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Contacts with member countries. Brazil - Correspondence 04

OFFICE OF THE PRESIDENT

Meeting with Governor-Elect Francelino Pereira of Minas Gerais, Brazil, January 5, 1979

Present: Messrs. McNamara, Pereira and Associates, Kafka, Franco, Barletta, Lerda, Mirza

Mr. Pereira said that Bank operations in Minas Gerais had made a very important contribution to the development of that State. Public opinion was aware of that fact. Collaboration between the Bank and the State should continue and help address the serious problems of urban, agricultural and industrial development. His Government would place particular emphasis on people-oriented programs in order to reduce income distribution disparities and regional imbalances. The capital of Minas Gerais, Belo Horizonte, was growing at 6% per year. Brazil would have to deal more effectively with its population growth problem; according to recent projections, Brazil would have a population of 206 million people in the year 2000. The task for his Government would be (a) to fix the population in the rural areas, (b) to transform medium-size cities into barriers against migration into the large cities, and (c) to develop the low-income neighborhoods of Belo Horizonte.

Mr. McNamara said that he was glad to hear about the Bank's contribution to the development of Minas Gerais. However, there were still problems of reaching the small farmers under some of the rural development projects financed by the Bank. These issues had to be addressed by the State Government in collaboration with the Bank. The Bank was willing to consider a second rural development project in the State of Minas Gerais. He encouraged the Governor to bring issues of importance to his attention whenever the Governor wished to do so.

CKW
January 15, 1979

34
OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: January 4, 1979

FROM: Nicolas Ardito-Barletta

SUBJECT: BRAZIL - Briefing Notes re Visit on January 5, 1979 of Governor-Elect
of State of Minas Gerais, Francelino Pereira dos Santos

1. The Governor-elect of the State of Minas Gerais, Francelino Pereira dos Santos, will be visiting the Bank on Friday afternoon, January 5, 1979. You have agreed to receive the Governor at 6:30 p.m. for a brief courtesy visit. He will be accompanied by Mr. Francisco Afonso Noronha, President of CEMIG (the state power company, which is well known to the Bank), Luiz Anibal Fernandes, President of INDI (Minas Gerais State Institute for Development) and Mr. Daltro Nogueira, a director of the Banco Real. Earlier in the day, the delegation will have met with me and with Messrs. Qureshi and McClure of IFC. Attached as Annex I is a brief curriculum vitae which indicates, inter alia, that in 1975 Governor Pereira was elected president of the ARENA party (the official Government party), and that he is a lawyer and university professor with a long and active involvement in municipal and state affairs. The outgoing Governor of Minas Gerais, Antonio Aureliano Chaves de Mendonca, who visited the U.S. in December of 1978, will be Brazil's Vice President in the next administration of Gen. Joao Baptista Figueiredo, which is taking office in March 1979. The outgoing Minas Gerais state Secretary of Finance, Mr. Joao Camillo Penna, is frequently mentioned as a candidate for one of the federal ministries. Governor Pereira does not speak English but will be accompanied by a translator from the Embassy.

State of Minas Gerais

2. The State of Minas Gerais is one of the larger states in Brazil, and the largest in the Southeast region, with an area of about 490,000 km² (representing about 6.9% of Brazil's total land area) and a 1977 population of about 13 million of which 61% is estimated to be urban and 39% rural, about the same as for Brazil as a whole. While containing relatively developed and rapidly growing mining and industrial sectors, Minas Gerais also has some very poor agricultural zones, including the northern part of the state which is included in the Northeast "drought polygon". The 1976 GDP per capita for Minas Gerais is estimated at about \$810, as compared to about \$1,140 for Brazil as a whole. The state is the most important producer of mining products, iron and steel, and cement in Brazil.

Lending Program in Minas Gerais

3. The State of Minas Gerais has been a major beneficiary of World Bank lending, in the early years mainly in the power sector, and more recently in water supply and sewerage, aluminum, steel, fertilizers, rural development and urban development. Attached as Annex II is a list of Bank-financed projects in Minas Gerais (or which include major components in Minas Gerais). In addition to these, other projects which are national or macro-regional in scope (such as agricultural research and extension, highways, railways, livestock

and grain storage, secondary and feeder roads) have benefitted or are benefitting Minas Gerais. Out of 82 Bank loans made to Brazil (for a total of about US\$3.9 billion), 21 have been in Minas Gerais (for a total of about US\$1.0 billion). The state is developing rapidly under very able leadership. The Bank has always had excellent cooperation from the state authorities.

Issues Under On-Going Loans

4. Attached as Annex III are notes on the progress of the following projects:

i) Loans No. 1009-BR and 1309-BR (First and Second Minas Gerais Water Supply and Sewerage Projects); and

ii) Loan No. 1362-BR (Minas Gerais Rural Development Project).

You may wish to comment on the need for a further tariff increase during 1979 in order to enable the water company to achieve a sound financial position. You may also wish to underscore our concern that there has been disappointing progress in reaching the smallest farmers and sharecroppers under the rural development project, although there has been a recent improvement in this regard since mid 1978. (1) (4)

Future Lending

5. We have tentatively included in our lending program in Minas Gerais a loan for a second rural development project (\$70.0 million in FY82), a loan for the Mendes Jr. steel project (\$150 million in FY83 standby), and an industrial pollution control project for Belo Horizonte (\$80.0 million in FY84 standby). The second rural development project remains to be identified, and could be either in the Jequitinhonha Valley in the Northeast, a follow-up in the Zona da Mata in the Southeast (the area of the ongoing project), or in the Northwestern part of the state. The Mendes Jr. steel project remains quite uncertain because the Brazilian government has not yet decided whether new steel projects should be started. It is reviewing its present commitments to this sector and will make a decision after full funding of the steel projects presently under construction. A third water supply and sewerage project and a suburban railroad project for Belo Horizonte are additional possibilities for future lending.

IFC

6. The briefing notes prepared for Governor Pereira's visit with Messrs. Qureshi and McClure are attached as Annex IV (Memorandum dated December 29, 1978 from Mr. Ruisanchez to Mr. Qureshi).

Other

7. We have not been informed of any issues which Governor Pereira may wish to raise with you. We understand that this will be just a courtesy visit but he may use the occasion to talk about his plans for development of the state. He may also wish to discuss the Belo Horizonte (capital of the state) component of the Urban Transport Project for which a loan of US\$88 million was made in 1978. Disbursement for the component (US\$15.7 million) was contingent upon the completion by EBTU (the federal urban transport company) of a satisfactory appraisal report and an agreement between it and the state and the Municipality of Belo Horizonte on the subproject components, their costs, implementation schedule and timetable of complementary policies. The appraisal report was received recently and is presently under review. We have been advised that a draft of the proposed agreement referred to above is being sent to the Bank for review shortly. We expect to start disbursement for this component in about two months.

8. In recent contacts with senior state level officials in the out-going state government, considerable interest was expressed in our participation in a state level medium-sized cities development project, and in a rural development project for the Northwest. As regards medium cities development, we expect to present in FY79 a loan in support of the national medium cities program, and have not encouraged the state authorities as regards our eventual participation in its program because we have agreed with the federal government to channel our support to the urban sector through federal rather than through state agencies. This provides us with substantial economies of scale and allows us to reach several states with each operation, particularly the poorer ones. However, the city of Juiz de Fora in Minas Gerais is included in our proposed project. A mission is going to Brazil later this month to complete appraisal of the project and it is quite possible that another city in Minas Gerais, Montes Claras, may also be included.

9. As regards rural development in the Northwest of the State, this region is apparently of high productive potential but consists mainly of large landholdings. Our participation in a project in this region will depend on our ability to identify a target group of small-farmer beneficiaries. This is now being looked into by our staff. It would appear, however, that the Jequitinhonha and Zona da Mata areas include significantly higher concentrations of rural poverty, and therefore may be deserving of a higher priority for our lending. The Governor-elect is from the Jequitinhonha region and can be expected to support a development program there.

Attachments

cc Messrs: Koromzay (LAC II)
Plant (IFC)

DKoromzay:bab

FRANCELINO PEREIRA DOS SANTOS,
ARENA, Minas Gerais

Profession: Lawyer, Professor

Born July 2, 1921 in the State of Piauí.

Parents: Venancio Pereira dos Santos and Maria Ana de Souza (deceased).

Wife: Latife Haddad Pereira dos Santos.

Children: Luiz Marcio, Maria Eugenia, and Paulo França.

Educational background: LLB, Minas Gerais School of Law (1959).

Terms as legislator: 1963-67; 1967-71; 1971-75, 1975-79.

Highlights of public life:-Member of the City Council and Municipal Legal Advisor, Belo Horizonte, Minas Gerais;

- Director, Administration and Accounting Institute of the City of Belo Horizonte, M.G.;
- Chief of Staff, Secretary of the Interior and Director, General Administration Department, Minas Gerais State Government;
- Chief, Municipal Affairs at Governor's Palace during Governor Magalhães Pinto's term;
- Counsel to the City of Belo Horizonte;
- President of the Commission on the Drought Polygon;
- Member of the Constitution and Justice Commission, Social Legislation Commission (1970), Public Service Commission, and Drought Polygon Commission;
- Alternate Member of the Mines and Energy Commission (1971);
- Member and rapporteur of the Parliamentary Investigation Commission on Drugs (1973-74);
- Member of the Civil Service Commission and Alternate Member of the Mines and Energy Commission (1975) of the House of Deputies.

Elected president of ARENA , Aliança Renovadora Nacional - Government Party (1975).

Elected Governor of the State of Minas Gerais (1978).

Published work: As Tensões Humanas na Empresa Capitalista (Human Tension in the Capitalist Business).

World Bank Loans in Minas Gerais

Loan No.	Year	Borrower (Project)		Amount (in US\$ millions)	Undisbursed (as of Oct.31, 1978)
76	1953	Centrais Eletricas de Minas Gerais, S.A. CEMIG (Itutinga Hydroelectric Project)	Power	7.3	-
93	1953	Centrais Eletricas de Sao Paulo, S.A. (Salto Grande Hydroelectric)	Power	10.0	-
211	1958	FURNAS Centrais Eletricas, S.A. (FURNAS Hydroelectric Project)	Power	73.0	-
403	1965	FURNAS Centrais Eletricas, S.A. (Estreito Hydroelectric Project)	Power	57.0	-
442	1966	Centrais Eletricas de Minas Gerais, S.A. CEMIG (Jaguara Hydroelectric Project)	Power	49.0	-
474	1966	FURNAS Centrais Eletricas, S.A. (Estreito Hydroelectric Project)	Power	39.0	-
478	1966	Centrais Eletricas de Minas Gerais, S.A. CEMIG (Power Distribution Project)	Power	6.3	-
526	1968	Companhia Mineira de Aluminio Alcominas (Aluminum Project)	Industry	22.0	-
565	1968	FURNAS Centrais Eletricas, S.A. (Porto Colombia Hydroelectric Project)	Power	22.3	-
566	1968	Centrais Eletricas de Minas Gerais, S.A. CEMIG (Volta Grande Hydroelectric Project)	Power	26.6	-

Loan No.	Year	Borrower (Project)	Purpose	Amount (in US\$ millions)	Undisbursed (as of Oct. 31, 1978)
787	1971	Mineracoes Brasileiras Reunidas, S.A. MBR (MBR Iron Ore Project)	Industry	50.0	-
812	1972	Usinas Siderurgicas de Minas Gerais, S.A.- USIMINAS (Steel Expansion Project)	Industry	63.0	-
677	1970	FURNAS Centrais Eletricas, S.A. (Marimbondo Hydroelectric Project)	Power	80.0	-
829	1972	Centrais Eletricas de Minas Gerais, S.A. CEMIG (Sao Simao Hydroelectric Project)	Power	60.0	-
923	1973	FURNAS-Centrais Eletricas, S.A. (Itumbiara Hydroelectric Project)	Power	125.0	45.9
1009	1974	Banco Nacional do Habitacao (Minas Gerais Water Supply & Sewerage Project)	Water Supply	36.0	6.1
1309	1976	Banco Nacional do Habitacao (Second Minas Gerais Water Supply & Sewerage Project)	Water Supply	40.0	34.3
1362	1977	State of Minas Gerais (Minas Gerais Rural Dev. Project)	Rural Development	42.0	34.8
1411	1977	Fertilizantes Vale do Rio Grande, S.A. (Phosphate Fertilizer Project)	Industry	82.0	64.8
1538	1978	Centrais Eletricas Brasileiras, S.A. ELETROBRAS (Power Distribution Project)	Power	58.1	58.1
1563	1978	Federative Republic of Brazil (Urban Transport Project)	Transport	15.0	15.0

First and Second Minas Gerais Water Supply and Sewerage Projects
(Loans No. 1009 BR and 1309 BR)

US\$36 million loan of June 17, 1974;

Effective Date: January 9, 1975;

Closing Date: August 15, 1979.

US\$40 million loan of August 27, 1976;

Effective Date: January 18, 1977;

Closing Date: September 30, 1980.

1. Both projects consist of the construction or upgrading of water supply and sewerage facilities for Belo Horizonte and a large number of medium-sized and small towns throughout the state. The execution of both projects is progressing satisfactorily. Sixty five small towns, most of them in rural areas, are benefitting from the Bank support.

