Brazil to allow the large FDI flows observed in recent years to be sustained.

Nevertheless, I think that trend is predicated on a relentless continuation of the authorities' pursuit of greater openness of the economy, further market liberalization, and, more generally, increased competitiveness. Judging from Mr. Portugal's helpful statement, the authorities fully share that view, so I am confident we will continue to see the result of that policy in future years.

With these remarks, I thank the staff for providing us with this well written and most enlightening report, and I support the proposed decision.

Mr. Al-Turki made the following statement

I congratulate the Brazilian authorities on their continued record of improved economic performance across a wide range of indicators. The persistent commitment to adjustment and reform is paying off. Growth has resumed this year in per capita terms in an environment of low inflation, increased employment, a stronger fiscal position and external payments improvements, including a reduction of the debt exposure. Prospects that these favorable trends will be sustained are also promising, especially in view of the authorities' policy commitment that Mr. Portugal and Mr. Mori confirm in their buff statement.

I broadly agree with the staff appraisal and have only three brief comments.

First, I share staff's view of the critical importance of a continued favorable external environment for the growth outlook. As for other emerging markets, an orderly resolution of the persistent misalignment of major currencies and greater stability of the leading financial markets are crucial for Brazil's economic prospects. This highlights once again the importance of appropriate policies in the major advanced economies. That said, I share staff's emphasis on policies aimed at enhancing Brazil's resilience to changing external economic conditions.

Second, in paragraph 64, in recommending early consideration for a further rise in domestic oil prices, the staff notes that "The proposed budget relies on substantial revenues from the petroleum account." This is potentially an important issue in view of the adverse impact that high taxation of this commodity can have on the economy's overall efficiency. Therefore, while I appreciate the details provided in the staff supplement and Mr. Portugal's remarks at the beginning of today's discussion, I will appreciate from staff an assessment of the effective tax-component of the end-user price of petroleum products. In that context, I will also appreciate staff's views on Brazil's scope for further diversification of budgetary revenues.

Third, it is encouraging that unemployment has declined despite the sharp rise in labor participation rates. This is part of the gains that are accruing from the authorities' policy activism, including reforms of particularly the banking system and public sector. However, more effort is clearly needed for a viable reversal of the drop in average real earnings and for addressing the broader distributional issues noted in paragraph 71. Here, greater attention is important especially for labor market reforms. Indeed, as noted in Box 2, all but two of the eight policy initiatives that staff lists are still pending as matters that await legislative consideration. This also underscores the need for greater emphasis on labor market reforms in the staff appraisal.

With these remarks, I support the proposed decision and wish the authorities further success.

Mr. Wijnholds made the following statement:

Although Thanksgiving is just behind us chairman, Brazil continues to have a lot to be thankful for. Growth has rebounded, employment is rising, the primary surplus targets continue to be met and several important structural measures have been taken. The inflation targeting framework appears to be working well, the Fiscal Responsibility Law seems to have imposed some healthy fiscal discipline at all levels of government, and continued privatization is bringing important efficiency gains to the economy. The authorities deserve to be commended for these achievements.

Like some other colleagues, however, I want to reflect more generally where Brazil's economy stands two years into the program and with just one year left to go. Specifically, how vulnerable does Brazil remain to external shocks and how resilient are the public finances to a growth slowdown?

First, and most importantly perhaps, one of the key stated objectives of the program—to stabilize the debt/GDP ratio—runs at least some risk of not being achieved. Although the authorities own budget proposed for 2001 would bring the debt ratio down somewhat (from 50 percent GDP in 2000 to 49.7 percent of GDP in 2001) this is based on rather optimistic assumptions. While none of us possess a crystal ball, I believe staff is right in deeming as optimistic the assumed oil price of $25 per barrel, the assumed rate of decline in the SELIC rate and the assumed exchange rate level which is more appreciated than the current Real/dollar rate. If I understand paragraph 37 correctly, staff believes that the central government deficit will in fact be 0.6 percent GDP higher than the authorities project.

Moreover, as Mr. Bernes notes, the budget proposals make no allowance for some of the fiscal skeletons that may fall out of the closet. The costs related to the recapitalization of federal banks are still unknown as are the costs of legal challenges demanding compensation for losses imposed by underindexation rules. In addition, the costs related to the FVCS (housing-mortgage insurance/subsidy fund) and the FGTS (workers severance payments fund) will have to be added to the stock of public debt. It was not entirely clear to me to what extent the 2001 budget had already provisioned for this. In any event, if we add up all these possible contingencies and assume that staff's baseline assumptions are more realistic than those of the authorities, there seems to be a substantial risk that the debt/GDP ratio will rise this year rather than fall. If this is the case, the Fund program will indeed not have succeeded in fully stabilizing debt/GDP ratio by the end of 2001. Indeed, this seems to be what staff is saying in paragraph 39. Could they confirm that they do not believe that the primary surpluses as projected by the authorities for 2001 and beyond would be sufficient to stabilize the debt/GDP ratio? If so, this raises questions about the program targets to be negotiated for 2001.

I should say that I have continued to be impressed by the ability of the Brazilian authorities to meet almost every kind of fiscal setback or challenge thrown their way. It is thanks to their resolve that the program has stayed on track and confidence has recovered. But I fear that there are limits even for the

Brazilian authorities to continue to achieve the fiscal targets as if they are continuously playing sudden-death-overtime in a tied football game.

Of course, achieving fiscal sustainability is probably not something one achieves overnight. In this regard, I read with great interest staff's chapter on medium and long-term fiscal sustainability in Brazil. They note that the fiscal adjustment effort over the last two years has been necessarily biased towards increases in revenues, some of which non-recurrent, due to the short-term rigidities of several expenditure items. Staff emphasizes that from now on the focus will have to be on structural fiscal reforms. Needless to say I agree with this but it will be more difficult to achieve. I was most struck, however, by staff's sensitivity analysis of fiscal balances. Staff's analysis shows in particular the very large sensitivity to lower growth rates and higher interest rates. They note that: "if the average real GDP growth between 2000 to 2010 turns out to be 1 percentage point lower, the path of net public debt will show an increasing trend after 2003." They go on to say that the critical points beyond which unstable debt dynamics seem to kick in are around 75 basis points of lower average real GDP growth or 130 basis points of higher real interest rates.

I believe this underscores the importance of the growth rate assumptions underlying the medium term fiscal scenario. While the baseline assumes four percent growth – in itself optimistic - this will be heavily ependent on the absence of any kind of external shock, such as a slowdown of growth in export markets or, for instance, rising emerging market spreads. It is worth pointing out that the 4 percent growth assumption in the baseline for the next decade compares to an average growth rate of only 1.8 percent in the1990's. One can only conclude that there is virtually no buffer for any setbacks. As staff concludes in the background paper: the baseline cannot sustain high levels of stress both to real GDP growth or the level of interest rates. Thus it is imperative that the fiscal effort is sustained.

Let me then finally turn to Brazil's vulnerability indicators, which I believe highlight Brazil's continued vulnerabilities, despite present positive policy performance. Like staff I welcome the improvements made in the structure of public debt, with an increasing share of fixed rate debt and a lengthening of maturities. However, as Mr. Faini also notes, the level of floating rate and foreign exchange indexed debt remains high so work remains to be done.

Mr. Bernes has already highlighted the still high level of the current account deficit which will continue to have to be financed. I will not repeat the points he makes. What I would add is a concern about the still relatively low levels of gross and net reserves. The reserves to short term debt ratio on a residual maturity basis is virtually unchanged from two years ago at 56 percent, which I believe is substantially below the emerging market average. At the same time, the level of gross reserves itself now stands $14 billion lower than in1998 ($29.7 billion projected for end-2000) and, as a result of that, the ratio of gross reserves to broad money (a measure of capital flight) has also fallen substantially. Moreover, the reserves to import ratio has also come down since the beginning of the program. None of these ratios show rapid improvements in the staff's medium term scenario which leads to the question if reserve targets are ambitious enough.

In conclusion, I am encouraged by developments in Brazil but feel that there is still a considerably way to go and look forward to discussing the 2001 targets in a few months time.

Mr. Callaghan made the following statement:

At the outset, I would like to identify this chair with all the comments that have been made congratulating the authorities for the management of their economy. Brazil has clearly benefited, and continues to benefit, from sound macroeconomic and structural policies. In particular, I like the way Mr. Toyama summed up one of the reasons for the improvement in the economy in his statement when he said that the effectiveness of the floating exchange rate regime has been proved in the Brazilian case; I think that is right. Yet, while the recent performance is impressive, a clearly worrying aspect of the staff report and a theme that has consistently been picked up in the statements and comments today is that significant vulnerabilities remain. The staff and many Directors have identified that the Brazilian economy is particularly vulnerable to a less benign external environment, such as a hard landing in the U.S., increases in oil prices, or a crisis in confidence, including the possibility of contagion from regional developments. Of course, the economy is ultimately vulnerable to inappropriate domestic policy settings or, more specifically, the perception by the market that policy settings are not appropriate. The challenge the authorities face is maintaining the confidence of capital markets.