2. In late 1978, the state government applied to the federal government for two tariff increases for 1979: one (of 35%) to become effective in January and another (of 27%) in July. The federal government approved a 37% increase effective January 1, but did not act on the increase requested for July, since it felt that it could only approve tariff increases that would become effective during its term in office (which expires on March 15). Another tariff increase is clearly necessary later this year in order to enable the state water company to continue to meet the requirement of our rate covenants. The support of the state government is essential for the state water company to achieve this objective.

Minas Gerais Rural Development Project (Loan No. 1362 BR):

US\$42.0 million loan of February 23, 1977;

Effective Date: June 13, 1977;

Closing Date: December 31, 1981

1. The objectives of the project are to improve the living standards and incomes of small farmers in the Zona da Mata in Southwest Minas Gerais, through provision of agricultural credit, agricultural support services such as extension and reasearch, and social infrastructure including health and education. It was intended that out of about 25,000 beneficiaries of the credit component, about 14,000 would be small scale owners with less than 50 ha of land and 9,000 would be sharecroppers.
2. After a hesitant start the project gained momentum in 1978. Although the results to this time are below expectations, the state authorities are confident that project targets will be achieved on time. For some components, such as education and reforestation, this is clearly overoptimistic and for other components such as health services and cooperative assistance, success will depend on improvement of interagency cooperation in the near future. Coordination of implementation activities is mostly realized at the local level, on the basis of personal motivation. It is not institutionalized at the central state level. The coordinating committee in charge of project management has limited authority and Bank missions have repeatedly had to involve high level state authorities to solve coordination problems, such as, for example, between extension services and applied research. More direct involvement of the state Secretary of Planning on a continuous basis in interagency coordination would be useful.
3. The Bank was initially disappointed in the performance of the credit component. The local banking agencies maintained their bias to deliver credit to larger and medium-sized farmers. As of mid-1978, a negligible number of low-income farmers and landless farmers had received credit, and the justification for the project was being questioned since one of its primary objectives was not being achieved. Since then, in a joint effort of the participating agencies, the procedures for credit-delivery to the target group were re-examined, certain obstacles were removed, a general promotion effort was organized and performance objectives agreed. It appears that by the end of 1978 about 1,000 low-income farmers have been effectively reached. Although this still falls far below original targets, it is expected that the project can substantially reach its goals, provided the state and the participating agencies maintain their 1978 initiatives.

OFFICE MEMORANDUM

TO: Mr. Moeen A. Qureshi

FROM: J. M. Ruisanchez *JMR*

SUBJECT: BRAZIL - Visit of Dr. Francelino Pereira dos Santos,
Governor-elect of the State of Minas Gerais

DATE: December 29, 1978

Prior to assuming office as Governor of Minas Gerais, Dr. Pereira dos Santos is visiting the U.S. and will be at the World Bank on the afternoon of January 5, 1979. I understand he will be seeing Mr. McNamara at 6:30 p.m. Before that he plans to visit the Bank's Vice President for Latin America and the Caribbean at 3:30 p.m. before seeing us at 5:00 or 5:30 p.m. Dr. Pereira dos Santos is president of the ARENA governing party--a key position in Brazil. He is a lawyer and university professor who has risen to his position through the Belo Horizonte municipal government and the Minas Gerais state government. With him on this visit will be Dr. Francisco Noronha, President of CEMIG (the excellent Minas Gerais state power company), who is well known to the Bank; Dr. Luiz Anibal Fernandez, President of INDI, the Minas Gerais State Promotion Group, and Dr. Daltro Nogueira, a director of the large Banco Real.

Aureliano Chaves, the Vice President-elect of Brazil, is Dr. Pereira's predecessor as Governor of Minas Gerais, and the outgoing State Secretary of Finance of Minas Gerais, Mr. Joao Camilo Pena, is talked about as candidate for one of the federal ministries.

Attached as background is a list of IFC investments in Brazil, to which may be added Volvo do Brasil, approved by IFC's Board of Directors on December 21, 1978. The three projects in Minas Gerais have been marked.

CIMINAS, whose majority shareholder is Holderbank, is doing well and has good liquidity, although its net income has been affected by continuing exchange losses on the large outstanding amount of its Swiss Franc-denominated debt to IFC (participated to Union Bank of Switzerland). It wishes to double the size of its 1 million tons/year cement plant at Pedro Leopoldo and has been awaiting the approval of the Federal Minister of Industry and Commerce for the expansion. The expansion could be important for Minas Gerais. CIMINAS is a very efficient producer and does not cause pollution.

FMB, the Fiat/Government of Minas Gerais foundry project near Belo Horizonte, reports that it is completing the last (unit product costing system) requirement for the disbursement of the remaining \$2 million of our loan and will soon be curing several (small) deviations from the covenants. We are planning a Completion Report Mission during the first calendar quarter of 1979.

Cimetal Siderurgia S.A., whose steel plant expansion at Barao de Cocais IFC is helping finance, has suffered over the last 18 months from the weak market for pig iron, its traditional product, in Brazil, the EEC and in the U.S. As a consequence its cash generation has been below expectations and it needs more long-term funds to replace expensive short-term borrowings. IFC has

December 29, 1978

disbursed part of its loan but before disbursing the remainder wishes to be sure that the extra long-term financing, which we understand the Government of Minas Gerais intends to provide or cause to be provided, is sufficiently firm and in sufficient amount to cover, jointly with IFC's and other financing, all CIMETAL's needs. Fortunately the pig iron market is improving and CIMETAL expects to sell substantial quantities to mainland China. Progress with the Barao de Cocais mill has been good and production of steel products is increasing. However, full use of the steel mill will not be possible until further charcoal blast furnace capacity is installed, and this awaits the availability of more long-term financing. We have invested a lot of time in helping CIMETAL improve its financial reporting and control system (Summer 1978) and had a follow-up mission in December 1978 on the basis of whose report we expect to disburse at least part of our remaining commitment.

We may wish to tell the Governor-elect that IFC continues to be interested in assisting basically private sector projects in Minas with high developmental impact. We recognize the State's immense, still unutilized, potential in the agricultural and agro-industry sectors (which President-elect Figueiredo has singled out for special priority) as well as in basic industry and mining. To that end we would welcome any indications, now or in the future, of projects considered by the Minas Government to be of high priority and suitable for consideration by us. While very big industrial or mining projects such as MBR, Usiminas, Acominas and Mendes Junior are often more appropriately financed by the World Bank, there may be other projects that we would like to consider. An important criterion for us is that a project be competitive in international terms.

IFC has had several recent contacts with BDMG (the State Development Bank) and INDI, both of which have done a great deal of good work in Minas Gerais. We hope to continue these contacts and that they will be fruitful. We would also welcome contacts with members of Mr. Pereira dos Santos' forthcoming administration, once it has come into office, to discuss what IFC might be able to do. Who should we contact?

Attachment

GPlant/ews
IFC-CL2BB

cc: Messrs. McClure
Ruisanchez
Plant
Koromzay (IBRD)

BRAZIL

Statement of Investments as of October 31, 1978

----- (US\$ million) -----

Invest- ment No.	Year	Obligor	Type of Business	Equity	Loan	Total	Held by IFC	Total Undisbursed Including Participants
11 BR	1957	* Siemens do Brasil	Electrical Equip.	-	2.00	2.00	-	-
5 BR	1958	* Olinkraft S.A.	Pulp & Paper	-	1.20	1.20	-	-
6 BR	1958	* D.L.R. Plasticos	Automotive Parts	-	0.45	0.45	-	-
8 BR	1958	* Willys-Overland	Motor Vehicles	-	2.45	2.45	-	-
10 BR	1959	* Cimento Portland	Cement	-	1.20	1.20	-	-
21 BR	1959	Champion Celulose S.A.	Pulp	-	4.00	4.00	-	-
101 BR	1966	Acos Villares	Steel	1.93	8.00	9.93	1.15	-
126 BR	1968							
222 BR	1972							
108 BR	1966	Catarinense	Pulp & Paper	3.41	3.78	7.19	3.41	-
146 BR	1969							
118 BR	1967	Ultrafertil S.A.	Fertilizers	3.03	8.22	11.25	2.95	-
	1972							
138 BR	1969	Petroquimica Uniao S.A.	Petrochemicals	2.88	5.50	8.38	2.64	-
162 BR	1970	Poliolefinas S.A.	Petrochemicals	2.88	5.50	8.38	3.29	-
190 BR	1971	Oxiten S.A.	Petrochemicals	1.44	4.60	6.04	3.83	-
197 BR	1971	Borregaard S.A.	Pulp	-	4.90	4.90	3.18	-
224 BR	1972	Ciminas	Cement	3.20	29.14	32.34	6.87	-
	1975							
230 BR	1973	Cosigua	Steel	7.50	76.97	84.47	16.44	-
273 BR	1974							
	1977							
234 BR	1973	"FUMCAP"	Cap. Mkt. Develop.	-	5.00	5.00	0.50	-
254 BR	1973	* "CODEMIN"	Nickel Min. & Refin.	8.34	85.00	93.34	8.94	8.94
420 BR	1978							
263 BR	1974	Industrias Villares S.A.	Elevators & Indus. Equip.	-	6.00	6.00	1.94	-
270 BR	1974	Tatuape	Textiles	-	31.00	31.00	6.20	-
294 BR	1975	Capuava	Carbon Black	1.08	6.18	7.26	3.18	-
314 BR	1975	Oxiten Nordeste	Petrochemicals	-	10.00	10.00	10.00	0.38
341 BR	1976	Tecanor	Textiles	-	6.00	6.00	5.65	-
347 BR	1976	Santista	Textiles	1.00	6.45	7.45	4.69	-
361 BR	1977	FMB	Iron & Aluminum Castings	-	20.00	20.00	20.00	2.00
377 BR	1977	Mineracao Rio do Norte	Bauxite Mining	-	15.00	15.00	15.00	-
384 BR	1978	Cimetal Siderurgia S.A.	Steel	3.00	7.00	10.00	10.00	6.00
TOTAL				39.69	355.54	395.23	129.86	17.32

* Investments which have been fully cancelled, terminated, written off, sold, redeemed or repaid, for Codemin only with regard to original investment.

IFC LAC II December 1977

BRAZIL

Existing Investments of IFC 1/

Champion Celulose S.A. - 21 BR - 1959 - Pulp

IFC's loan was repaid on June 30, 1969. IFC holds about 2% of the share capital, acquired without cost. The Company is operating profitably. An expansion to double previous production capacity is approaching completion. (IFC/R77-15).

Acos Villares S.A. - 101 BR - 1966; 126 BR - 1968; 222 BR - 1972 - Steel

IFC has made three investments in this Company, which produces special steels, rolls, castings and forgings. In 1971 IFC sold all its shareholdings of the first two investments to private investors in Brazil. The third investment was made to increase the Company's capacity in rolling mill rolls and castings and to shift the product mix towards higher grade steels. This project was completed in late 1976 at a cost of \$21.7 million compared with \$19.5 million original estimate. The overrun was financed with internal cash generation. The Company is operating profitably, and is carrying out further investments to expand capacity. (IFC/R77-36).

Papel e Celulose Catarinense S.A. - 108 BR - 1966; 146 BR - 1969 - Pulp and Paper

IFC joined in the financing of a plant for production of paper and pulp in 1966. In 1968, increases in the project cost required additional financing in which IFC participated by subscribing convertible debentures. The project was completed by mid-1971. Sales and production have been generally above nominal capacity. Dividends have been paid annually since 1973. (IFC/R78-22).

Ultrafertil S.A. - Industria e Comercio de Fertilizantes - 118 BR - 1967 and 1972 - Fertilizers

IFC helped finance the fertilizer complex. Commercial operations began in October 1970, 15 months behind schedule. Actual project cost was US\$105 million instead of the originally estimated US\$70 million. Financing for the overrun was provided under the Project Funds Agreement (US\$7.0 million), and by loans provided or guaranteed by Phillips Petroleum and short-term borrowings (US\$28.0 million). In March 1974, Petroquisa, the Government-owned holding company for petrochemical investments, purchased Phillips' majority shareholding in Ultrafertil. The Company is operating profitably and paying dividends. IFC's loan has been fully repaid. (IFC/R76-71).

Petroquimica Uniao S.A. - 138 BR - 1969 - Petrochemicals

Following the completion of Phase I of the project in which IFC financing was involved, the Company completed construction of Phase II in the first quarter of 1974. The total cost of the Phase II expansion of about US\$25 million was financed by additional borrowings. The Company is now operating at the expanded capacity of 330,000 tons of ethylene per year. Operations are profitable and dividends have been paid since 1976. (IFC/R77-4).

Poliolefinas S.A. Industria e Comercio - 162 BR - 1970 - Petrochemicals

IFC helped finance the construction of a low density polyethylene plant. The expanded project was completed in November 1972, with a capacity of 80,000 mt/year instead of the 60,000 mt/year originally provided for, at a project cost of US\$35.1 million instead of the original estimate of US\$29.0 million. The additional investment was financed by equity (US\$1.9 million) and medium-term debt (US\$4.2 million). The Company is operating profitably and paying regular dividends. A new plant is planned in southern Brazil. (IFC/R78-6).

Oxiteno S.A. - Industria e Comercio - 190 BR - 1971 - Petrochemicals

Oxiteno manufactures ethylene oxide and derivatives. The project was completed in late 1973 at a cost of US\$24.1 million compared with the original estimate of US\$24.0 million. The Company is operating profitably and paying regular dividends. (IFC/R77-4).

Industria de Celulose Borregaard S.A. - 197 BR - 1971 - Pulp

IFC helped finance the construction of a pulp mill and the purchase and development of 30,000 hectares of land for plantations. The plant was completed four months ahead of schedule in March 1972 at a final project cost slightly below the original estimate of \$76.1 million. The Company experienced initial operating losses and was closed from December 1973 to March 1974 because of malodorous emissions. Despite the shut down the Company operated profitably in FY1974. In mid-1975 control of the project was purchased by Montepio da Familia Militar, a Brazilian public pension fund, from the original sponsors, Borregaard AS, and the Company renamed Rio Grande - Cia de Celulose do Sul (Riocel). The Company has incurred losses recently and its financial position has deteriorated, due largely to the depressed world market for pulp. IFC's loan is guaranteed. (IFC/R77-15).

Ciminas - Cimento Nacional de Minas S.A. - 224 BR - 1972 - Cement

The project, a cement plant with a capacity of about 960,000 tons/year, is physically complete and has been operating satisfactorily since January 1975. The final project cost was US\$75.3 million compared with the original estimate of US\$46 million. The overrun was financed principally by an increase in the participated IFC "B" Loan and by extra equity and subordinated debt financing provided by the sponsors. The Company is operating profitably and paying dividends. (IFC/R76-62).

1/ These notes are designed to inform the Board of Directors on the status of the existing projects and to report upon problems, including those relating to undisbursed investments, which are being encountered and of the actions that are being taken to remedy such problems. These notes are not comprehensive in terms of factual content nor are they intended to present a balanced evaluation of each investment. Reference is made at each note to the prior report upon each investment contained in the Monthly Report or in other submissions to the Board.

Capuava - Companhia Siderurgica de Guanabara - 230 BR - 1973; 273 BR - 1974 - Steel

IFC helped to finance a 220,000 mt/year scrap-based steel mill to produce wire rods and concrete reinforcing bars. Operations started in November 1972. IFC's second investment (IFC/R74-13) in the Company will help increase production of non-flat steel products from 240,000 tons/year to 480,000 tons/year. With the exception of a direct reduction unit, which is still undergoing startup, project equipment and facilities began commercial operation during the second half of 1976. (IFC/R77-4).

FLMCA - Capital Market Development Fund - 234 BR - 1973 - Capital Market Development

IFC opened a revolving line of credit of US\$5.0 million in favor of a syndicate of selected Brazilian investment banks. The credit line was designed to provide financial support for the underwriting activities of these banks. \$4 million of the credit has been cancelled and the application of the remainder is under discussion. (IFC/R76-23).

Industrias Villares S.A. - 263 BR - 1974 - Elevators and Industrial Equipment

IFC helped to finance an expansion program designed to raise Industrias Villares' production of elevators and escalators by 28% and that of industrial equipment by 50%. The cost of this expansion was in line with the original estimate of US\$20.3 million. The program was completed in late 1976. The Company's operations, profits and financial position have been satisfactory. A new expansion program is under implementation. (IFC/R77-15).

Fabrica de Tecidos Tatuape S.A. - 270 BR - 1974 - Textiles

IFC helped to finance a new integrated textile mill at Americana, Sao Paulo State, which expanded the Company's capacity by about 45%. The Company has informed IFC that the cost of the project is expected to increase from the original estimate of US\$53.0 million to US\$65.3 million. The overrun is being financed by a share capital increase, by cash generation and senior loans. The project is completed and the Company is operating profitably. (IFC/R76-62).

Capuava Carbonos Industriais S.A. - 294 BR - 1974 - Carbon Black

The project, for a 15,000 tons/year carbon black plant near Sao Paulo, was delayed by an enforced change in plant site within the Capuava petrochemical complex. There was an increase in the project cost from US\$11.0 million to US\$15.25 million. The Carvalho Group joined in providing the extra financing required. Commercial operations began in November 1976. After an \$1.2 million loss for the first year the Company is now operating profitably. (IFC/R76-71).

Oxiteno Nordeste, S.A. - 314 BR - 1975 - Petrochemicals

The project, part of a new petrochemical complex under construction at Camacari, Bahia, is the construction of a plant to produce 52,500 tons/year of ethylene oxide which will all be converted into glycols. The plant will use ethylene from the upstream Copene plant, currently under construction. The estimated project cost is US\$65.0 million. The plant is almost complete and commercial operation is scheduled to begin in the third quarter of 1978. (IFC/R77-4).

Sitene - Santista Industria Textil do Nordeste S.A. - 348 BR - 1976 - Textiles

IFC helped finance the doubling of capacity by this textile manufacturer in the Northeast of Paulista, Pernambuco, to 25,200 spindles and 336 looms. Project cost, at \$28.4 million was below the estimated \$33.1 million. Full capacity operations began ahead of schedule in October 1977. The Company is operating profitably. (IFC/R76-17).

Tecanor S.A. - Textil Catarinense do Nordeste - 341 BR - 1976 - Textiles

IFC has provided a US\$6 million loan to assist in the financing of the expansion of this textile plant in Pernambuco state in Northeast Brazil. The estimated project cost is approximately \$18 million. The project was physically completed in the second half of 1977 and commercial production has begun. (IFC/R76-34).

FMB S.A. Productos Metalurgicos - 361 BR - 1971 - Automotive Foundry

IFC is helping to finance the construction of a US\$205.4 million foundry located at Betim, Belo Horizonte, Minas Gerais, with a capacity to produce annually 57,200 mt of iron castings and 8,200 mt of aluminum castings. The sponsors are Fiat of Italy and the State of Minas Gerais. Commercial production of iron castings started in 1977. (IFC/R77-7).

Mineracao Rio de Norte S.A. - 377 BR - 1977 - Bauxite Mine

IFC is assisting in the financing of a US\$330 million bauxite mining project in the Trombetas Region of the Amazon Basin. The major sponsors are Companhia Vale do Rio Doce and Alcan Aluminum Limited of Canada. Initial production, scheduled to begin in 1979, will be 3.4 million metric tons annually of bauxite on a washed and dried basis. (IFC/R77-34).

Cimetal Siderurgica S.A. - 384 BR - 1978 - Steel

IFC is helping finance the modernization and expansion of an integrated charcoal-based steel mill located at Barao de Cocais, Minas Gerais. The Company will increase production of light steel sections from 50,000 tpy to 142,500 tpy at an estimated project cost of \$42.1 million. Full production is scheduled to commence in late 1978. (IFC/R77-49).

Empresa de Desenvolvimento de Recursos Minerais "Codemin" S.A. - 1978 - Nickel Mining and Smelting

IFC is helping to finance this nickel mining and smelting project (average output 5,000 tpa of ferronickel, estimated project cost \$98.4 million) with a loan of \$59 million and an equity investment of up to \$3.94 million. Commercial banks will participate in the IFC loan with \$54 million. Project completion is expected for mid-1981.

Ares Industrias de Base S.A. - 1979 - Steel and Capital Goods

IFC is helping to finance this \$545 million project with a stand-by subordinated loan of US\$5 million. Project completion is expected for end-1979.

OFFICE MEMORANDUM

TO: Memorandum for the Record
DATE: March 13, 1979

FROM: Humayun Mirza, Acting Division Chief, LAC H

SUBJECT: BRAZIL - Visit of Governor-Elect of the State of Rio Grande do Sul

1. Mr. Jose Augusto Amaral de Souza, Governor-elect of the State of Rio Grande do Sul, called on Mr. McNamara on March 2, 1979. Governor-elect de Souza will take over the administration of the State of Rio Grande do Sul on March 15. His mission was aimed at informing the various international agencies of the plans of his administration with a view to getting support for the development program of his state. He had already visited Europe and on the previous day had meetings with the Inter-American Development Bank. Before the meeting with Mr. McNamara, he had met with the Projects Departments, both in the Region and in Central Projects, to discuss the proposals attached to an undated letter which he formally handed to Mr. McNamara at the meeting. Accompanying Governor-elect de Souza were Mr. Eduardo E. M. Muller and Mr. Leodegar Jost, Secretary and Deputy Secretary of Planning, respectively, Mr. Roberto Maisonave, President of the Maisonave Bank, and Mr. Jose Duarte, President of a construction company. Mr. Kafka, Mr. Franco-Holguin, Mr. Lerdaun and myself were also present.

3/13
2. The main theme of Governor-elect de Souza's presentation to Mr. McNamara was the need for assistance for the urban and rural poor in the State of Rio Grande do Sul. As regards the urban populations of the metropolitan areas, he said that around 50% of the population is below the three minimum wages level and about 60% below the five minimum wages level. Furthermore, the populations in the urban areas are growing faster than the provision of basic services, and therefore it is necessary for the new administration to take action to provide these services to improve the standard of living of these people. In his judgment, the people earning less than five minimum wages would reach two million by 1985. The Governor emphasized that he thought that his state had to confront the problem of poverty through an integrated approach involving many sectors, including population planning.

3. He also expressed to Mr. McNamara the problem of the "minifundios" in his state. He stated that land holdings of about 50 hectares per farmer had gradually been reduced to small holdings of around 10 hectares or less through division of property between dependents over the years. These farmers with small land holdings were now at or below the three minimum wages level and he felt that the Bank should assist the poor in his state and not confine its activities to helping other states in Brazil just because the per capita income in the State of Rio Grande do Sul is higher than that of the other states.

March 13, 1979

4. Mr. McNamara told Governor-elect de Souza that if the Federal Government asked the Bank to finance projects that would help the poor in the State of Rio Grande do Sul, the Bank would be very interested in providing such assistance.

Cleared with and cc: Mr. Lerdau, LAC II

cc: Messrs. Glaessner, LACP
Wyss, LACP
Greening, LACP
Strombom, CPS
Brazil Division

HMirza:nev

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
(through Eugenio F. Lari, Acting Vice President, LAC)
FROM: Enrique Lerda, Director, LAC II

DATE: February 28, 1979

SUBJECT: BRAZIL - Briefing Notes re Visit on March 2, 1979
of Governor-Elect of State of Rio Grande do Sul,
Mr. Amaral de Souza

3/1
1. The Governor-elect of the State of Rio Grande do Sul, Mr. Amaral de Souza, will be visiting the Bank, IFC and IDB on March 1-2, 1979. You have agreed to receive the Governor at 6:45 p.m. on March 2, 1979, for a brief courtesy visit. He will be accompanied by Mr. Emilio Muller, Secretary of Planning of the State of Rio Grande do Sul of both the present and future administrations, and the state government's key man for the COPESUL petrochemical complex (being partly financed by the Bank); Mr. Leodegar Jost, Deputy Secretary of Planning; Mr. Jose Duarte, President of a regional construction and agricultural equipment firm; and Mr. Roberto Maisonave, President of the regional Maisonave Group, which has interests in a commercial and an investment bank, a brokerage house and a department store chain. The Governor-elect is coming from a two-week trip to France, England and Germany aimed at attracting foreign investment to the State of Rio Grande do Sul, particularly in the field of coal. He does not speak English and an interpreter from the Brazilian Embassy is going to accompany him.

State of Rio Grande do Sul

2. The State of Rio Grande do Sul is Brazil's most southern state and has Brazil's only border with Uruguay and Argentina. Its area is 266,000 km² (representing about 5% of Brazil's total land area) and a 1978 population of almost 8 million of which 59% is estimated to be urban and 41% rural, about the same as for Brazil as a whole. The per capita of the state in 1977 was US\$1,540 compared with US\$1,390 for Brazil (IBRD Atlas). Rio Grande do Sul is an important beef and dairy cattle raising area. Among the principal crops raised are soybeans, wheat, corn and rice. The state also has a large wine production. Important industries include chemicals (including the petrochemical pole under construction), agro-industries, shoes, textiles, pulp and paper, cement, and metal-working. Rio Grande do Sul farmers have been very active in expanding the agricultural frontier of Brazil in other states. The state has played a considerable role in Brazilian politics; Presidents Vargas (1930-45 and 1951-54); Goulart (1961-64); Medici (1969-74); and Geisel (1974-79) came from Rio Grande do Sul.

Bank Lending in Rio Grande do Sul

3. In recent years, the State of Rio Grande do Sul has benefited from a US\$85.0 million Bank loan (FY78) for the COPESUL petrochemicals project and from a share of the US\$88 million loan for the urban transport

project (FY78). In addition to these, the state has benefited from other projects which are national in scope (such as agricultural extension, highways and railways). Both the COPESUL petrochemicals and the urban transport projects are progressing satisfactorily.

4. For the future, the preparation of a water supply and sewerage project in the southern region (which includes Rio Grande do Sul) and a power distribution project in the state are well advanced. We expect to propose loans of about US\$110 to 130 million and of about US\$70 to 80 million for these projects respectively in the coming fiscal year. The preparation of the national medium-sized cities development project, which includes the city of Pelotas in the state, is also well advanced. A suburban railroad project for the capital city of the state is an additional possibility for future lending.

Matters the Governor may Raise

5. We have not been informed of any issues which the Governor may wish to raise with you. We understand that this will be just a courtesy visit. He may wish to talk about his plans for the development of the state. In particular, he may be interested in exploring the possibility of obtaining Bank support for the development of the state's ample coal resources. He may also wish to propose to you an integrated rural development, a small-scale industry, and a feeder roads project in the state.

6. With regard to coal, we feel that it would be interesting for the Bank to explore the possibilities of developing Rio Grande do Sul resources as a new source of energy for Brazil. If economically justified, the Bank could very well finance the exploration, mining and processing of the Brazilian coal within the policy guidelines recently approved for lending to the energy sector. It should be noted that last year we sent a mission to Brazil which explored the possibility of using Rio Grande do Sul coal as raw material for fertilizers. The mission's findings were negative because the proposed process, gasification, seemed uneconomic at present. But this does not preclude, of course, using such coal for other purposes, including power generation.