The staff notes that Brazil is clearly better placed now than before the1998 crisis to respond to potential shocks that have been identified; this has certainly been the case. It is in better shape now because of policy reforms that have been initiated in recent years, but is it in sufficient shape? This goes to the heart of the question facing the authorities; namely, what more needs to be done to help reduce the vulnerability of the economy to an interruption to sustained, noninflationary growth. But, going back to a positive point, one of the important things that is under way in Brazil at the moment is the introduction of what one might call the institution building that would help ensure the continuation of appropriate economic policies. For example, in the area of fiscal policy, an important development has been the introduction of the Fiscal Responsibility Law. In many respects, legislation like this is helping institutionalize good fiscal policy by requiring administrators to meet fiscal targets. Importantly, it helps with the prospect that appropriate fiscal policies will be maintained if there is a change of government. Such legislation is particularly important, and should be encouraged. Another important step in terms of institutionalizing the prospects of continued sound policy is the prospective legislation to increase the independence of the central bank. Inflation targets set for 2002-03 are likely to remain, irrespective of what happens in the political landscape. This is an important development. The authorities should be encouraged to continue to put in place structures to help maintain sound economic policies. Again, such developments are particularly important in terms of reassuring the markets that appropriate policies will be maintained. Having said that, it is unfortunate that when it comes to fiscal policy, and as the authorities themselves have admitted, the pace of reform has deteriorated somewhat. In fact, if we are worried about vulnerabilities, now is exactly the time when the pace of fiscal reform should pick up when the environment is rather benign. In particular, Brazil needs a robust, medium-term approach to fiscal policy, which is consistent with reducing public debt. This is essential to the maintenance of market confidence.

Unfortunately, it appears that the current projections of the fiscal limit set for the medium term do not really appear to be consistent with a continued decline in the public debt-to-GDP ratio. It is this, rather than potential external developments, which may be the main source of vulnerability for the economy. The work that the staff has done clearly demonstrates the need for greater fiscal effort. Many Directors already have identified the clear pressures on the expenditure side of the 2001 budget, including no allowance for an increase in the minimum wage and no allowance for retrospective wage increases, along with a number of other measures. There is clearly a pressing need for ongoing reform on the expenditure side of the budget, such as social security reform, the restructuring of public debt, and reforming the management of public spending. However, there is also a pressing need to broaden the tax base and to improve the administration of the tax system. The revenue side of the budget needs greater robustness and integrity. The staff papers note that there are a number of tax reform bills before Congress. Perhaps they could provide some progress on developments in broadening the tax base and improving tax administration. In particular, there is a pressing need to reform the indirect tax base and achieve a uniform base rate for the VAT. Efforts in this area are important, in that it would introduce greater efficiency in administration of the tax system and reduce the prospects of tax competition between the states. It is unfortunate, however, to see that political agreement remains elusive in this area. Monitoring the robustness of the revenue base would appear critical to ensure that fiscal policy is set on an appropriate path and will respond to future pressures.

One other area that I would mention where an ongoing reform effort would appear essential is improving the efficiency of the financial system. The cost of bank credit is still high due to large bank spreads. The staff report notes that, in order to reduce intermediation costs, the authorities have been reducing the minimum reserve requirements, publishing information on lending rates to promote competition, and attempting to improve the risk information systems of banks. I am not sure of the relative importance of each of these factors. Moreover, the Selected Issues paper, which touches on this topic, notes that, in addition to the reserve requirements, there are some other factors that can be expected to reduce lending spreads, including tightening fiscal policies, improving property rights, and reducing bank administrative costs. I would suspect, for example, that any shortcomings in a competitive environment in the banking system goes beyond deficiencies in promoting information on lending rates. I would be interested to know to what extent the dominance of federal banks is distorting the overall efficiency of the banking system.

Improving the operation of the financial system is essential, although success in this area may have implications for the operation of monetary policy. For example, to the extent that the authorities are successful in reducing intermediation costs, the cost of financing will be lowered, which would have a stimulatory impact on activity. This could come at a time when there is already concern about a possible acceleration in domestic demand. The work undertaken by the staff in the Selected Issues paper notes that a the interbank rate is a key instrument of monetary policy and can affect lending rates. I do not think the staff explored the possibility that a reduction in lending spreads induced by moves to reduce bank spreads may prove a stimulatory impact on the economy and have implications for monetary policy. There may well be a need for adjustment in monetary policy, although fiscal policy may also need to take its share of the burden.

On the question of privatization, it is reasonable that delays may occur, as there is a need to engender sufficient political support. We recognize the need for modifications to the structural benchmarks proposed in the staff report. However, there are a number of key factors, apart from the general efficiency of privatization, for proceeding quickly on this front. Any further delays will have direct implications presumably for projected changes in debt stocks. Also, the paper notes that market perceptions are that privatization, and perhaps structural reforms more generally, is stalling. Further delays in the privatization front can only have an adverse impact on market perceptions.

To conclude, the reform task that remains is substantial, but, as already noted, the authorities should be congratulated for what they have achieved. They should push ahead with the reform agenda with renewed vigor and with the knowledge that benefits can be obtained from sound policies. We support the completion of the sixth review.

Mr. Le Fort made the following statement:

We welcome the sustained recovery of the Brazilian economy supported by a rebound of all components of domestic expenditure and the increase in net foreign demand, in the wake of the competitive gains brought about by the real depreciation of the Brazilian Real. In particular, we welcome the recovery of investment which is expected to return to the levels prevailing before the last crisis, after the sharp contraction suffered.

The subdued behavior of inflation is one of the most successful aspects of the present program and an important factor to ensure a sustainable and equitable path of economic growth. Cost pressures stemming from the increase in the domestic currency prices of importable goods in general and oil in particular, have not been passed through to consumer prices, in part due to the low level of capacity utilization prevailing before the crisis and the remaining output gap. In these conditions companies have had to compensate the narrower profit margins with expanded volumes. Wage-cost pressures have been also very subdued helped by the increase in labor market participation. However, to the extent that sustained economic growth rates in excess of the expansion of productive capacity absorb the output gap, the labor market would tighten and consumer prices could begin to be more sensitive to cost pressures. Thus, continuous vigilance of these factors that are key drivers in the inflation front would be more than justified.

The success in controlling inflation in the context of the inflation targeting framework and a flexible exchange rate system adds Brazil to the list of countries which have successfully introduced an alternative nominal anchor. The Central Bank (BCB) has implemented so far a cautious monetary policy while testing at the same time the limits of non-inflationary growth. Looking ahead there may be some room for a further easing of the monetary policy (SELIC) interest rate, particularly if the normalization of international oil prices contributes to dampening inflationary pressures as is presently expected.

As discussed in Chapter VI of the Selected Issues paper, however, the transmission mechanisms of monetary policy in Brazil may not be working as predictably as hoped for. This could be the result of the extreme disparity between the SELIC and market interest rates and the structural changes taking place that widens access to financial system credit. In this regard, the risk of excessive demand pressures stemming from rapid consumer credit growth, alluded to by staff in paragraph 45, is significantly reduced by the still exceptionally high real interest rates applied to such credits.

Continued high differentials between the SELIC and market interest rates may hamper the effectiveness of monetary policy and the inflation target framework. At the same time, the large spreads result in high real interest rates in the local financial market, which could over time damage the efforts to stir the economy solidly in the path of high and sustainable growth. We agree with the assessment of the staff in Chapter VII of the Selected Issues Paper, therefore, that a more detailed research on the accuracy of the transmission mechanisms of monetary policy embedded in the structural models used by the authorities to predict inflation would be desirable.

In any event, it should be noted that more precise modeling will not be able to answer all the many questions open about the transmission mechanism of monetary policy and the relationship between policy actions and macroeconomic results. These are always complicated issues, but even more so in the context of an ongoing structural reforms process. In particular, continued progress in financial sector structural reform may result in innovations in the effects of monetary policy and in additional uncertainty at this respect, but after the reform process is completed, its benefits will also include more clear and predictable transmission of policy actions. During the transition period we would recommend continued prudence in respect to the use of monetary policy, and readiness to react to indicators that may anticipate deviations with respect to inflation targets.

On the fiscal front, we commend the authorities for the impressive fiscal performance, with all targets having been met so far. There remains the need, however, to replace distortionary sources of revenue for more neutral ones. The fact that the most buoyant taxes in the first nine months of 2000 were the financial transactions tax, the turnover taxes and the social security contributions exemplifies those concerns. On the positive side, we should acknowledge the efforts to mobilize local revenue including at the municipal level aimed at fostering transparency and efficiency particularly in the provision of social services and public investment. The sustained improvement of the fiscal performance of the states, related in part to the elimination of bailouts by the federal government, along with constraints on personnel expenditures and on debt levels of both the state and federal governments, as mandated by the recently enacted Fiscal Responsibility Law, bode well for the success of the process of medium-term fiscal consolidation in Brazil. This is by all means the most critical factor to assess the future prospects of the Brazilian economy.

In addition, and joining the request in Mr. Tornqvist's statement, we would appreciate staff's comments on the treatment of quasi-fiscal deficits, particularly those stemming from subsidized loans from public banks.

It is important that this successful performance under the program does not lead to complacency and that continued efforts are made both to strengthen revenues and to control expenditures through a renewed emphasis on structural fiscal reforms. It is to be noted that the gradual decline of the net public debt in relation to GDP projected in the paper is predicated not only on a given fiscal effort but also on a continued GDP growth of 4 percent during the next 5 years, which in itself entails a virtuous circle of declining nominal fiscal deficits leading to lower risk premia and to enhanced growth. To increase the chances of such a scenario it is crucial that the envisaged program of structural reforms including in the fiscal and financial areas, privatization, deregulation, and liberalization of markets in general be thoroughly implemented.

However, there are risks for the materialization of the favorable debt dynamics. In particular, lower US dollar GDP could result from the deterioration of the terms of trade and a further real depreciation of the currency, leading to an increase in the measured debt burden. We consider, however, that those risks are limited and could be managed using additional windfalls from privatization to reduce public debt. Box 3 provides compelling evidence of the magnitude and benefits derived from the privatization program in Brazil which in the last 10 years has rendered almost US $ 92 billion of exceptional fiscal revenue. The successful privatization of BANESPA this week in addition to those mentioned in Mr. Portugal and Mr. Mori's statement, increased that amount to more than US $ 100 billion . Thus, the restructuring of the state banks including through closings, capitalization and privatization continues unabated as revealed by the steep decline in the share of state banks in financial system assets from 17 percent at the beginning of the restructuring process in late 1996 to 4.5 percent of total assets even before the recent privatization of BANESPA. In this regard, we see merits in broadening the privatization process to federal banks. The increasing share of foreign banks should contribute to further strengthening the liquidity and solvency indicators of the Brazilian financial system and compound the benefits of the improved supervisory arrangements alluded to in the comprehensive statement of Mr. Portugal and Mr. Mori. I would appreciate if staff could give us some indication of the present scope of foreign banks participation in total financial assets and what it is envisaged for the future.

It is to be noted also that despite this impressive privatization drive the size of the public enterprises sector is still relatively large, with expenditures in the order of 8.5 percent of GDP. There remains, therefore, a relatively large scope for additional financial and efficiency gains to be derived from further strengthening the privatization process. To ensure appropriate debt dynamics its is vital that future privatization receipts be used to reduce public debt as contemplated in the program.

On the external trade front, Brazil's substantial gains in competitiveness, both in terms of relative CPIs and of ULCs, led to a strong performance of exports in volume terms. However, the economic recovery and the subsequent increase of imports of intermediate goods has slowed the process of reverting the trade accounts deficits. We share staff's views on the benefits in terms of productivity and competitiveness gains to be derived from a more rapid pace of reduction of tariffs in general and on imports of capital goods in particular. Such a measure would also help, in the present context of a heightened import substitution process, to avoid the building up of inefficiencies that may translate into renewed protectionist pressures in the future.

On the capital account, the strong performance of the FDI flows, which again this year are expected to be higher than the projected current account deficit, is a clear sign of the productive potential of the Brazilian economy, and of the degree of investors confidence which bode well in terms of its external sustainability. The exceptional increase in labor productivity in sectors with high participation of transnational enterprises and their contribution to the Brazilian external accounts as indicated in Chapter IX of the Selected Issues Paper confirms this positive outlook.

On labor market developments, the relatively low unemployment rate, presently at 6.7 percent, the strong increase of the labor market participation rate, and the very modest growth of real wages projected for the year as a whole would all be pointing to a structurally sound labor market. However, the list of critical reforms that according to Box 2 have not yet been implemented is extensive. Particularly regarding the reduction of severance costs and the possibility of collective bargaining at the plant level. It is important therefore to advance the process of reforms of the labor market so as to increase the market flexibility and the economy's resiliency against external shocks, and to accommodate the process of structural reform, particularly the intensified privatization process and the administrative reform without significantly rising unemployment.

In sum, we concur with the overall positive assessment of the Brazilian economy presented by staff and other Directors and would encourage the authorities to persevere in their strong performance particularly through the intensification of the structural reforms process to further strengthen the policy framework and to create higher future growth opportunities. We support the proposed decision and wish the Brazilian authorities every success in their endeavor.

Ms. Bonomo made the following statement:

I join many other Directors in welcoming the continued good performance of the Brazilian economy under the SBA and in commending the authorities for the achievement of this satisfying outcome. I fully agree with the staff that measures taken in the wake of the1998 / 1999 crises significantly shaped the road for the rather fast and so far steady recovery of economic activity.

Despite the favorable current state of the economy, I also agree with the staff and other Directors that there are significant vulnerabilities and challenges. The intertwined developments of first, public debt, and second, of the current account deficit are crucial and are consequently closely monitored, since large - and possibly increasing - current account deficits inevitably raise the question of the sustainability and the financing of such deficits. I echo others stressing that there are internal risks, such as a considerably higher domestic demand that could push up prices and put pressure on the current account. Among external vulnerabilities, I would like to point out what some people call the "tango-effect": jitters in Argentina's financial markets could cause investors to ask for higher risk premia and reduce their investments in emerging markets in general.

The policy options to contain the remaining vulnerabilities are not manifold. I continue to believe that public finances are key to achieving stability and sustainable growth in the medium term. The debt-over-GDP ratio should be stabilized and eventually decline. Primary surpluses which could eventually trigger a virtuous cycle of lower interest rates and lower debt service are needed.

In that respect, while I can agree with the fiscal target for 2001, I am less satisfied with the suggested measures. Like in past periods, the government relies too much on one-off revenues, such as the receipts from concessions. Moreover, there are many uncertainties regarding the assumptions for the budget. Like other Chairs, I urge the authorities to take additional measures to achieve the targeted budget, if it becomes apparent that the assumptions for the budget were too optimistic. The recent increase in the domestic oil price was a step in the right direction to preserve revenues from the petroleum account, and further increases might have to be considered, depending on developments.

Furthermore, in the medium-term structural fiscal reforms are essential in order to safeguard future fiscal strengths. The authorities should spare no effort in pushing forward a deep-rooted tax reform. Moreover, public expenditure management must be strengthened further, also to abate concerns that the government might be tempted to increase fiscal spending in the forefield of the presidential elections 2002.

On monetary policy, as the staff correctly says, the room for maneuver to lower interest rates could be rather limited. In the view of considerable uncertainty with respect to inflation and international financial market developments, the monetary authorities should stand ready to act decisively. A substantial external shock, e.g. a sudden loss in investor's confidence, would definitely require a tightening of monetary policy and fiscal policy as well.

Finally, steady progress in structural reforms will contribute to underscore the authorities' determination in facing challenges. The recent successful sale of 60 percent of BANESPA's voting shares is certainly a welcome sign of progress—and more of those need to follow. While I agree on revising the structural benchmarks as proposed, I particularly urge the authorities to do all they can to implement the rescheduled privatization program without further slippages. The authorities might also give some consideration to a more rapid reduction of tariffs, which would enhance efficiency and ultimately competitiveness.

With these remarks, I support the proposed decision and wish the authorities good luck in their endeavor.

Mr. Palei made the following statement:

The staff has prepared one more set of excellent papers on Brazil. The Article IV report and selected issues papers clearly describe the post-crisis achievements of the authorities as well as the remaining challenges. Many of the worst expectations with respect to price behavior and output contraction did not materialize in Brazil. The inflation remains within the band established by the central bank, and import substitution is now followed by a more broad-based growth close to 4 percent. The overall prospects for the Brazilian economy remain bright, unless unforeseen external shocks affect negatively the current adjustment.

Given that the Brazilian crisis worked its way through the capital account of the Balance of payments, it would be fair to view the post-crisis adjustment from the perspective of capital markets. The staff correctly points out that today Brazil is less vulnerable to external shocks, thanks to the switch to a flexible exchange rate regime and forceful policy response in the aftermath of the devaluation. The high level of FDI is a demonstration of foreign investors' confidence in the future of the large Brazilian economy. There are other signs, however, that point to remaining concerns of the international investors about the path of adjustment in Brazil. Since the outbreak of the Asian crises, international investors learned to differentiate better between resilient and vulnerable economies. The spreads on the debt instruments of Mexico and several other economies benefited from such differentiation. Unfortunately, the spreads on Brazilian debt remain at a very high level. Brazil has also been noticeably affected by the recent pressures on Argentina when the debt spreads went sharply up. The exchange rate has also been volatile with the Real/dollar rate at 1.96 at the end of last week. One explanation of still present volatility is that the critical mass of reforms in Brazil is still not sufficient to change the investors' perceptions.