7. We are reluctant to make a firm commitment to enter into rural development in the South at this stage. As you know, up to now, we have concentrated our efforts in the Northeast and we believe that we should continue to assign priority to that area. However, we feel that we should investigate the situation in the South further. If this investigation shows that in fact there is a large enough poor rural population which can be the target of a Bank project we might be justified to expand our rural development lending to the South.

8. The state development bank of Rio Grande do Sul has an innovative and successful program in support of small-scale and micro enterprises.

We would wish to support it but subsidized interest rates have up to now precluded our participation. There is some hope that the new Federal Government may change this policy.

9. As for secondary and feeder roads, the State of Rio Grande do Sul is not as yet participating in the Bank-supported (Loan No. 1206-BR) Secondary and Feeder Roads Program of the National Development Bank (BNDE). Under this line of credit both states and municipal consortia may submit applications for financing. I understand that one municipal consortia, CINTEA, within the state has forwarded an application to BNDE for a sub-project of US\$4.5 million with a Bank contribution of about US\$1 million. While BNDE expects that pending applications, including CINTEA, will fully commit the present line of credit, the Bank is processing a second loan of US\$110 million. Should it be approved the State of Rio Grande do Sul's participation would, of course, be welcome.

Cleared with and cc: Messrs. Fuchs, IPD
Glaessner, LACP
Wyss, LACP
Greening, LACP

cc: Messrs. Stern
Ardito Barletta, o/r
van der Meer, LACP
Goffin, LACP
Cash, IPD
Perram, IPD
Wessels, LACP
Doyen, LACP
Strombom, CPS
Renger, LACP

UAguirre/AHowlett:glw

OFFICE MEMORANDUM

TO: Memorandum for the Record

FROM: Humayun Mirza, Acting Division Chief, LAC II

SUBJECT: BRAZIL - Meeting with Mr. Antonio Delfim Netto,
Minister of Agriculture, on June 7, 1979

DATE: June 28, 1979

1. On June 7, 1979, Mr. Antonio Delfim Netto, Minister of Agriculture of Brazil, paid a visit to Mr. McNamara, accompanied by Mr. Kafka. Also present were Messrs. Stern, Ardito Barletta, Lerdau, Yudelman, Goffin, Koch-Weser and Mirza.
2. Minister Delfim Netto said that he, along with the Ministers of Interior and Transport, are planning to implement a large program for the development of Northeast Brazil. The purpose of his visit to Mr. McNamara was to request the Bank's technical assistance to prepare a pipeline of projects for the development of the Northeast. He said that he was not asking for any finance at this stage. However, if suitable projects are prepared then the Government of Brazil may come back to the Bank for financial assistance. Mr. McNamara responded positively to the Minister's request and said that it would be given very high priority. However, with respect to further Bank support for agriculture in the Northeast, the sequence should be to first undertake an overall review of the country's agricultural sector policy, which would serve as the foundation for a regional plan for the sector, which in turn could lead to further project financing by the Bank. Mr. Delfim Netto said that a more rational sector policy for agriculture was clearly needed and he agreed with the proposed approach.
3. Mr. McNamara pressed the issue of interest rate subsidies further with the Minister by questioning the wisdom of using this as a vehicle to distribute income. Minister Delfim Netto said that once agricultural production increases, he would be able to remove price controls which in turn would enable him to remove the interest rate subsidies.
4. Mr. McNamara also said that he was somewhat uneasy about the fact that not enough was being done to address the fundamental development issues in Brazil of which past neglect of the Northeast is one. He said that in his view, Brazil does not need money from the Bank but needs help to do more to solve these problems. In the case of the Northeast, he felt that the Bank's projects lacked progress in helping overcome the fundamental problem of rural development. These rural development projects, and also the nutrition project, had suffered from institutional weaknesses -- particularly in the case of SUDENE -- lack of local funding and, in the case of one project, dismissal of project staff. The Minister replied that he intended to strengthen SUDENE and he was confident that, with the three key Ministries cooperating in a joint effort, significant progress will be made.
5. Turning to the question of the landless in the rural areas, Mr. McNamara asked what the Minister's views were in this respect. The Minister said that he was using taxation to pressure the present landowners to better utilize their land or to redistribute it in accordance

June 28, 1979

with the law. The Government at present has 600,000 ha. of land for distribution which it is offering for sale in lots of 100 ha. each on credit terms of 15 years with 5 years of grace and 7% interest without monetary correction. He said that his Ministry can prepare a further 2 million ha. of land for distribution during the next one to two years. However, even with the attractive terms offered there have been few takers. The Minister felt that he must now consider how the people can be persuaded to acquire this land. In response to a question from Mr. McNamara, Minister Delfim Netto said that the land was located primarily in the Northeast and that it was very fertile. Mr. Yudelman commented that the land distribution program had suffered from serious administrative problems.

6. The meeting concluded with Mr. McNamara agreeing that the next step would be for the Bank mission scheduled for the end of June to explore further with the Brazilian Government the manner in which the technical assistance being sought can be given so that it is most effective.

Cleared with and cc: Messrs. Lerdau, LAC II
Goffin, LACP
Koch-Weser, EXC

cc: Messrs. Stern
Ardito Barletta
van der Meer, LACP
Yudelman, AGR
Pfeffermann, LAC II
Greening, LACP
Mahar, LAC II (o/r)
Knight, LAC II
Gelb, LAC II

HMirza:nev

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

FROM: Nicolas Ardito Barletta

SUBJECT: BRAZIL - Briefing Notes for Visit on June 7, 1979 of
Minister of Agriculture, Antonio Delfim Netto

DATE: June 6, 1979

1. The Minister of Agriculture of Brazil, Mr. Antonio Delfim Netto, will be visiting the Bank on Thursday afternoon, June 7, 1979. You have agreed to receive the Minister at 5:00 p.m. Mr. Delfim Netto is an economist, and former Professor of Economics at the University of Sao Paulo. He served as Minister of Finance during 1968-74. Before assuming his present position, Mr. Delfim Netto was Brazil's Ambassador to France.

Government Agricultural Development Policies

2. The new Government, which took office on March 15 of this year, has already announced that the further expansion of agricultural output will be a high-priority goal in the coming years; a goal that will complement present efforts to redress balance-of-payments difficulties, reduce the rate of inflation, increase rural employment opportunities and alleviate poverty. Though details of the new agricultural strategies are not yet fully known, it would appear that subsidized credit will continue to be made available to small- and medium-scale farmers, but that interest rates will be raised somewhat for larger scale operations. Mr. Delfim Netto has stated that any significant reduction in the level of credit subsidization should be linked to a gradual dismantling of controls over agricultural prices. The new Government has also publicly recognized the need for policies to improve the land tenure situation, but is not advocating a comprehensive agrarian reform to achieve this end. Mr. Delfim Netto favors a graduated rural land tax to promote a more intensive use of underutilized land. Another priority of the new Government is the expansion of agro-industry, both to substitute imports and to increase rural employment opportunities. A recent step in this direction was the decision to channel significantly increased amounts of credit to agro-industry through the National Development Bank (BNDE). Though Mr. Delfim Netto is commonly associated in the public eye with corporate agricultural interests in Sao Paulo State who have recently acquired large tracts of land in the Center-West and Amazon regions, the new Government plans to intensify its assistance to small-scale farmers, particularly in the Northeast. The POLONORDESTE program (under which the Bank is presently helping finance four integrated rural development projects)^{1/}, for example, is expected to be immune from the budgetary cuts being made as part of the present stabilization program. Moreover, the new Government has already confirmed to us that it intends to continue and strengthen the program.

IV could 7 Fed. Gov. & State could on own program (Sudam 1979)
V Rural financing delays

- 1/ A fifth such project (Sergipe-Tabuleiros Sul) was approved by the Board on May 31, and a sixth (Pernambuco-Agrete Setentional) is scheduled for Board presentation on June 14.

I approve pricing policy for credit (that of pricing + credit + interest)
II Road for landless? - land reform
III Priority of NE & NW Center West & Amazon

Bank Involvement in the Agricultural Sector

3. Attached as Annex I is a list of Bank-financed projects in agriculture and rural development to date. Notes on the status of projects in agriculture and rural development presently under disbursement are attached as Annex II. Attached as Annex III is an annotated list of projects in our future lending program for agriculture and rural development.

Topics for DiscussionA. Agricultural Development in the Northeast

4. Institutional Arrangements. During a recent mission to Brazil, Mr. Mirza was informed by Mr. Delfim Netto that the Government plans to make an intensive effort in developing the Northeast of Brazil. He has been very impressed by the success GEIPOT^{1/} has had in the transport sector and would like the Bank to assist the rural sector similarly by forming a team of experts to prepare plans for the development of the Northeast and assist in the implementation of projects. This team would also review the progress of ongoing programs and projects (including the integrated rural development projects being assisted by IBRD). It is likely that Mr. Delfim Netto will raise this with you and ask for Bank support in establishing a team of experts in the Northeast. You may wish to inform him that the Bank itself has been contemplating strengthening its office in Recife which at present contains only one professional. We have been working principally with the rural development program (POLONORDESTE), linked to the regional development agency (SUDENE) that reports to the Minister of Interior. However, the rural development effort in the Northeast (owing to its multisectoral approach) involves numerous federal Ministries and state agencies. The organizational structure of our expanded effort in the Northeast, therefore, has to be carefully assessed. To do this, a mission is planned for the last week in June to be headed by Mr. S.M.L. van der Meer, Projects Director of the Latin America and Caribbean Region, and it is hoped that this mission will be able to define clearly what role the Bank should play in further expanding our presence in the Northeast of Brazil. In this respect, we have also been in touch with the UNDP representative in Brasilia and he has informed us that he will be prepared to support a UNDP project to provide the necessary experts to work with us.

5. Land Redistribution as Part of Rural Development. As indicated in Annex III, Bank staff are assisting in the preparation of a proposed integrated rural development project in the State of Piaui. The majority of the producers in the proposed project area are landless, and it will be very difficult to prepare a meaningful rural development program with long-term benefits for this population unless action is taken to improve

^{1/} GEIPOT is entrusted with transport planning and reports to the Minister of Transport. It was formed at the initiative of the Bank when the Bank had a large lending program in highways in Brazil. The original core of the Brazilian counterpart personnel to the Bank team was later expanded and formed into an agency which is now called GEIPOT.

June 6, 1979

the land tenure situation. The State Government has been reviewing for some months the possibility of utilizing public land and acquiring private land for subsequent redistribution to small-scale farmers, but progress in this regard has been slow. You may wish to learn the Minister's views on this specific issue, and on the issue of land reform generally.

B. Agricultural Development in the Northwest

6. The Brazilian Government has asked the Bank to finance an integrated development project in the State of North Mato Grosso and the territory of Rondonia. Apart from the asphaltting of the trunk road between the cities of Cuiaba and Porto Velho, the project would consist of colonization schemes, storage facilities, feeder roads and a program for a possible increase in production of rice, maize, beans and cocoa. It would be useful to learn the Minister's views on the agricultural development potential of the area.

C. Agricultural Sector Study

7. The Bank would like to undertake a study covering an overall review of sectoral development during the past decade and the policies that have shaped it. Some two to three man-weeks would be spent in June preparing the outline of the study. A mission would then go to Brazil during the fall to do the study and seek Government views. A final report and mission recommendations should be completed before the end of the year. Before committing Bank staff to this study, we would need to obtain the Minister's approval, and, therefore, you may wish to raise this subject during your discussions. Any suggestions the Minister may have on the issues to be addressed in this proposed study would be welcome.

D. Irrigation Projects

8. Mr. Delfim Netto indicated to a Bank mission in April 1979 that the new Government was making a comprehensive assessment of the country's irrigation possibilities and requirements and that some type of Bank involvement in this endeavor would be welcome. The Minister informed the mission that data were being collected on a proposed irrigation project in the Irece area of Bahia State and that he would like the Bank to mount a mission to examine the proposals in detail when enough data are available. He also discussed a proposal to look at the irrigation needs of the southern states; a proposal evidently made in response to the recent droughts in this region. It was clear that Mr. Delfim Netto would like the matter followed up, but he did not specifically suggest that the Bank be involved. It would be useful to know the status of the Government's review of national irrigation needs, and to inquire as to how the Bank could be most effectively involved in this subsector.

E. Staff Allocations

9. The lending program being proposed for agricultural development in Brazil is a large one and will require considerable staff input. Therefore, the Bank will have to assess the availability of staff against requirements before committing itself to undertaking the tasks being proposed.

Attachments

Cleared with and cc: Messrs. Lerdau, LAC II
Goffin, LACP

cc: Messrs. Mirza, LAC II
Greening, LACP
Mahar, LAC II

DJMahar/HMirza:nev

ANNEX IAGRICULTURAL LENDING IN BRAZIL

<u>Loan No.</u>	<u>Year</u>	<u>Borrower</u>	<u>Purpose</u>	<u>Amount Less Cancellations (US\$ Millions)</u>	<u>Undisbursed (as of 3/31/79)</u>
516	1967	Banco Central do Brasil	Livestock Development	40.0	
853	1972	Brazil	Land Settlement	6.7	1.5
857	1972	Banco do Brasil S.A.	Grain Storage	18.2	
868	1972	Brazil	Interim Second Live- stock Development	20.5	
924	1973	Brazil	Agro-Industry	54.0	31.2
1153	1975	Brazil	Agriculture	23.0	16.6
1195	1976	Brazil	Rural Development	12.0	11.0
1249	1976	Brazil	Agriculture	40.0	36.5
1317	1976	Brazil	Agro-Industry	83.0	83.0
1362	1977	State of Minas Gerais	Rural Development	42.0	28.3
1488	1977	Brazil	Rural Development	17.0	16.4
1537	1978	Brazil	Rural Development	24.0	23.8
1568	1978	Brazil	Agricultural Extension	100.0	100.0
1589	1978	Brazil	Rural Development	37.0	37.0
	1979*	Brazil	Rural Development	26.0	
				<hr/> 543.4	

* Approved by Board on May 31, 1979.