Two years ago, faced with the crisis of confidence in the financial markets, the authorities and the Fund emphasized the importance of the public debt and fiscal accounts in Brazil. These two areas remain under the scrutiny of observers. In their statement, Mr. Faini and Mr. Nardelli have asked many relevant questions about debt dynamics. It is likely, however, that, at this stage, investors' cautious attitude towards Brazil has little to do with the authorities' debt management skills. Indeed, it is now broadly acknowledged that, under the existing circumstances, the authorities are doing an excellent job in this area.

At the same time, the progress in fiscal reform carries the main weight in affecting the investors' perceptions about Brazil. And there is a clear understanding in the markets that despite the significant progress in fiscal area, the fiscal reform is far from being completed. It appears that the authorities' current approach to fiscal consolidation relies excessively on discretionary measures. During the initial months of 2000, the expenditures had been depressed while the authorities were depressed due to the delayed approval of the budget. As a result and in combination with higher revenues, the primary surplus for the first five months was about 4.7 percent of GDP. By the end of September, the primary balance of the consolidated government had already reached R $35.3 billion (about 4.4. percent of GDP). Finally, as a result of additional negotiations, the authorities and the staff have agreed not to decrease the end-year 12-months' primary surplus target of R $36.7 billion, which amounts to about 3.4 percent of a revised GDP. This pattern of significant fiscal over performance in the initial quarters of the year and weakening of fiscal position in the last quarter is not new for Brazil. It creates an impression of an ad-hoc approach as opposed to the rule-based fiscal management. Similarly questionable, in my view, is the authorities' readiness to "move quickly to restrict spending commitments below budgetary authorizations" or to "underexecute" the budget. Meanwhile, on the revenue side, to fine-tune the fiscal outcome, the authorities still rely on discretionary increases in petroleum prices and continue to depend on maintenance of some of the distortionary taxes.

It is worrisome that there are significant differences between the views of the staff and those of the authorities on the appropriate for Brazil path of fiscal consolidation. As it is described in the Article IV report, the authorities' 2001 budget is based on optimistic assumptions and many of the risks are on the downside. Quite oddly, it seems that the authorities are inclined simultaneously to downplay the potential of the economy to generate fiscal revenues and to apply unduly optimistic forecasts of the interest rates, exchange rate, and other parameters affecting expenditures. As a result, the ability of the observers to predict the fiscal outcome based on economic data and analysis is constrained. Instead, the fiscal performance of Brazil to a large extent is subject to the discretionary actions of the authorities.

Without repeating the arguments presented by the staff and the previous speakers, I agree that, given the higher ratios of the public debt to

GDP and taking into account less favorable interest rate environment, higher primary surpluses are called for. Similarly to the decision made this year, it would be advisable for the Brazilian authorities to adopt more ambitious targets for primary balances. The downward revision of nominal GDP time series is a legitimate reason to introduce and adopt higher targets.

Furthermore, given the recent stability of the domestic interest rates in Brazil, the observers seem to pay more attention, in addition to the primary fiscal deficit, to the overall fiscal deficit. The latter is still very high for Brazil. The overwhelming emphasis on primary fiscal balance was justified in the initial stages of the program, when the inevitable volatility of interest rates obscured the authorities' progress on the fiscal front. The environment has changed now and, in my view, the authorities' aspirations and targets should be adjusted accordingly.

My concerns about the pace of fiscal reform in Brazil do not diminish the impressive progress achieved by the authorities in many areas. In particular, the authorities certainly deserve credit for bringing more order into fiscal relations between different levels of government, improving transparency in the budget process, and, more recently, making the decision to introduce a quarterly adjustment mechanism for petroleum products. They also have to be commended for their achievements in the conduct of monetary policy, strengthening of the financial sector, and their proactive approach to broadening and deepening of capital markets. The pace of reforms in all of them is rather fast, especially when compared with a slowdown in the fiscal reform.

I welcome Brazil's subscription to the SDDS scheduled for the end of this year and look forward to the FSSA papers envisaged for the near future.

I wish the authorities success and support the completion of the review.

Mr. Pickford made the following statement:

Like others, I am grateful to the staff for their efforts in preparing this voluminous set of papers. The Selected Issues paper, in particular, addresses a number of topics which have been prominent in recent discussions in Brazil; they are a very timely contribution to a number of debates and form a useful research document. I agree with most other speakers that the authorities deserve high praise for their recent accomplishments. The framework that they put in place for both fiscal and monetary policies is now more robust. I congratulate them for that, which is now showing up in economic results. However, significant vulnerabilities do remain, given Brazil's large external and domestic financing requirements. These vulnerabilities can only be reduced by sustained commitment to the macroeconomic framework set out in the program and by continued structural reform. The message which we would like to send to the authorities is a familiar one: now is not the time to give up on the process and succumb to reform fatigue. Like most others Directors, I am in broad agreement with the views in the staff report.

On fiscal policy, I share the views of many Directors that Brazil's debt dynamics are finally balanced at the moment. Moving toward a stable path for public finances is key to this program and also key to re-establishing Brazil's credibility in the markets. Unfortunately, a number of developments recently have raised a few question marks in this regard: revisions to the nominal GDP figures have raised the headline debt ratios; the optimistic exchange rate and oil price assumptions that underpin the public finance projections; and the impact of the likely 20 percent increase in the minimum wage. In addition, the substantial amounts of contingent liabilities, while absolutely right to bring these liabilities on budget in a transparent manner, nevertheless, continues to add to the measured stock of debt. Looking beyond the short-term fiscal risks, the authorities must build on their hard-won gains and demonstrate that they have a convincing medium-term strategy for ensuring that the public finances remain on a sustainable path. There appears to be agreement between the government and the staff that the target of 3 percent of GDP of the consolidated public sector primary surplus is appropriate for next year, but, beyond that, there is less agreement regarding the medium term, with the staff arguing for higher surpluses. More generally, while the program is due to end in 2001, it would be helpful to move further in the direction of a rolling medium-term strategy which goes beyond the period covered by the program.

On the structure of Brazil's debt, the authorities have been following a sensible debt management strategy and have been successful in starting to improve the structure of public debt. Nevertheless, more than 70 percent of public sector debt still remains linked to foreign exchange rates or short-term interest rates and is therefore highly sensitive to changes in investor sentiment and to the risk of contagion. This remains one of the key vulnerabilities facing Brazil and it leaves the authorities with little room for policy slippage.

I welcome the progress that has been made to strengthen the regulatory framework for financial institutions. I also encourage the authorities to continue their efforts to reduce the spreads between commercial lending and deposit rates which, despite the recent reforms, remain substantial. Also, I welcome the authorities' interest in participating in an FSAP. This could usefully build on the assessments that have already been done against the Basel Core Principles and the Fund's own code on transparency in monetary and financial policies, which are referred to in the staff paper. I would look forward to seeing these documents. I also urge the government to consider publishing the reports along with the Article IV staff report. Publication of reports like these would help differentiate Brazil's policies from other emerging markets and help to reduce these vulnerabilities.

In terms of the impact of events on Brazil from Argentina, I suspect Mr. Milleron is right in thinking that a direct impact is rather limited. But, indirect effects could be somewhat larger, so I look forward also to comments by the staff on the impact on Brazil.

In conclusion, I support the proposed decision and wish the authorities well.

Mrs. Hetrakul made the following statement:

At this stage of discussion, I will be brief.

First, I would like to join other Directors in commending the Brazilian authorities for the skillful management of the macro adjustment and reform policies as reflected in the impressive economic performance in all areas, i.e. satisfactory growth, inflation under control, declining unemployment, restored fiscal discipline and improved current account position.

Second, I am encouraged by the strong commitment of the authorities in implementing the required policy measures. Not only all quantitative performance criteria have been met, but also most indicative targets and many of the structural benchmarks. In this respect, I can therefore support the staff recommendation to complete the sixth review.

Third, I broadly concur with the thrust of the staff's appraisal. I also share all the concerns on the remaining vulnerabilities raised by other Directors and encourage the authorities to continue to build up more resiliency of the Brazilian economy in all areas, in particular in furthering structural fiscal reforms and managing Brazil debt as well as speeding up privatization programs to enhance productivity and competitiveness. The authorities need to continue to be vigilant to take prompt policy response in case domestic shocks occur or the external environment deteriorates.

With these brief remarks, I wish the authorities further success.

Mr. Donecker said that he agreed with the staff appraisal, as well as the points raised by Mr. Pickford and Mr. Callaghan. He supported the completion of the sixth review, and trusted that the summing up would reflect the Board's appreciation of Brazil's commendable achievements, as well as the Board's call for continued increased efforts at fiscal and structural reform.

Mr. Prader made the following statement:

Brazil's recovery is well under way and its strong performance under the program has continued. Since the devaluation of the real, economic growth has become more broadly based. Growth is now driven by an interesting combination of an accommodative monetary policy and an improved export performance. The strong initial fiscal adjustment, and declining inflation, have paved the way for a gradual reduction of interest rates. In turn, the lower interest rates fueled economic growth, which has rapidly reduced the nominal fiscal deficit. But even as I applaud these impressive results, I must agree with the staff that serious challenges remain. Although the free floating exchange rate provides more room for maneuver, fiscal policy must remain at the center of the policy mix. And despite the successful stabilization of the economy, Brazil remains vulnerable to external shocks. It is quite sensitive to interest rate movements in the United States and to developments in emerging markets. It might be asked whether Brazil should not respond to this situation with a renewed reform and adjustment effort.

Before making specific comments on fiscal and monetary policy, I should like to respond to some of the points raised by other speakers:

I agree with the staff's recommendation that spending commitments be kept below budgetary appropriations in anticipation of worsening external developments. In his comprehensive statement, Mr. Portugal does not address this point, and I wonder how he views it.

I also share Mr. Abbott's call for moving structural reform higher on the agenda. Accelerating the reform of social security and public debt management would also reassure the markets and help the risk premium on Brazil's debt. Incidentally, the statement of the staff representative gave no information about the behavior of Brazil's market spreads.

I am interested in the staff's reaction to Mr. Wijnholds's comments concerning the program's failure to stabilize the debt-to-GDP ratio.

And finally, I should say that I am concerned about wage developments.

The authorities can justly take satisfaction in the performance of the public accounts, but caution must be maintained. Much of the improvement to date resulted from temporary emergency measures such as increasing indirect taxes and cutting public investments, and the authorities are running out of room for further spending cuts. In general, spending cuts are neither politically nor economically sustainable in the medium term, and there is no alternative to successfully completing the structural reform program.

In addition, most of the progress to date has occurred at the federal level, rather than at the state or municipal levels of government. This underscores the great importance of the Law of Fiscal Responsibility, whose full effects are not yet realized. Delays in the sale of key public sector enterprises this year have dimmed the outlook for privatization revenues this year. All in all, it appears that while the primary surplus target for 2000 is still feasible, the surpluses expected in 2001 and beyond may be more difficult to achieve.

The primary surplus target of the federal budget was cut from the 2.5 percent of GDP set last May to 2.2 percent of GDP in November. This relaxation of fiscal targets at the federal level will be offset by increased profits from state enterprises, leaving the combined primary surplus broadly unchanged this year and slightly less next year (3.4 percent of GDP in 2000 and 3.0 percent in2001). Though these changes are not large, it should be noted that the expected primary surpluses will generally not suffice to further reduce the public debt, which is hovering around 50 percent of GDP. Since next year's growth outlook is now more uncertain than it was a couple of months ago, it could prove difficult to meet the fiscal target. I was also disappointed by the large number of missed structural benchmarks. Most of these slippages have political causes, and although most of them are beyond the government's control, they bode ill for the future. If structural reforms lag seriously behind schedule, the whole adjustment process could be at risk.

The new inflation targeting framework seems to be working well. Nevertheless, inflationary pressures have emerged, one of them beyond the reach of monetary policy, and another that is not.

The most troubling for the short term are high fuel prices and supply shocks in the agriculture sector. Monetary policy can do little about price shocks, which sooner or later will reach domestic prices and boost the headline inflation that Brazil has chosen as its monetary target. And despite a very loose target range, domestic price increases have breached the "upper limit of the inner band" of the inflation forecast for September 2000, an event which triggers compulsory consultations with the Fund.

In his statement, Mr. Portugal informs us that inflation declined in October, which suggests that the year-end target is still reachable. Since wages are the quickest, most reliable indicator of changing inflationary expectations, the next question is how wages will respond to price developments: Will private sector wage demands remain subdued?

At present, increasing interest rates would not be the best response. Nonetheless, it appears that the gradual reduction of interest rates may have come to an end. The central bank must carefully analyze the developments and refrain from further decreases until inflation is firmly back on its downward path. It should be recalled that in the past, hidden price pressures accumulated in domestic fuel prices, which were partly shielded from the world market. I was therefore relieved to learn that the government has decided on a gradual modest increase in domestic fuel prices. This response is all the more justified by the declining revenues of the petroleum accounts. It is to be hoped that its effect on inflation will be modest.

In the medium term, shrinking excess capacity, tighter labor market conditions, and the growth of aggregate demand could exert pressure on underlying inflation. And although such pressure can probably be managed by an appropriate fiscal policy, there will not be much room for setting ambitious targets. I doubt that an annual inflation rate of 4 percent can be reached by the end of 2001. I think the main goal of monetary policy should not be a lightning inflation reduction, but one that is slow and steady. Success depends on setting realistic targets so that the credibility of the new monetary framework can continue to grow. A very careful balance should be struck between economic growth, disinflation, and the external current account. The main burden of the adjustment should be borne by fiscal policy.

Another weakness of Brazil's inflation framework is the effect of exchange rate behavior. The authorities cannot afford the inflation effects of a weaker exchange rate. The situation is further complicated by uncertainties about U.S. interest rates. The authorities are obliged to keep an eye on the exchange rate when deciding on Brazil's interest rates. This link has led to somewhat erratic interest rate movements in the recent past, which have undermined market confidence and made liquidity management more difficult.

The Deputy Director from the Western Hemisphere Department, in response to questions and comments, made the following remarks:

A number of Directors have expressed concern about the prospects for the budget for 2001, in light of the ongoing press coverage of the budget debate in congress over the past few weeks. The Fiscal Responsibility Law explicitly stipulates that any new expenditure should be accompanied by the identification of permanent sources of revenue to fund that expenditure. This is an important element of discipline that has been introduced in what Mr. Callaghan has referred to as the institutionalization of fiscal discipline in Brazil. We are now seeing the benefits of this. For instance, when the government agreed to raise the minimum wage to 280 reais, that was accompanied by an identification of the sources to finance this increase. Among the sources that have been identified so far is the allocation of the 1.6 billion debt reserve in the budget that was included in the budget proposal for congress, although it is not clear that congress will go along with this. There are also some savings in the budget that can be made through a linear cut in discretionary spending. This would yield about 300 million reais in savings. There is also some possibility of increasing revenue in the budget if congress agrees to pass one of the pending measures to reduce tax evasion, which has to do with a reduction of the bank secrecy guarantees that are currently in the legislation. All of these new sources of revenue would help fill the gap.

Another important source would be the proposed 11 percent contribution from the retired civil servants. This is a politically unpopular measure, although from an equity standpoint, it is well justified. The government is putting forward to congress the choice between continuing to pay high pensions to civil servants versus increasing the minimum wage, which is an effective instrument for reducing poverty in Brazil. The staff is convinced that the government is fully determined to have the Fiscal Responsibility Law respected in this context.

There are other risks for the budget for 2001. One is the wage increase for military personnel, which has been agreed to by the executive branch, but on a two year schedule, and accompanied by a commitment by the military to raise their social security contributions to the same level as for civilians. The expected net cost to the Budget in 2001 is equivalent to workers of 0.1 percent of GDP in 2001. An additional possible source of pressure comes from the 12 percent wage increase granted to the electoral tribunal, which most likely will have to be extended to other members of the judiciary. This will also cost about 0.1 percent of GDP. On the other hand, some revenue items are in our judgment somewhat underestimated, in the traditional conservative practice of the government to understate revenues to be on the safe side. If the international environment remains broadly in line with the scenario underlying the budget and allows a further small reduction in interest rates, it should be possible to manage these expenditure pressures with additional revenue resources and with some of these offsetting cuts. Therefore, it should be possible to maintain the primary surplus at 3 percent of GDP. Under this scenario, no substantial additional measures would be needed to reach the 3 percent target and to achieve a small decline in the debt-to-GDP ratio. However, if the external environment were to turn significantly worse, it is clear that the 3 percent target would not likely be realized, and therefore the authorities would have to take additional measures, although they may not be sufficient to ensure a reduction in the debt-to-GDP ratio. For both of these considerations, it would be important for the government to take additional steps to tighten fiscal policy, thereby contributing to the maintenance of a good perception of Brazil’s risk in the markets.