LOANS UNDER DISBURSEMENT IN AGRICULTURE AND RURAL DEVELOPMENT

- 853 Alto Turi Land Settlement Project: US\$6.7 million loan of July 24, 1972; Effective Date: February 15, 1973; Closing Date: June 30, 1980. The road component of the project now completed was reduced from the original 306 km to 238 km. The settlement agency, COLONE, has prepared revised farm development plans whose credit component, to be financed by public financial institutions, will be significantly higher than originally estimated, although still low in comparison to other settlement projects. Administrative delays in the release of public funds for farm credit, road construction and COLONE working capital requirements and difficulties in recruiting project staff delayed the start of project execution. COLONE continues to be hampered by the lack of assured financing, and this problem is compounded by cost overruns presently amounting to about 240%.
- 924 Agro-Industries Credit Project: US\$54 million loan of August 1, 1973; Effective Date: March 11, 1974; Closing Date: June 30, 1979. Disbursements for sub-loans totalling US\$14.7 million were made during 1975-76 under procedures which were not in accordance with the Loan Agreement. These funds have now been prepaid by the Government, reducing the effective loan amount to US\$39.3 million. Commitments under this loan are almost at a standstill as a result of competing credit lines at subsidized rates and a general slow-down in industrial investments. Sub-loan commitments and disbursements are more than 2 years behind schedule. The Bank has agreed to an interim postponement of the closing date to June 30, 1979, pending a review with the new Government, which took office in March 1979, on the prospects for future disbursements.
- 1153 Lower Sao Francisco Polders Project: US\$23.0 million loan of August 4, 1975; Effective Date: November 25, 1975; Closing Date: December 31, 1979. Construction on this project was delayed because of heavy rains in the project area, and serious flooding in February/March 1979 has further delayed project progress. Current cost estimates show an 80% increase over the appraisal estimate of US\$56.5 million. These increases have resulted from design changes, rapid increases in the costs of civil works and equipment, and in the cost of land expropriation. The waters from the recent floods have substantially receded, and construction is expected to resume at a normal rate later in 1979.

- 1195 Rio Grande do Norte Rural Development Project: US\$12.0 million loan of March 1, 1976; Effective Date: July 30, 1976; Closing Date: June 30, 1981. Phase I of this project ended satisfactorily in the areas of extension, marketing, applied research, and health. Two potential problems could affect Phase II implementation: (i) the possibility of a severe drought, and (ii) the relocation of the POLONORDESTE program between government agencies and between cities, and the possibility of a reorganization. The change in state administration is having a favorable impact on the project. The new administration is already taking drought-relief measures and has indicated its strong support of the project, particularly of Phase II implementation.
- 1249 Agricultural Research I Project: US\$40.0 million loan of June 23, 1976; Effective Date: September 21, 1976; Closing Date: December 31, 1981. Project implementation experienced a significant slow-down because of changes in the higher administrative positions at EMBRAPA, which took place after federal and state elections. Imposed hiring constraints significantly affected the civil works, consultant services, and training components of this project. The outlook for the remainder of 1979 should be more favorable with a resumption of normal hiring procedures since the new government has now taken office.
- 1317 Second Agro-Industries Credit Project: US\$83.0 million loan of September 22, 1976; Effective Date: March 25, 1977; Closing Date: December 31, 1982. Because of commitment delays under the First Agro-Industries Credit Project, commitments for the second loan have not started.
- 1362 Minas Gerais Rural Development Project: US\$42.0 million loan of February 23, 1977; Effective Date: June 29, 1977; Closing Date: December 31, 1981. Organization of this project is progressing satisfactorily after initial delays. The credit component is gathering momentum. Mainly as a result of administrative difficulties, participation in this project by landless producers is significantly lower than originally envisaged, but concerted efforts by the state government and the participating banks have improved this situation recently. The health component has advanced significantly.
- 1488 Ceara Rural Development Project: US\$17.0 million loan of November 17, 1977; Effective Date: March 28, 1978, Closing Date: December 31, 1982. The implementation of the project has proceeded satisfactorily after initial local funding delays. Agricultural extension and experimentation services, agricultural credit, input supply, marketing and storage services are making good progress, while the parts of the project relating to land purchase credit, agricultural mechanization and cooperative societies organization are progressing at a slower than expected rate.

- 1537 Paraiba Rural Development Project: US\$24.0 million of May 8, 1978;
Effective Date: October 19, 1978; Closing Date: September 30, 1983.
The project is proceeding satisfactorily and generally on schedule. Civil works are underway and progressing well, and the non-farm development component is showing encouraging initial results. However, administrative problems are causing difficulties in making credit available to the smaller farmers and tenants.
- 1568 Agricultural Extension Project: US\$100.0 million loan of May 22, 1978;
Effective Date: September 22, 1978; Closing Date: December 31, 1982.
The executing agency EMBRATER has initiated work with state/territory agencies for project implementation. The Project Coordination Unit has been effectively organized and project execution is proceeding satisfactorily.
- 1589 Bahia Rural Development Project: US\$37.0 million loan of July 19, 1978;
Effective Date: December 5, 1978; Closing Date: December 31, 1983.
Implementation of the project has advanced satisfactorily after initial local funding delays. Substantial progress was made in the majority of the components and targets for numbers of farmers to be assisted with extension and credit were exceeded. However, project activities were sharply disrupted in March 1979 with the change in State administration and subsequent dismissal of large numbers of project-funded staff. Discussions are underway with the new State Government with a view to reactivating the project.

ANNEX III

FUTURE LENDING PROGRAM IN AGRICULTURE AND RURAL DEVELOPMENT

Northeast Agricultural Credit (FY80; US\$135 million)

Would provide credit to small-scale farmers. Preparation has been slow owing to lack of leadership in preparation team. Responsibility for project preparation recently transferred from Central Bank to Bank of Brazil, and pace of preparation is expected to accelerate.

Piaui Rural Development (FY81S; US\$40 million)

Integrated rural development. Recently slipped from FY80. Preparation has been slow owing to lack of experience (on the part of Piaui State Government) in project preparation, and because of difficulties in defining possible means to attack what is viewed in the potential project area as the key constraint to rural development -- an extremely skewed land distribution. The State hopes to organize the transfer of some public lands to small-scale producers, and to acquire private holdings for the same purpose.

Ceara II Rural Development (FY81; US\$70 million)

Statewide rural development with emphasis on selected bottleneck sectors. Preparation is in early stages, but Government has already indicated its support of the project to Bank staff.

Agricultural Research II (FY81S; US\$100 million)

Follow-up to Loan No. 1249-BR. Would attempt to further strengthen National Agricultural Research Agency (EMBRAPA). Pace of preparation slow owing to change of EMBRAPA administration.

Northeast Inland Fisheries (FY83; US\$50 million)

Development of inland fisheries. Joint FAO/Bank reconnaissance mission in February 1979 tentatively identified a project. Timing of identification mission pending further progress by Government in more precisely defining project suitable for Bank financing.

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: June 18, 1978

FROM: Nicolas Ardito Barletta

SUBJECT: BRAZIL - Your Meeting with Brazilian Finance Minister,
Mr. Karlos Rischbieter, on June 19, 1979.

1. You are scheduled to meet with Brazilian Finance Minister Karlos Rischbieter on June 19 at 6 p.m. Mr. Rischbieter 50, is from the southern State of Santa Catarina and before his present appointment was President of the Bank of Brazil. Our understanding is that Minister Rischbieter is merely paying a courtesy visit with the object of inviting you to visit Brazil at your convenience. However, we have been discussing with the Brazilian Government our lending program for the next two years and it is possible that he may wish to review this program with you.

Current Economic Situation

2. Since the 1973-74 jump in oil prices, Brazil has faced the necessity of adjusting the rate and pattern of its economic growth to a consequently more constrained balance-of-payments situation. Growth has been erratic since 1974 but has, nevertheless, averaged more than 7% per year (as compared to 11% during the "miracle" years of 1967-73). Although the overall growth of imports has been contained through administrative, controls large current account deficits and a policy of international reserve accumulation (about US\$7 billion between 1975 and 1978) led to a rapid increase of gross external debt, reaching US\$43 billion by the end of 1978. At the same time, inflation, which had fallen to 15% in 1973, reaccelerated and has exceeded 40% per annum since 1976. Increasing efforts to curb credit and public sector investment have been offset by droughts affecting the agricultural sector, the monetary impact of foreign exchange reserve accumulation, and some relaxation of wage policy in the face of spreading work stoppages.

3. Inflation reached a monthly rate of 5.8% in March of this year, prompting the Figueiredo Government, which took office on March 15, to make its control the number one economic priority. Toward this end, a "package" of measures was introduced in April including further cutbacks in public expenditures, prohibitively costly deposit requirements on private financial borrowings abroad, a 60-day price freeze on the sales of retail supermarkets, and interest rate limits on retailer credits to consumers. As a result of these measures, inflation fell to 3.8% in April and 2.3% in May. Further reductions during 1979 will be made difficult, however, by OPEC price decisions and by floods and droughts which, though less severe than in 1978, will again restrict agricultural exports and increase the demand for imports.

4. We now foresee for 1979 the following:

(\$ billion)

Merchandise trade balance	-1.5
Current account balance (% of GDP)	-6.8 (33)
Amortization	-5.8

The Government had previously announced its intention to draw down its international reserves (which totaled almost US\$12 billion at the end of 1978) by about US\$3 billion in 1979, but is now considering a larger drawdown of, about US\$4 billion. After taking account of expected traditional credits and direct investments, this will leave a gross borrowing requirement of some US\$4-5 billion in financial credits, less than half the rate of such borrowing in 1978. Raising this amount should pose no problem; most of it has already been contracted.

Economic Policy Dialogue

5. During the next several years, the need for restraint on the growth of demand will confront increasing pressures emanating from the opening political system. The new Government, more explicitly and seemingly with greater determination than its predecessor, has accepted the necessity of restraining growth in recognition of the balance-of-payments constraint and the need to control inflation. It has also indicated a desire to reduce over time the distortions introduced by increased administration of the economy.^{1/} A primary topic of our policy dialogue with the Brazilian authorities in recent years has concerned the adequacy of existing monetary and fiscal tools and policies for achieving the Government's aggregate demand, distributive, and allocative objectives.

6. Credit and Monetary Policy. The influence of monetary policy over economic activity has been seriously weakened over the past decade by the proliferation and rapid growth of special funds and selective credit lines whose subsidy element alone was by 1977 equivalent in size to about half of central government revenue collections and more than 5% of GDP. The subsidy element, financed largely by the monetary authorities, has grown rapidly, as the adjustment of fixed interest rates, with few exceptions, has lagged far behind inflation. An annual Monetary Budget is supposed to govern the overall dimensions of these programs, but it is frequently adjusted upwards during the year, as credit demands press against the initial ceilings.

7. The major recipient of these credit subsidies is the agricultural sector, but there is little knowledge of their effects on production. It seems that the subsidies have gone disproportionately to the relatively larger farmers and that a significant fraction of the funds designated for agricultural uses has been diverted to other ends.

8. The need for reform of monetary policies and institutions is evident. The new Government has indicated it intends to take steps in this direction, including the gradual dismantling of the Central Bank's development banking functions, explicit incorporation of credit programs into the

^{1/} As a start, the excess rebate of taxes to exporters and the prior deposit requirement on imports are to be phased out over the next four years, with a compensating gradual real devaluation of the cruzeiro totaling about 25%. A major beneficiary of this move toward trade liberalization should be the agricultural sector which the Government has named its highest development priority.

public sector budgetary framework, and the upward revision of interest rates paid by large farmers. President Figueiredo has placed very high priority on the dampening of inflation, and Planning Minister Simonsen's (formal) power to restrain the expansion of credit has accordingly been enhanced. Nevertheless, the reform process is still in the planning stage, and no firm decisions appear to have been made regarding its extent and timing.

9. You may thus wish once again to impress on Mr. Rischbieter the Bank's concern with interest rate subsidies and the efficacy of monetary policy generally and to inquire about the Government's plans for reform in this area. (A Bank study of the credit system is currently in progress, and a first draft with policy recommendations will be ready by mid-July.)

10. Public Finance. Increasing institutional complexity and dispersion of authority have also eroded the Government's ability to manage the fiscal aggregates of the public sector and to shape the composition of the sector's expenditures in accordance with national priorities. The lack of management authority is reflected in the paucity of information available to the Government regarding the activities and resources of the various agencies and enterprises that would permit even an ex post consolidation of public sector accounts and analysis of their economic impact.