I agree with the comments that have been made by a number of Directors that, although vulnerabilities have been reduced, compared to two years ago, they still remain significant. The spreads in the market, which remain relatively high, are indicative of this. In this connection, the spreads on Brazilian debt closely follows the EMBI. There has been no reverse differentiation of Brazil as there has been, for instance, in Argentina, where the increase in the spread has been practically double that of the EMBI in general.

The Fiscal Responsibility Law was passed only a few months ago, and the government has taken a number of steps to help its own agencies and those of the states and municipalities to become familiar with the operation of the law. An important political test was already passed when a number of mayors asked for an exception to the law for expenditures that were contracted in advance of the elections, but the government refused this and was sustained by the senate. Therefore, those expenditures that were contracted in violation of the law will not be paid. This is sending a clear signal to future contractors or providers of services that there will be no bailout ex post.

Mr. Toyama inquired about the effects of the tax on financial transactions. The Fiscal Affairs Department has prepared a paper on this, which includes a study of the effect on these taxes in various Latin American countries. On a general level, there appears to be some preliminary evidence that it may have had a distortionary effect with respect to, for instance, foreign equity investment, and the government has taken steps now to exempt foreign equity investors from the financial transaction tax. On the other hand, this tax acts as a de facto minimum income tax, and it has been used by the internal revenue service as a cross-check on declarations under the income tax for both enterprises and individuals.

Mr. Faini asked about the reasons why the debt-to-GDP ratio is not expected to decline over the period as much as it was anticipated in the previous program. This is a reflection of a more depreciated exchange rate assumption, and also higher interest rates, which seem more appropriate under the current scenario, reflecting precisely the vulnerabilities of Brazil to external circumstances. The level effect on the stock of debt from a small revision in the national accounts has been largely shrugged off by the markets. However, as a result of a less favorable international environment and its implications for the relevant variables for the debt dynamics, including potentially the growth rate, the scenarios suggest that, over the medium term, larger surpluses than what the authorities currently envisage could be could be required to ensure the continued decline of the debt-to-GDP ratio.

On the contingent liabilities, Box 5 in the report provides an extensive account of the various potential liabilities. The liabilities from the FGTS have been taken into account in the medium-term baseline projection in the staff report.

The analysis in the Selected Issues paper identifies some of the main determinants of the lending spreads. Clearly, the improving loan default rate is a factor. Some tax factors also affect these spreads, as well as administrative costs and the minimum reserve requirements, which the central bank is trying to reduce as the liquidity conditions of banks permit. It is clear that, although the private component of the banking system in Brazil is efficient, the system remains relatively segmented and the degree of efficiency in the federal banks and in those state banks that still remain under state control has significant room for improvement. The central bank and the government are committed to reaching an adequate solution for the federal banks in the course of the next several months. In fact, the introduction of the new loan classification system has exposed publicly some of the weaknesses in these banks, which were not clearly evident before. The central bank has gone into this with fully open eyes, realizing that this was a way of forcing a decision on the recapitalization and restructuring of these banks. Important and politically sensitive decisions need to be taken on the role of these banks, as well as on the clearer separation of their commercial banking versus development functions by making explicit the quasi-fiscal component of their operations. This requires the creation of better insurance mechanisms for the risk of loan defaults, especially in the agricultural sector and in the housing sector, where these risks are particularly high. Explicit budgetary subsidies are already in the budget. However, the main element of weakness in the federal banks has been the relatively high rate of nonperforming loans, as opposed to the more traditional quasi-fiscal operations in the form of subsidized or below market loans for which an explicit budgetary subsidy is not provided.

At the moment, federal banks comprise about 40 percent of total assets of the banking system, while foreign banks account for about 50 percent of total assets of the private sector banks. Including BANESPA, 25 to 30 percent of the banks are in foreign hands. This is an important development. BHSC will be the third largest private bank in Brazil, and this will certainly provide a degree of competition in the system, which can only help in promoting further efficiency and in reducing the dominance of a few major players among the private banks. Over time, this will help put downward pressure on lending spreads.

Administered prices have been an element of upward pressure this year. This is not to say it would not have been desirable to increase domestic oil prices earlier, although the good results of the overall budget performance so far this year did reduce pressures on the government to increase domestic oil prices. For all the products under administered price controls, the increases exceeded average inflation. The main factor that moderated inflation was agricultural prices, which had a spike in the summer months, but have been quite subdued both earlier in the year and over the past few months. In fact, there has been price deflation in the past few weeks, essentially owing to the development of agricultural prices.

On why the staff did not include the privatization of the electrical and insurance companies as structural benchmarks, the staff intends to revisit the structural benchmarks for 2001 in the course of the next review, which will be early in the new year to fix the targets for 2001. At that point, the structural benchmarks would be made more specific. The staff wanted first to receive inputs from the authorities about the calendar of privatization of the electrical companies, which are intended to be privatized in the course of 2001.

The proposed central bank draft law, which has not yet been submitted to parliament, aims to establish a firmer legal basis for the operational independence of the central bank, which is now based on a presidential decree, which could, in principle, be revoked. This law will give a clearer mandate to the central bank to pursue inflation targeting, and it will also propose some terms of office for the board members of the central bank, which could only be removed by the president with a majority support from the congress. On the privatization of the federal bank BASA, the government intends to begin divesting the bank, although it has not given a clear indication as to whether it intends to completely relinquish control of it, sell the whole bank, or only begin with a partial privatization of the institution.

With the oil account in virtual balance or even a small deficit for this year, the mechanism of cross-subsidization among domestic oil products is leading to a small net subsidization of such products, so taxation of these products is not a major source of revenue. For next year, the authorities' projection, which we will need to discuss in greater detail in the context of the next review, envisages a surplus of the petroleum account on the order of between 3.5 to 4.5 billion reais, about 0.3 to 0.35 percent of GDP. This is not a major source of revenue, considering that the overall tax ratio is closer to 30 percent of GDP.

In response to a question from Mr. Abbott on the near-term growth outlook, it is difficult at this point to say with any certainty what the outlook for next year will be, as we have not had the benefit of recent discussions with the authorities on that. Probably, if the international environment remains reasonably benign, it should not be difficult to reach even a 4.5 percent growth rate, although perhaps it would be closer to 4 percent. Certainly, if the international environment were to deteriorate further, for instance, a hard landing of the U.S. economy or a major shock in another emerging market, there could be a substantial contagion effect through spreads and the bond market. This would require the central bank to tighten monetary and fiscal policies, and that would make the outlook for growth more problematic. Nevertheless, the current pace of growth is in line with at least a 4 percent growth rate.

As regards the medium-term growth potential of the economy, with the continuation of the appropriate structural reform efforts, Brazil could grow more than 4 percent on average a year because it has a competitive exchange rate. It has also made substantial adjustments on the fiscal side, which, although they need to be sustained, do not need to be increased. In fact, the medium-term scenario suggests that a primary surplus on the order of 2 percent of GDP to 2.5 percent of GDP is reasonably robust in terms of leading to a decline in the debt-to-GDP ratio. Whether Brazil can grow substantially more than 4 percent, depends on the kind of structural reforms undertaken, such as the further modernization of the economy and greater flexibility in the formal labor market. Also further improvements in the delivery of social programs, particularly in education and health, would help raise the potential growth rate. While improvements have been made in primary education, more are needed to strengthen the quality of secondary education in Brazil. Another area is making the tax system less distortionary by replacing the cascading taxes with VAT-type taxes. The authorities could also further broaden the tax base, although the tax base is already quite broad. While further improvements could be made in tax administration, the improvements that have been made over the past few years have been remarkable, as evidenced by the robust growth of revenues that every year keeps surprising us favorably. All these structural reforms will make the difference as to whether Brazil will be able to grow moderately or grow strongly. We certainly hope that the authorities will have the political conditions necessary to implement successfully these reforms.

Mr. Portugal made the following concluding remarks:

I would first like to thank Executive Directors for their statements, which contained many valuable points and suggestions. I have already sent to Brazil the written statements, and I will pass on the oral comments made today. I would also like to thank the Board for the completion of the review, and the staff and management for the excellent quality of the policy dialogue that has been maintained with the Brazilian authorities. I would like to thank Directors for their generally positive assessment of the policy framework and the efforts made by the authorities.

On the question of the relatively optimistic assumptions with respect to oil prices, the budget was presented to congress in August just prior to the latest turmoil in the Middle East. At that time, US $25 per barrel was more or less in the middle range of what the OPEC countries had indicated their stabilization effort would be. That was the assumption used, but this has changed. With the price increase of last week, the new oil price is now between US $28 per barrel to US $30 dollars per barrel.

On the question of the minimum wage, the government has included in the budget an allowance for an increase in the nominal minimum wage from 151 reais to 159 reais. Congress has been requested to increase the nominal wage to 180 reais, and it is currently discussing how to cover that. If nominal wages go up to 180 reais, that would generate an extra cost of 2.4 billion reais for next year if it starts in April. However, for the entire year, the cost will be 3.7 billion reais. The government suggested to congress to use their allowance for the wage increase in the budget, which amounted to 1.8 billion reais. There are other spending cuts. There are two laws that are pending in congress which would eliminate bank secrecy for tax purposes. The expectation is that they could use the extra annual revenue of 1.2 billion.

Mr. Prader asked what my views were on keeping actual expenditure below budget authorization. The government is committed to taking the necessary measures to ensure that actual expenditures were not greater than budgeted.

There were a number of questions about the debt dynamics and, especially if the debt-to-GDP ratio that is projected is stable or not. Anyone who has done any of these exercises knows how sensitive they are to the assumption of what is the rate of growth of GDP and what is the real interest rate. This is really what determines the outcome.

Directors asked whether the 4 percent growth rate of potential GDP is an upper limit, or is it exaggerated, considering that in the last decade the average was lower. It is difficult to determine with any certainty the rate of growth of potential GDP in an economy. Even in the U.S., we have been wrong in determining what was the potential GDP growth rate. For next year, we probably cannot hope for a growth rate of more than 4 percent, but over the medium term, the Brazilian economy has a potential for a rate of growth that is larger than 4 percent. Of course, that would depend on the continuation of structural reforms. There is no doubt in the Brazilian authorities' mind of the importance of that. In fact, we agree with what has been said by Directors, that it would be good if those reforms could be speeded up. Unfortunately, we do not have control over this process, because it is a process that depends on negotiations with congress. For instance, the reform of the indirect taxation system, which does not aim to increase revenue because the tax burden in Brazil is already adequate for the level of per capita income of Brazil, but which aims to increase efficiency. These measures require a constitutional reform in Brazil, with two votes in the house of representatives and two votes in the senate, all requiring 60 percent majorities of all members. It also requires an agreement by the states, because they are the ones who charge this value add tax. That agreement has already been reached. The whole issue is hanging on a negotiation with members of congress because they want to include in the constitution certain provisions for including a non-cumulativity of tax, which the government does not want to include in the constitution because of legal disputes. This tax that we are trying to replace is the second largest tax we collect, second only to income taxes. So, we cannot afford to make a mistake on that, although we wish the negotiations could go faster.

There were also a number of points in the statements regarding the large current account deficit. The government still has large interest payments on its external debt. Certainly, the government is conscious of the need to increase exports. Nevertheless, under the floating exchange rate regime, there is a built-in market mechanism to make adjustments and to make corrections over the medium term. Sometimes some are still thinking in an old frame of mind. For instance, there was a question today to the staff as to whether the net international reserve targets are ambitious enough. They also wondered what would be the adequate level of international reserves for a floating exchange rate, which is different than under a fixed exchange rate regime. Then, some pointed out that the current account deficit will continue to be financed by the large level of foreign direct investment for at least another 2 to 3 years. Of course, this high level of FDI that we have been enjoying since 1995 is bound to have a sizable impact in terms of raising productivity and competitiveness in the Brazilian economy as a whole, and I would be surprised if that were not the case. This is another consideration that we have to take into account when we discuss what is the rate of growth of potential GDP in Brazil. There are a number of large investments, both foreign and domestic, that have been made, especially in the intermediate goods industry, that are going to start maturing by end 2002 and onwards. Of course, that would also help in terms of both substituting efficiently for imports, and also in helping to increase exports. And, in the short term, we still hope that there will be some improvement in the terms of trade.

For next year, at least seven state banks are scheduled to be privatized. Those who want to buy banks in Brazil will have plenty of opportunities. Foreign banks comprise 28 percent of total assets in the financial system in Brazil. This has been a remarkable rate of growth, compared to 1995 when foreign banks comprised 9 percent of total assets.

Let me conclude by saying that the Brazilian authorities will not rest on the good results and the achievements that have been accomplished so far. We all see this result as an opportunity for deepening the implementation of the program. The authorities are conscious that there is still a daunting policy agenda ahead of them. They are also conscious that there are still a number of vulnerabilities in the Brazilian economy. The recognize that the external environment is not a good one at the moment, and they intend to continue implementing this program with strength and determination.

The Chairman made the following Article IV consultation summing

up:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the skillful management and satisfactory performance of the economy and felt that the proposed stance of macroeconomic policies for 2001 was broadly appropriate. The rapid and sustained recovery from the crisis of late-1998/early-1999 reflected the authorities' continued commitment to the program's policy framework, particularly the strong macroeconomic adjustment and fiscal and other structural reform efforts, together with short-term official financial support, and the constructive, voluntary involvement of the private sector. Directors noted that output is growing strongly, employment has rebounded, and consumer price inflation has remained subdued and in line with the government's target. They cautioned, however, that the economy remains vulnerable to external shocks. This makes it imperative that the authorities persevere in their fiscal consolidation and structural reform efforts.

Directors agreed with the authorities that the benefits of sustainable economic growth need to be more equitably distributed, also to facilitate continued social support for the government's economic policies. They noted with satisfaction the continued improvement in key social indicators, especially in the areas of education and health.

Looking ahead, Directors noted that, while the outlook for the external environment remains uncertain, Brazil is better placed now to withstand external shocks, given its enhanced competitiveness, its increasingly diversified export base, its diminishing dependence on imported oil, and the relatively limited reliance of the public sector on foreign financing sources. At the same time, they urged the authorities to work further to enhance the resilience of the economy, and thus reduce the still high interest rate spreads on Brazilian debt, by strengthening public finances and pressing ahead with structural reforms. Resolute actions, especially on the fiscal policy front, should help put Brazil on a trajectory of dynamic private sector-led growth.

Directors felt that the strong fiscal performance so far during the year provided comfort that the program's fiscal targets for the year would be met, and commended the authorities for maintaining in nominal terms the year-end target for the primary surplus of the consolidated public sector, notwithstanding the recent downward revision of nominal GDP.

Directors supported the proposed fiscal stance for 2001, and the objective of achieving a consolidated primary surplus of at least 3 percent of GDP in 2001. However, several Directors noted that the 2001 budget assumed favorable domestic and international developments. Directors therefore stressed that, if external conditions were to deteriorate or domestic demand were to be stronger than envisaged, the authorities should be prepared to tighten the fiscal stance so as not to unduly burden monetary policy, and ensure the targeted reduction of the net public debt in relation to GDP.

Directors were reassured by the authorities' efforts in the ongoing congressional debate of the federal budget to ensure that additional spending requests are backed by additional revenue, or to insist on offsetting cuts in other proposed spending.

Directors welcomed the steps taken by the government to recognize contingent liabilities, which improve the transparency of the public accounts, but noted that the resulting increase in the public debt underscores the need for continued fiscal consolidation. They commended the authorities for enacting the Fiscal Responsibility Law, which is expected to institutionalize budgetary discipline at all levels of government, as well as promote transparency. Significant progress has also been made in reforming the social security system for private-sector workers. Directors noted, however, that further progress in pending structural fiscal reforms—including of the social security system for public-sector workers, the system of indirect taxation, the liberalization of the domestic fuel market, and management of public spending and the public debt—will be needed to improve the quality and sustainability of fiscal adjustment over the longer term. They also welcomed the authorities' initiative to develop a multi-year fiscal framework, which would bring an element of greater predictability and help in the fiscal adjustment efforts. In this connection, Directors noted that adequate primary surpluses would be needed over the medium term to ensure a continued decline of the public debt relative to GDP.

Directors noted that the Brazilian financial system remains relatively strong, although the high intermediation costs suggested the scope for significant efficiency gains, especially in public banks. They welcomed the recent implementation of a new assessment and provisioning system for credit risk, and other efforts by the central bank to strengthen the regulatory framework for banks. Directors also noted the completion of the assessments of the Basel Core Principles for effective banking supervision and the Code of Good Practices on Transparency in Monetary and Financial Policies. They also welcomed the authorities' ongoing efforts to strengthen bank supervision, further develop domestic financial markets, and improve the legal framework for corporate governance. Directors welcomed the authorities' ongoing efforts and their intention to devise and begin to implement a comprehensive strategy to address weaknesses of the federal banks, to make them more transparent, efficient, and competitive. They were also pleased by the recent successful privatization of the former state bank of São Paulo (BANESPA), and encouraged the authorities to press ahead with their privatization agenda, particularly with respect to the remaining state-owned banks, as well as the energy sector. Directors welcomed the authorities' interest in participating in the Financial Sector Assessment Program (FSAP) at the earliest convenient date.