11. The Bank has long pressed the Brazilian Government regarding the need to improve its budgetary system and toward that end has offered to send a mission to assist in the consolidation of public sector accounts and the preparation of a public sector investment program. In response to a request from the Secretary General of Planning, Mr. Holsen and Mr. Levy will visit Brazil for two weeks in late July to advise the Planning Secretariat on plans for establishing an effective public sector budgetary system. Unless Mr. Rischbieter and Mr. Simonsen act quickly and forcefully to get the President's support in this area, the outlook for extensive fiscal reform is dim. You may wish to raise the matter with Mr. Rischbieter, perhaps going to the extent of pointing out the difficulty we will face, when presenting loans to the Board, in testifying as to Brazil's overall creditworthiness as well as to the specific projects we are financing so long as the Government's own control over the economic operations of the public sector is so tenuous.

12. Other Economic Work. We are proposing to carry out during FY1980: (a) a comprehensive examination of policies affecting the performance of the agricultural sector -- e.g., price controls, credit and interest rates, exchange rate -- and a separate study of the various programs aimed specifically at agriculture in the Northeast; (b) a survey of resources and policy issues in the energy sector; and (c) a study of the distributional impact of public sector revenue collections, including taxes, social security contributions, and user charges. Discussion of these activities with the Brazilians is still at a preliminary stage and are subject to our own budgetary and manpower limitations. You may nevertheless want to inform Mr. Rischbieter of the directions we propose to take and solicit his comments.

Bank Lending Strategy

13. Brazil has demonstrated its ability to borrow on reasonable terms in the foreign private capital markets. Because the majority of the disbursements of Bank loans are being made in hard currencies, the cost of Bank money is considered by the Brazilians to be much higher than that from other sources. Thus, while both the Government and we agree that increasing the Bank's lending program in Brazil is important for maintaining the confidence of private external lenders, it should be tailored to meet the key development needs of the country. Our lending in the social sectors would, therefore, be addressed to supporting programs that help the rural and urban poor and to develop institutions to implement them. In the production and infrastructure sectors it will serve as a catalyst for additional private finance and assist in developing sound institutions. An additional objective is to help ease the burden on the country's balance of payments by supporting projects that expand export capacity or result in efficient import substitution. Our program also responds to the high priority being given by the Government to reduce its dependence on imported oil by continuing to lend to the power sector. In addition, our presence in this sector enable us to maintain our dialogue with the Government through which we are able to influence the direction of planning of investments and strengthen the financial position of the power companies. As in the past, we plan to balance our lending program between social and productive sectors, so that although we would finance 35% of the total cost of social projects with low foreign exchange contents, our aggregate lending is likely to continue to represent less than the total foreign exchange cost of projects.

14. Attached is a list of projects under preparation for FY1980 and FY1981 which follow the objectives explained above and have been agreed with the Brazilian Government. This lending program is basically the same as was approved by you last year, the amounts adjusted to reflect the current situation. Two additional projects, proposed recently by the new Government for financing in FY81, are tentatively included pending receipt and evaluation of further information. One is an integrated development project in the Northwest (Mato Grosso and Rondonia), with excellent colonization prospects and the other is for a sixth railway project. Loan amounts of \$200 million are being proposed for each of these projects.

Other Topics of Discussions

15. New Projects. The Minister may request Bank assistance to finance the Government's alcohol program, which calls for expanding the annual production of alcohol from 3.5 billion liters to 20.5 billion liters by 1985 (10.7 billion liters as a substitute for gasoline and 9.8 billion liters as a substitute for fuel oil and diesel oil). This would represent about half of Brazil's projected oil import bill. The investment involved would be about \$8 billion, of which 90% would be in local currency and 10% in foreign exchange. The project would be for the construction of distilleries and related facilities plus the improvement of technology both for alcohol and sugar cane production. The project looks ambitious, and its economics need

June 18, 1979

a careful review. Our present information on the costs of production is inadequate, and we do not know whether other technical alternatives such as synthetic fuels from low-grade coal or shale -- which are in abundant supply in Brazil -- have been studied. We would welcome any information that can be provided on this matter. Given the rising cost and short supply of oil and the possibility of reducing the cost of alcohol production by large-scale operations, the Government's program warrants a closer look. The energy sector survey mission planned for later this year (see para. 12) could review this program.

16. Power Sector Tariffs. You may wish to point out (we will be presenting more detailed analysis to you on this matter) that the Bank plans to continue to lend to the power sector to assist Brazil to reduce its dependence on oil imports. We are also anxious to maintain a close dialogue with the Government on the financing of the sector and on planning for its future development. Our presence has helped to provide a direction which otherwise would be lacking. In addition, this sector is an excellent vehicle for attracting foreign private credits in co-financing operations with the Bank. Recently, however, we have been somewhat concerned that tariff levels have not been maintained in real terms, while the cost of investment in the sector has been increasing. Without a further tariff increase later in 1979, some of our borrowers may be unable to achieve in 1979 the minimum 10% return on remunerable investment stipulated in our various agreements. You may wish to point out to the Minister that part of the board is opposed to our lending much for power in Brazil and that this makes it all the more important that our borrowers be granted the necessary tariff increase to enable them to meet the commitments entered into by them with the Bank.

Cleared with and cc: Mr. Lerdau, LC2

cc: Messrs. Stern
Holsen, LCNVP
van der Meer, LCP
Rovani, CPS
Mirza, LC2
Pfeffermann, LC2
Levy, LC2

HMirza/FLevy:smn

BRAZIL - APPROVED LENDING PROGRAM

<u>FY1980</u>	<u>US\$ Million</u>
Northeast Agricultural Credit	135.0
Piauí Rural Development	40.0
Rio de Janeiro Pollution	60.0
Northeast Education IV	70.0
Railways V - RFFSA	140.0
Urban Rail Transport	80.0
CEEE Distribution	100.0
South Water and Sewerage	130.0
Integrated Urban I - CURA	<u>70.0</u>
	<u>825.0</u>

<u>Slipped from FY1979 to FY1980</u>	<u>US\$ Million</u>
Sao Paulo Industrial Pollution	<u>66.0</u>

<u>FY1981</u>	<u>US\$ Million</u>
Agricultural Research II (S)	100.0
Ceara Rural Development II	70.0
Highways VII (S) <u>1/</u>	135.0
Southeast/Northeast Power Interconnection <u>1/</u>	105.0
ELETROBRAS I Distribution	100.0
ELETROSUL Transmission	100.0
Northeast Water and Sewerage II	100.0
Carajas Iron Ore <u>2/</u>	200.0
Urban Transport II - Medium Cities	<u>110.0</u>
	<u>1,020.0</u>

<u>Additional Projects Proposed by the Brazilian Government for FY1981</u>	<u>US\$ Million</u>
Northwest Integrated Development - Mato Grosso/Rondonia	200.0
Railways VI - RFFSA (Export Corridor to Paranagua)	200.0

1/ These may either have to be postponed or deleted depending on outcome of further discussions with the Government and the operating entities.

2/ The priority of this project has not as yet been confirmed by the Government.

OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: October 1, 1979

FROM: Guy Pfeffermann

SUBJECT: 1979 Annual Meetings -

BRAZIL: Meeting with Mr. McNamara (Monday, October 1)

Most of the meeting was devoted to the economic situation and prospects. Minister Rischbieter started off mentioning that the country had suffered three bad harvests but that this year's prospects were better in this respect. The hope is that a larger harvest will reduce inflation, cut imports and increase exports (the latter by some US\$ 2 billion). Export targets were about US\$ 20 billion in 1980 (up from 15 in 1979).

The Minister mentioned efforts in the energy field. Imports of petroleum will be kept to 7.5 million barrels in 1980. The cement industry will be converted to coal. Substantial domestic savings will be channelled into the alcohol program, and an increase in domestic oil production is planned. Mr. McNamara expressed the opinion that Brazil was so large that it was likely that more oil would be found there. A somewhat inconclusive discussion of world energy prospects followed. It was agreed that the real price of oil was likely to rise.

Minister Rischbieter then mentioned Brazil's external debt of about US\$ 50 billion (against reserves of 10), of which a large part was private debt. An effort is being made to get the multinationals to convert some of their debt into equity.

The inflation target for 1980 is 40 percent (down from over 60 this year), thanks to a series of measures including conservative fiscal management, the abolition of some credit and other subsidies and some price controls.

The Minister mentioned the idea of seeking Bank financing for a soy-bean corridor.

He also mentioned the high priority accorded to the Northeast by the government.

This led to an expression of interest in the Northeast by Mr. McNamara. He then broached the question of the vote on the Bank's capital increase (which the Brazilians are planning to do presently) and that of the amount Brazil would contribute to IDA, seeking larger amounts than had been contemplated in Brazil and stressing that contributions involved no actual disbursements in the near future. In turn, he pledged continued financial support for Brazil in terms of the Bank's lending volume.

cc: Mr. McNamara's office (2)
Messrs. Stern
Ardito Barletta

Lerdau
van der Meer
Skillings

GPfeffermann/rh

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Meeting with President João Baptista Figueiredo of Brazil, Brasilia, Nov. 12, 1979

Present: President Figueiredo, Mr. McNamara, Minister of Finance Rischbieter, Messrs. Barletta, Clark and Koch-Weser

President Figueiredo enquired about Mr. McNamara's impressions and conclusions arrived at after his almost week-long visit to different parts of Brazil. Mr. McNamara said that he wished he were young and a Brazilian, considering the exciting challenges posed by Brazil's development potential and progress. He was most impressed with the change in development philosophy which had occurred over the past 10 years, i.e., since he had last visited the country. Everybody he had talked to supported the Government's objective of achieving political liberalization, growth and reduction of poverty simultaneously; even the business leaders with whom he had met in São Paulo believed in this strategy. This was most impressive, not only because it represented a fundamental change in the attitudes of the country's leadership, but also because it was different from the situation in many other countries.

President Figueiredo emphasized that it was his Government's great concern to improve income distribution; he agreed that 10 years ago this had only been a secondary concern in Brazil. His other deep concern was the energy crisis which had been neglected in the past and for which there was no solution without sacrifice by everybody. He observed that his Government had to pay a high price for redemocratization in terms of the patience required; the dust of the public euphoria on redemocratization still had to settle.

President Figueiredo emphasized that another great concern was the development of the Northeast. This was not just a matter of industrialization but required employment creation through broader programs, particularly in agriculture. The country could not afford simply to send food from Paraná and São Paulo to the Northeast and in return send industrial products manufactured in the Northeast to the South. This constituted a waste of resources and was not energy-efficient. Minister Rischbieter added that the energy crisis should be used for stimulating regional development in Brazil. President Figueiredo agreed; the point could be made that, rather than being one large integrated economy, Brazil still consisted of "a number of small countries." Whereas in the past the Northeast had been depleted of its resources, the Government was now making good progress in developing that region. Mr. McNamara said that, in his view, the Northeast's agricultural sector could be developed. Ministers Rischbieter and Delfim Neto had explained the Government's strategy for agricultural development in the Northeast and the Bank would be willing to assist the Government in its efforts.

President Figueiredo pointed to the excessive population growth in the Northeast. In his view, Brazil had to achieve a modus vivendi with the Church on the issue of population control. Mr. McNamara said that 10 years ago he had encountered fierce opposition to family planning; during this visit, he had noticed that a consensus was building up on the need for population control. President Figueiredo agreed. Opposition to family planning was no longer based so much on religious grounds but rather on political reasons. However, the Pope's recent statements during his visit to the U.S. were unfortunate. He would hope that the Pope's forthcoming visit to Brazil and the Northeast would modify his views because it would expose him to human tragedies such as the one illustrated by the following example: during a recent visit to the Northeast, he (President Figueiredo) had met a woman in the sugar belt who had had 24 children; questioned about how she could feed them, she had replied that God was feeding 18 because they had died. If the Pope moved on the issue, the politicians would be pressed to change

their political positions on population control. He agreed with Mr. McNamara's point that the Pope's statements were inconsistent in the sense that the objective of eradicating poverty could not be obtained without some sort of family planning program. In this context, the President pointed to the very substantial benefits extended to 96 million people through Brazil's social security system; it had become a major budget item and was stretched to its financial limits. The Government was aware that in many cases health care services had become too sophisticated, relying on specialized curative services rather than a preventive, primary health care approach for the interior of the country.