Directors commended the authorities for their prudent conduct of monetary policy under the inflation targeting framework that was adopted in mid-1999, which has been instrumental in anchoring inflation expectations and securing inflation outcomes broadly in line with the government targets in both 1999 and 2000. They felt that, particularly in light of the external uncertainties, the cautious approach adopted by the authorities with respect to interest rates is appropriate. Directors agreed with the authorities' view that the scope for further reductions in interest rates in 2001 would be influenced not only by the external environment, but also by the government's success in preventing, through an appropriately firm fiscal policy, domestic demand and cost pressures that may be inconsistent with the targeted further decline in inflation. They noted that a further institutional strengthening of the monetary policy framework would be desirable, and welcomed the authorities' plans in this area.

Directors welcomed the fact that the exchange rate has been managed flexibly under the new regime, and that the central bank has virtually abstained from intervening in the spot market since the middle of 1999. They felt that Brazil's external competitiveness was adequate, as evidenced by the continuing strong growth of exports in volume terms.

Directors especially welcomed the continuing strong growth of foreign direct investment, an important engine of modernization and efficiency of the economy. Some Directors noted, however, that the portion of foreign direct investment flows related to the privatization program would likely abate in the medium term, and that therefore it is all the more important to continue reforms that will increase efficiency and the attractiveness of Brazil to foreign investors. Noting that foreign trade flows still remain rather small relative to the size of the Brazilian economy, Directors encouraged the authorities to promote greater openness and competition, through a progressive reduction of tariff and nontariff barriers. They also welcomed the authorities' efforts to deepen regional integration, by promoting the expansion of Mercosur and the harmonization of statistics among its current and prospective members, as a step toward the adoption of mutually agreed macroeconomic and fiscal targets.

Directors noted that Brazil's statistical base is generally adequate for surveillance, and welcomed the substantial progress made toward meeting the requirements of the Special Data Dissemination Standard, to which the Brazilian authorities aim to subscribe by end-2000. They welcomed, in particular, the ongoing efforts to improve the national income accounts, including the compilation of quarterly demand-side accounts, which they viewed as a near-term priority.

It is expected that the next Article IV consultation with Brazil will be held on the standard 12-month cycle.

The Chairman made the following use of Fund resources summing up:

Executive Directors commended the Brazilian authorities for the overall performance under the program supported by the Stand-By Arrangement. In particular, they noted with satisfaction that all performance criteria and most indicative targets have been met, frequently with significant margins. Directors also endorsed the proposed program targets for the rest of this year. Noting that slippages in some structural reforms and the privatization program were largely due to reasons beyond the authorities' control, they agreed to the proposed rescheduling of some of the relevant benchmarks, but called on the authorities to press ahead with their structural reform agenda, which Directors viewed as important for the program's continued success over the medium term.

Directors felt that the proposed stance of macroeconomic policies for 2001 was broadly appropriate and endorsed the authorities' efforts to ensure that the budget for next year—as eventually approved by congress—is consistent with the primary surplus target specified in the budget guidelines law. However, Directors also highlighted potential vulnerabilities to adverse external or domestic shocks. These include a hard landing of the U.S. economy, with adverse implications for the expansion of world trade and the flow of foreign financing, further increases in world market oil prices, and the emergence of domestic excess demand pressures. These general vulnerabilities are heightened by the fact that the external current account deficit remains substantial, although it is still more than financed by foreign direct investment. Against this backdrop, Directors stressed that, if the external environment were to deteriorate significantly, or if excess demand pressures were to emerge, the fiscal stance would need to be tightened—in particular by keeping spending commitments below budgetary authorizations—to avoid placing an undue burden on monetary policy.

The Executive Board took the following decision:

1. Brazil has consulted with the Fund in accordance with paragraph 3(b) of the Stand-By Arrangement for Brazil in order to review program implementation and to establish new performance criteria for the period through end-December 2000 .

2. The letter dated November3, 2000 , attaching a Memorandum of Economic Policies and a Technical Memorandum of Understanding ("the November 2000 TMU"), respectively, all from the Minister of Finance and the President of the Central Bank of Brazil, shall be attached to the Stand-By Arrangement for Brazil, and the letters from the Minister of Finance and the President of the Central Bank of Brazil dated November 13,1998 , November 25,1998 , March 8, 1999 , July 2, 1999 , November 12, 1999 and

April 20, 2000 , together with their respective attachments, shall be read as supplemented by the letters dated November 3, 2000 and their respective attachments.

3. Accordingly, the Stand-By Arrangement for Brazil shall be amended as follows:

(a) paragraph 2(a) of the Stand-By Arrangement for Brazil shall be amended to read as follows:

"2(a) Purchases under this Stand-By Arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 3,798.90 million until December 15,1998 , the equivalent of SDR 7,055.10 million until May 15, 1999 , the equivalent of SDR 8,764.605 million until August 31, 1999 , the equivalent of SDR 10,474.11 million until February 28, 2000 , the equivalent of SDR 11,288.16 until May 31, 2000, the equivalent of SDR 11,505.24 million until June 30, 2000, the equivalent of SDR 11,722.32 million until August 31, 2000 , the equivalent of SDR 11,939.40 million until October 31, 2000, the equivalent of SDR 12,156.48 million until February 28,2001, the equivalent of SDR of 12,373.56 million until April 30, 2001, the equivalent of SDR 12, 590.64 million until July 30, 2001 and the equivalent of SDR 12, 807.72 million until October 30, 2001 .";

(b) the ceilings and floors referred to in paragraph 3(a)(i) to 3(a)(v) shall, for the period up through December 31, 2000 , be as specified in Sections II.1.a, II.2.a, II.2.b, II.2.c and II.2.d of the November 2000 TMU, respectively;

(c) paragraph 3(b) of the Stand-By Arrangement shall be amended to read as follows:

"3(b) after February 27, 1999 , until the second review is completed, after May 14, 1999 , until the third review is completed, after August 30, 1999, until the fourth review is completed, after February 27, 2000, until the fifth review is completed, after October 30, 2000, until the sixth review is completed, after February 27, 2001, until the seventh review is completed, after July 29, 2001, until the eighth review is completed, as specified in page 1 of the TMU, Section I of the March 1999 TMU, Section I of the July 1999 TMU, Section I of the November 1999 TMU and Section I of the November 2000 TMU; or";

(d) sub-paragraphs (vi) and (vii) of paragraph 3(c) of the Stand-By Arrangement shall be amended to read as follows:

"(vi) fails to refrain from entering into any new operations in the foreign exchange futures markets, as set out in Section II.2.e of the March 1999 TMU, Section II.2.e of the July 1999 TMU, Section II.2.e of the November 1999 TMU, Section II.2.e of the April 2000 TMU and Section II.2.e of the November 2000 TMU, or

"(vii) or fails to refrain from entering into foreign exchange forward contracts, as set out in Section II.2.f of the March 1999 TMU, Section II.2.f of the July 1999 TMU, Section II.2.f of the November 1999 TMU, Section II.2.f of the April 2000 TMU and Section II.2.f of the November 2000 TMU; or";

and,

(e) paragraph 3(d) of the Stand-By Arrangement shall be amended to read as follows:

"3(d) until Brazil has consulted with the Fund as provided for in Section II.3.b of the November 1999 TMU, Section II.3.b of the April 2000 TMU and Section II.3.a of the November 2000 TMU."

4. The Fund decides that the sixth review contemplated in paragraph 3(b) of the Stand-By Arrangement is completed.

Decision No. 12331-(00/116), adopted
November 27, 2000

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/00/115 (11/22/00) and EBM/00/116 (11/27/00).

2. SDR DEPARTMENT—DESIGNATION PLAN FOR DECEMBER 2000—FEBRUARY 2001; AND FINANCIAL TRANSACTIONS PLAN FOR DECEMBER 2000—FEBRUARY 2001; AND FINANCIAL TRANSACTIONS PLAN—REVIEW OF GUIDELINES FOR ALLOCATION OF CURRENCIES

SDR Department—Designation Plan for December 2000—February 2001

The Executive Board approves the SDR designation plan for the quarterly period December 2000-February 2001 as set out in EBS/00/227.

Decision 12332-(00/116) S, adopted
November 22, 2000

Financial Transactions Plan for December 2000-February 2001

The Executive Board approves the list of members considered sufficiently strong and the financial transactions plan for the period December 2000-February 2001, as set out in EBS/00/226.

Decision 12333-(00/116), adopted
November 22, 2000

Financial Transactions Plan—Review of Guidelines for Allocation of Currencies

The Fund has reviewed the guidelines for the use of currencies in the General Resources Account approved by Decision No. 11837-(98/121), adopted November 30, 1998, and decides that they remain appropriate (EBS/00/226, 11/14/00).

Decision 12334-(00/116), adopted
November 22, 2000

3. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by Advisors to Executive Directors as set forth in EBAM/00/160 (11/21/00) is approved.

APPROVAL: June 1, 2001

SHAILENDRA J. ANJARIA
Secretary