Mr. McNamara thanked President Figueiredo for receiving him and his associates and for the magnificent visit to the different regions of the country, organized by Minister Rischbieter. It had helped him to understand the country's difficult problems better; the Bank would undertake every effort to assist Brazil in its development activities. In concluding, President Figueiredo asked Mr. McNamara to visit Brazil more frequently than in the past.

cc: Mr. Ardito Barletta

CKW
November 21, 1979

OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: March 5, 1980

FROM: Robert F. Skillings, Division Chief, LAC II 

SUBJECT: BRAZIL - Meeting on February 19, 1980 with Brazil Planning Minister Antonio Delfim Netto and Finance Minister Ernane Galveas in New York

1. Mr. McNamara met with Dr. Antonio Delfim Netto, the Brazilian Minister in Charge of the Secretariat of Planning in the Presidency, and Dr. Ernane Galveas, Minister of Finance, at the Bank's office at the United Nations in New York on February 19, 1980 at 5:00 p.m. Also present were Mr. Jose Carlos Madeira Serrano, Director in Charge of the Foreign Area of the Central Bank of Brazil, Minister Jose Botafogo Goncalves, Secretary of SUBIN, Mr. Alexandre Kafka, Mr. Gustavo Silveira, Press Advisor to Minister Delfim, and Mr. Lino Otto Bohn, Director of the Banco do Brasil in New York. Messrs. Ardito Barletta, Koch-Weser and Skillings attended.
2. Most of the discussion dealt with Brazil's short-term economic outlook. The Minister said that for 1980 his objective was to achieve equilibrium in the foreign trade account, which would imply a \$9 billion deficit in the current account (\$1 billion less than in 1979). This meant increasing exports from \$15 billion in 1979 to \$20 billion in 1980. He intended that of this \$5 billion increase in exports, \$2 billion should come from agricultural products as a result of both higher quantities and higher prices, and \$3 billion from a continued expansion of manufactured exports. On the import side, he expected that oil imports would rise from \$6.7 billion in 1979 to \$9.4 billion in 1980. Part of this would be offset by a reduction of food imports, expected to be \$1.4 billion less than in 1979. He thought that in 1980 Brazil would not have to import meat, corn, rice or beans all of which were imported in 1979. The objective was to reduce all other imports by 20%. This should be possible in view of the fact that 1979 imports of "other" goods had been unusually large and that the price response to the 107% devaluation in 1979 should be significant. Moreover, in 1980 virtually all imports would pay duties, exemptions for capital goods having been abolished with the cancellation of the law of similars.
3. Mr. McNamara asked how the Government expected to finance the balance-of-payments deficit. Minister Galveas said that in addition to the \$9 billion current account deficit, the Government would need to find \$7 billion for loan amortization. Of this total financial requirement of \$16 billion, he thought they could count on \$2 billion of direct investment, and \$2 billion of suppliers' credits. Of the remaining \$12 billion, \$7 billion represented rolling over of maturing loans and only \$5 billion represented net additional borrowing. The latter included disbursement on loans of international institutions available to cover local expenditures. Minister Galveas remarked that if it is not possible to borrow the full \$5 billion in new loans it would be possible to allow reserves to drop somewhat from their present level of \$9 billion.

March 5, 1980

4. The Ministers felt that the needed borrowing was feasible. It represented an increase of 10-15% in the Euro-money market's exposure in Brazil, an increase which is in line with the expected growth of the market. The major banks that they had visited during their current stay in New York had all said that they could accommodate Brazil's requirements. Mr. Serrano made the point that the banks had the necessary liquidity, but Mr. McNamara reminded them that domestic demand for funds in the United States was also increasing.

5. Mr. McNamara said that his real concern was the period 1981-85, when it appeared that Brazil would have a rising current account deficit. This was not a Brazilian problem alone. The Bank estimated that the aggregate deficit of the less developed oil importing countries would rise to as much as \$90 billion in 1990.

6. Minister Delfim said that Brazil was confident that if it could export \$20 billion in 1980 it could expand to \$24-25 billion in 1981. The balance of payments was Brazil's main constraint, and everything else including the country's rate of growth would be derived from the country's balance-of-payments performance. Export expansion was receiving the Government's main priority. Minister Galveas said that the target for 1981 was a trade surplus with exports growing by 20% and imports only by 10-15%. Minister Delfim said that the Government was seeking to reduce the import coefficient, mainly through its programs in agriculture and energy. They were concerned about protectionism in the U.S. although, said Minister Delfim, the U.S. would be well advised to open up its barriers to the import of cheap goods as a means of countering its 14-15% rate of inflation. Mr. McNamara advised the Brazilians not to rely on such a development, since the consumer's voice is not heard strongly in the U.S., while the voice of labor is very strong. There was not enough pressure on the U.S. Government at present to reduce inflation.

7. Mr. McNamara asked whether the U.S. bankers with whom the Brazilians had talked had given their views on lending to other oil importing countries. Minister Delfim said the subject had not been mentioned.

8. There was a discussion of the lending prospects of banks in various countries. The Brazilians repeated their optimism about their possibility of obtaining funds this year from U.S. banks. They said that the Bank of America was bidding keenly for a large syndicated loan now being discussed. The Royal Bank of Canada was prepared to increase its exposure in Brazil. Minister Galveas said that European banks were also prepared to increase their exposure by more than U.S. banks except for the German banks who had a temporary equity problem. He hoped this would be changed when the German banks went through with their plans for increasing their equity. He was especially hopeful for additional funds from the Westdeutsche Landesbank. Japanese banks were at present limited by instructions of the Minister of Finance, but the Brazilians felt that this would change after April 1, when the prohibition on Japanese bank participation in

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syndicated loans was expected to be removed, although there might still be a limit of 15% on the proportion of each operation that the Japanese banks would be permitted to take. Japan was now accumulating liquidity from oil deposits and there was increasing pressure upon it to lend abroad. This was a positive sign for borrowing countries. Mr. Serrano made the point that different tax treatment helped to explain differences in spread. U.S. banks were now requesting spreads of 1-1/8% or more over LIBOR, while European banks required less, in part because of their more favorable tax treatment.

9. Mr. McNamara said that he hoped the Brazilian Ministers would periodically transmit their views about what the Bank could do to improve the transferability of excess liquidity. He had real doubt that the commercial markets could handle the big trade deficit of the oil importing countries. This was part of the background for the proposal for structural adjustment lending in the World Bank due for discussion by the Executive Directors in March. He would welcome advice on what else the Bank could do to help.

10. Mr. Ardito Barletta asked the Brazilians about the prospects for domestic inflation in 1980. Minister Delfim said that he expected the rate of inflation to remain high through May or June. The cost-of-living was already beginning to stabilize but wholesale prices were continuing to rise. Almost all prices were now subject to price control and the Government sector was completely controlled. The public investment program for 1980 amounted to Cr\$1.1 trillion. It was now completely financed from non-inflationary sources -- 35% from cash generation within public enterprises, 20% from the Treasury (reflecting a surplus in the Treasury budget) and the balance from borrowing, domestic or foreign. The Minister expected agricultural price increases of only around 35% in 1980, reflecting good crop expectations for everything except beans. The Government intended to limit the growth of the money supply to 50%. The effects of wage increases on inflation could be critical, because an adjustment was now made every six months but with a time lag, so that it was difficult to reflect a turn around in inflation in the wage bill. This might force the Government to induce some unemployment, with reemployment being made at lower wages. Minister Delfim said that he was talking publicly about inflation of 45% in 1980 and foreign exchange devaluation of 40%, on the assumption that inflation outside Brazil would be 10% in reality. In fact, he believed inflation in 1980 would be 55% or 60%. Even a rate of 60% would be acceptable, since it would be a reduction from 77% in 1979. It was unfortunate that the balance of payments would not permit import liberalization. If that were possible, more downward pressure on prices could have been exerted.

11. In closing Mr. McNamara mentioned three critical operational areas which he wanted the staff to discuss with the Ministers:

- a) Rural development projects in the Northeast were not moving. He felt this was serious.

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- b) The heavy interest rate subsidy which resulted in a flat 10% interest rate for POLONORDESTE agricultural credits would make it almost impossible for the Bank to recommend a loan for the agricultural credit project scheduled for next year.
- c) Mr. McNamara was distressed that loan disbursements in Brazil lagged behind the general Bank average. It would be hard to justify the sustained high level of new lending unless disbursements on existing loans could be accelerated. The delay resulted partly from delays in counterpart finances. Minister Galveas felt that this was a problem caused in the Central Bank but Minister Delfim said that an interministerial financial committee had cut back expenditures in 1979. They were taking corrective measures and from 1981 on the problem should be overcome.

12. Messrs. Ardito Barletta and Skillings met again with Ministers Delfim and Galveas in Washington on February 21, 1980. Those discussions are recorded in separate memoranda dealing with individual subjects.

Cleared w/& cc: Mr. Ardito Barletta

cc: Mr. McNamara's Office (3)
cc: Messrs. Stern
Lerdau, LC2
van der Meer, LCP
Pfeffermann, LCNVP
Levy, LC2
Brazil Division

RFSkillings/cdr

357
February 29, 1980

Mr. Robert S. McNamara

Bob,

I met again with Ministers Delfim Netto and Galveas, both on working and social occasions. They were friendly and open meetings. The following are highlights:

1. They consider present working relations with the Bank to be good.
2. They appreciated your and mine understanding of the political constraints within which they are working.
3. They are pleased that the annual program of loans may grow and are desirous to do what is needed to achieve those targets, including the improvement of disbursement performance.
4. They welcome the idea of my working visit in April to analyze in depth and find solutions to some of the areas of difficulties in project definitions and structures.
- 2/29 5. They do not define as "credit programs" the on-going federal Government subsidies to Northeast Polo Nordeste farmers. They are straightforward subsidy programs for which small charge is collected from farmers in order to make them value the contribution to their production and well-being. They cannot be altered in the foreseeable future due to political constraints. We can either jointly design "non-credit" projects that would support such programs or postpone an outright credit program for the Northeast until inflation has been reduced enough (perhaps 20% p.a.) to make a 10% charge look "reasonable". Our staff is now exploring the full implications.
6. On the Northwest Road Development Project and related "Indian issue", it was made clear *by them* that Bank financing or participation for the Indian Affairs Institute as well as Indian settlements was not desirable. The project may go forward if a program for Indians is defined, which is agreeable, and our staff checks periodically and informally with the Indian Affairs Institute in Brasilia and in the field during execution. They would also provide written reports. I will explore further the operational parameters of these possibilities in Brasilia in April to ascertain viability or to pull out of participating in such a project. So far, it sounds acceptable.

7. There were no unsolvable problems with water or electricity tariffs. Mutually acceptable operational parameters were found which would be confirmed shortly.
8. Concerning FEPASA (Sao Paulo), an arrangement has been made by which capital contributions will be made to FEPASA by the state of Sao Paulo over the next several months. The Ministers insisted that under such circumstances it would be totally counter-productive to suspend disbursement of our loan at present. I reiterated to them that the important thing was that action be taken to improve the financial situation of FEPASA and that we were glad some such actions were already taking place.

Our meeting ended with great cordiality and with appreciation for our understanding of their political difficulties and the complexity of their economic situation and policy implementation now underway.



Nicolas Ardito Barletta

cc: Mr. Stern o/r

53 ROUTING SLIP	DATE February 15, 1980
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FROM THE OFFICE OF THE
REGIONAL VICE PRESIDENT

NAME	ROOM NO.
Mr. Robert S. McNamara	
2/15	

APPROPRIATE DISPOSITION	NOTE AND RETURN
APPROVAL	NOTE AND SEND ON
COMMENT	PER OUR CONVERSATION
FOR ACTION	PER YOUR REQUEST
INFORMATION	PREPARE REPLY
INITIAL	RECOMMENDATION
NOTE AND FILE	SIGNATURE

REMARKS

Bob,

The attached illustrates the problems we are having with agriculture credit lending for Northeast Brazil because of subsidized interest rates. You may want to use it as an example of your conversations with Mr. Delfim Netto; or you might prefer to have us discuss it in a working meeting afterwards.

AB

FROM

N. Ardito Barletta

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: February 15, 1980

FROM: Nicolas Ardito Barletta, RVP, LAC

SUBJECT: BRAZIL - Proposed Northeast Small Farmer Credit Project

1. In view of our planned talks with Planning Minister Delfim Netto, I would like to bring to your special attention our position on a difficult operational and policy issue which we are facing.
2. As you know, we have been discussing with the Brazilians for several years the possibility of financing a small farmer rural credit project in the Northeast. A loan of US\$135 million is scheduled in our FY81 program. After a slow start in project preparation by the Central Bank, the Government transferred responsibility for completing the project to Banco do Brasil. Work has progressed reasonably well lately, and we believe that Banco do Brasil would have sufficiently completed the preparation work to allow Bank appraisal by April/May. The project would support the Government's POLONORDESTE rural development program by providing, over the next 2-3 years, for the agricultural investment and incremental working capital credit needs of some 100,000 - 150,000 low income farmers in 35-40 POLONORDESTE integrated rural development or colonization projects in the Northeast. Virtually all of the expected participants, who have incomes below Brasil's relative poverty level, would be expected to be new clients of the banking system, and POLONORDESTE-funded rural extension assistance would help assure productive use of the credit.
3. Our support of this Brazilian project preparation effort has, in part, been conditioned by our expectation that the Government was about to begin a serious, though gradual, reduction of agricultural interest rate subsidies. Indeed, in December, as part of the package of economic measures described in other briefing papers already provided to you separately, the Government increased agricultural interest rates to a range of 21% to 39% (depending on region and loan size). However, it excluded from the adjustment the credit lines for "special" programs in the North and Northeast, including POLONORDESTE. Thus, while rates for "normal" credit for small farmers (e.g., not special program participants) in the Northeast were raised from the previous 13-15% to 21-26%, POLONORDESTE credit rates remained at 10%. Even assuming the Government can reduce inflation this year from the 75-80% level experienced in 1979, the implicit subsidy remains substantial, and greater than that prevailing (about 30-35%) when the Bank first acquiesced to subsidized small farmer lending in Brazil because of the important role of such lending in new rural development efforts.
4. On the one hand, we remain strongly convinced that the Bank should support viable efforts to increase the access of small farmers to banking credit; to help these farmers become users of credit on a normal commercial

basis; and, in general, to widen the range of financial choices of the rural poor. Supporting this objective, Banco do Brasil has developed several promising proposals to simplify small farmer credit administration (group loan proposals, fewer required trips by the farmer to the bank, new rural mini-branches, reduced security requirements, etc.). Furthermore, the banking system is still one of the few reasonably effective vehicles we have in the Northeast for expanding our support of rural development efforts, as the Government has been slow to develop a viable alternative institutional framework to allow Bank participation in large-scale integrated rural programs for the rural poor (e.g., a region-wide rural development program as compared to the various sub-regional integrated rural development projects we have been able to support up until now).

5. On the other hand, the Government's decision to maintain the POLONORDESTE interest rates has added to the subsidy of that line relative to other credit and will most certainly add pressure on local bankers and extensionists to allow farmers previously receiving "normal" credit to switch to the now significantly cheaper POLONORDESTE line. Therefore, even if we were to agree to the 10% interest rate for POLONORDESTE clients, the required effort to assure that the credit went only or mainly to new clients would probably involve significant control and supervision costs and difficulties. Although we understand that the Brazilians may well be willing to negotiate various further mechanisms to control access to the POLONORDESTE line, it is our feeling that the controls could well prove counterproductive. They could offset our support of efforts to reduce bureaucratic complications in the banking system, and to reduce the administrative costs of small farmer loans so as to encourage local financial institutions to better serve this clientele. Furthermore, and in the broader context, it is our continued belief that the credit subsidies are one of the significant fueling factors in Brazil's current inflation problems. For the Bank to support one of the most highly subsidized parts of the credit system may, therefore, not be in the interest of either overall economic policy or long term rural development goals.

Conclusion

6. The current circumstances put us in a very difficult position. Minister Delfim Netto has privately told us that he intended to continue the gradual reduction of interest rate subsidies. We can only surmise that he has been unwilling to make these reductions for some of the special programs because of regional political pressure. Furthermore, he recently publicly expressed his intention, at a meeting with high level Brazilian bankers, not to make any further changes in interest rates in the near future.

7. We do not believe that the World Bank should negotiate or approve a loan for the proposed Northeast credit project given the current interest rate structure. However, for us now to disengage from our collaboration on the proposed rural credit project would carry several risks. First, it could seriously damage our relationship with Banco do Brasil (which is the key credit intermediary for the proposed project as well as several others now

under execution), and discourage their efforts to improve rural credit services, especially in collaboration with the Bank, should we later want to revive our involvement in the project. Secondly, we may have to reassess how and whether the Bank should finance credit components of future rural development projects in Brazil. One such project, in Minas Gerais, has just been appraised. However, it is not covered by the POLONORDESTE program and its credit activities would be governed by the "normal" interest rates now in effect for small farmers in that state, namely 23-28%. A second project, in the Northeast state of Ceara, has also just been appraised and its credit component would be governed by POLONORDESTE regulations. A third risk is that our withdrawal from work on credit for small farmers may reduce the Government's interest in working with us on other rural development activities in the Northeast.

Recommendation

8. If, in our conversations with Minister Delfim Netto, we can elicit information on the Minister's plans for further adjustments in interest rates over, say, the next year, and those plans include increases in the rates governing POLONORDESTE credit, we believe we should offer to go ahead, as previously planned, with appraisal of the project in order to avoid a collapse of the current Brazilian preparation effort. At the same time, however, we believe that we should make it very clear to the Brazilians now that we would not be prepared to negotiate a loan for the project until: (i) the current interest rate differential between the "normal" and "special" lines for small farmers in the Northeast is largely eliminated (so as to minimize the need for creating cumbersome mechanisms to control against substitution); and (ii) the Government is able to show specifically that its steps for further interest rate shifts and for control of inflation show a reasonable continued progress toward the reduction of the overall rural credit subsidies.

cc: Messrs. Stern (VPO)
Lerdau (LC2DR)
van der Meer (LCPDR)
Pfeffermann (LCPDR)
Goffin (LCPDR)
Skillings (LC2)
Greening (LCPA3)
Koromzay (LC2)
Schloss (LC2)
Levy (LC2)

ESenner:nd

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara

DATE: February 14, 1980

FROM: Nicolas Ardito Barletta *NB*SUBJECT: BRAZIL - Briefing Notes for your Meeting on February 19, 1980 with
Brazil Planning Minister Antonio Delfim Netto and
Finance Minister Ernane Galveas

1. You will meet Planning Minister Delfim Netto and Finance Minister Ernane Galveas in New York on Tuesday, February 19, 1980, at 4:45 p. m. They may be accompanied by one or more of the following: Minister Jose Botafogo Goncalves, head of the Secretariat for International Economic and Technical Coordination (SUBIN) in the Ministry of Planning, Mr. Sergio Faria Lemos da Fonseca, Minister Netto's Chief of Staff, Mr. Gustavo Silveira, Coordinator for Public Relations in the Ministry of Planning, and Mr. Jose Carlos Madeira Serrano, Director of the Central Bank (External Relations). From the Bank side, I propose also to accompany you, together with R. Skillings. The principal purpose of Minister Delfim's visit is to reassure the commercial banking community of Brazil's continuing credit-worthiness. (You may wish to note in this connection, the article appearing in the February 4 issue of the Wall Street Journal, regarding Brazil's borrowing needs (Attachment 1) as well as the notes on Brazil's prospective external borrowings in AGEFI Bondletter No. 299 and No. 300 (Attachment 2)). Minister Delfim will be visiting the Bank on Wednesday, February 20, for further discussions with Bank operational staff including myself. Since you have recently received an extensive briefing in connection with your visit to Brazil last November, the following notes deal only with those key subjects that are likely to come up in your discussions.

The Economic Situation

2. The Brazilian Government has in recent months carried out important economic reforms to deal with its accelerating inflation and rising balance-of-payments deficit. These include a 30% devaluation of the cruzeiro, trade liberalization, and encouragement of external borrowing by the private sector. (For details and analysis, see Attachment 3.) The Minister's views on the development of the economic situation during 1980 should be sought. *ingine*

Current Lending Program

3. For the most recent version of our proposed FY80-84 lending program, see Attachment 4. Lending for FY80 would increase to US\$905 million (compared to US\$668 million in FY79). Lending for FY81-84 would average around US\$1,100 million per year. You may wish to point out to the Ministers that our ability to achieve these high proposed levels of lending will depend on a number of factors, including, in the case of the revenue earning sectors, agreement on private co-financing and adequate tariff levels (see paras. 4-8 and 21-23) and in the case of several other sectors (agricultural credit, fuel alcohol development, and possibly others), agreement regarding the Government's interest rate policies (see paras. 24-27). For brief descriptions of the projects included in the FY80 and FY81 lending program, see Attachment 5.

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Private Co-Financing

4. Since 1976, we have concluded eleven private co-financing operations with Brazil for more than US\$425 million. The most recent of these was a US\$60 million private bank loan for COPEL, the state power distribution company in the State of Parana, in connection with the COPEL Second Power Distribution Project for which a Bank loan of US\$109 million was approved in June 1979. The private co-financing was arranged by a syndicate of Japanese banks led by Nippon Credit Bank, on very favorable terms -- 12 years including 6 years of grace at 5/8 over LIBOR for 6 years and 3/4 over LIBOR for the remainder. In fact these terms are possibly the most favorable obtained by Brazil last year. The private co-financing for COPEL was considered by us an important justification for our loan.

5. Notwithstanding the favorable terms obtained by COPEL, the Brazilians have shown an increasing reluctance to agree to private co-financing for our projects since the departure of Minister Simonsen. It had been recommended for the proposed CEEE Power Distribution Project, for which we expect to present a loan of US\$114 million in March of this year, that CEEE should obtain, as a condition for effectiveness, private co-financing of not less than US\$110 million. At the negotiations, ELETROBRAS (the holding company for the power sector) and the Government strongly resisted any co-financing for the project, arguing that it had been their perception (i) that co-financing was not helping Brazil to obtain better terms than it could obtain on its own and (ii) that co-financing was imposing needless delays and complications in their negotiations with the private banks and depriving the sector of needed flexibility.

6. During the negotiations for the CEEE loan, we pressed the Brazilian delegation to accept private co-financing, and the Brazilians reluctantly agreed to allow CEEE to obtain private co-financing for "about" US\$110 million by June 30, 1982. However, this agreement was conditioned on our agreement, recorded in the minutes of negotiations, that the amount and timing of the co-financing would be reviewed in the light of CEEE's actual need for additional external financing in 1981 and 1982; and our further agreement that the private co-financing would only go ahead if the terms being offered were clearly better than the market. We have resisted the latter condition because we feel it is impossible, in a volatile market, to establish beyond question that co-financing is in fact bringing better terms. The negotiations have foundered on this point. The Brazilians further would like to limit private co-financing to new, as yet untapped markets. While this might be agreed to for some sectors -- see e.g., the Minas Gerais Rural Development Project referred to in the next paragraph -- it would probably be impractical in the case of the traditional revenue earning sectors.^{1/}

^{1/} In a meeting on February 13, 1980, Minister Galveas indicated to Mr. Skillings that he (the Minister) would support private co-financing for our projects on two conditions: first, that the ceilings on external borrowing established for particular sectors (and companies within these sectors) should be respected; and second, that any approaches to the market would be closely coordinated as to timing with the Central Bank authorities so as not to conflict with their own approaches to the market. These conditions are clearly acceptable to us. However, Mr. Skillings was unable to meet with Minister Delfim and the issue as to whether better terms must be obtained is one which apparently only Minister Delfim can resolve.

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7. You may wish to reiterate to Minister Delfim our strong interest in continuing private co-financing for the financially autonomous sectors (such as power and industry) and indeed, in extending private co-financing to other sectors. In this regard, we had proposed private co-financing for the upcoming Porto Alegre Urban Rail Transport Project, as well as for the Second Minas Gerais Rural Development Project, for which Bank loans of US\$159 million and US\$70 million respectively are being considered in this year's lending program. In both cases, the Brazilians have firmly rejected our proposal -- in the case of Porto Alegre because our loan would already finance over half of total project cost, the balance can be financed from local sources, and the project implementing authority is not financially autonomous; in the case of Minas Gerais because, while the State would be a qualified borrower on the international market, the Government apparently feels that it should not be borrowing externally to finance the local counterpart for rural development projects or similar projects with a low foreign exchange content. Because of strong other justification for our participation in these projects (and, in the case of Porto Alegre, because of the absence of a suitable financial intermediary), we do not feel that we should insist on private co-financing for them. However, in the case of industry and electric power in particular, you may wish to stress that without private co-financing, these projects can be extremely vulnerable to criticism from our Board and that accordingly our continued ability to lend for these sectors in substantial amounts is jeopardized. In this connection, three operations for the power sector, aggregating over US\$300 million, are proposed for the FY80 program. Private co-financing for two of these (CEEE and ELETROSUL II) are being recommended as conditions for these loans. It will be quite difficult, in the short/medium term, to meet our lending objectives -- financial and policy dialogue -- for Brazil without continuing support for the traditional, financially autonomous sectors.

Does Brazil agree? if yes, from which? only if we perform & succeed

don't insist

8. It should be accepted, of course, that the Brazilian Government will be imposing overall ceilings on public sector investments, and related limits on external borrowings by the public sector. Any private co-financing must necessarily be made consistent with such borrowing ceilings, and we propose to cooperate fully with the Brazilian authorities to ensure such consistency. Since they seem to be concerned about this point, you may want to give the Minister an appropriate assurance.

the point is to try and work out lending for these sectors

Northeast

9. You may wish to raise with Minister Delfim our continued concern with the lack of progress in strengthening SUDENE. Although the post of deputy superintendent which we recommended is in the process of creation, the man who, we have been informed, has been designated to fill that post is relatively weak and is unlikely to attract the qualified staff which we feel is necessary to supervise the rural development programs in the Northeast. Messrs. Lerda and Skillings expressed this concern to Minister Delfim privately during a meeting in Brasilia on January 14, 1980. The Minister agreed to discuss the problem with the Minister of Interior. We have not heard anything further.

10. The Bank had also suggested that the funding procedures for the POLONORDESTE program be streamlined and that greater authority in allocating funds be delegated to SUDENE. We have seen new draft regulations for this funding process which do not in fact delegate such authority and indeed appear

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to us to be very complicated. However, as long as we cannot be assured that SUDENE will have strong management we can hardly press for greater authority in the distribution of funds to be given to SUDENE.

Counterpart Funding

11. We have recently made another survey of the progress of loan disbursements in Brazil and have found them to be slower than average. One important reason for this has been the delays in Federal Government funding of the counterpart to our loans. This has been a particularly serious problem in the steel industry and in the rural development projects in the Northeast. We have made repeated representations to the Government, with some success in the steel sector but so far without great success in rural development projects. While it is understandable that Minister Delfim should wish to keep a tight control of public expenditures as part of his effort to contain inflation, you may wish to remind him that it is difficult for us to continue to propose a high level of lending for projects requiring government funds (including rural development projects), unless projects financed by the Bank are given high enough priority in the allocation of the Government's financial resources to be assured of regular funding in the required amounts. An example of the problem is described in the attached letter to the Minister which was recently delivered to him (Attachment 6).

Northwest Region (Rondonia and Mato Grosso) Integrated Development

12. As you know, the Government has requested the assistance of the Bank in helping finance its ambitious program of integrated development for the northwest region. This program would entail the reconstruction and paving of the region's 1470 km. main highway (linking Cuiaba with Porto Velho) coupled with measures (i.e., agricultural settlement and development, and feeder roads construction) to promote the productive occupation of the highway's area of influence. Our current lending program contains a US\$135 million loan in support of the highway component (FY81), two loans totalling US\$150 million in support of the agricultural component (FY82S), and a third secondary and feeder roads loan of US\$150 million which could be used to support the feeder roads component (FY82S).

13. The implementation of the program described above will certainly accelerate the migratory flow to the region (currently estimated to average 800 families per month) and this, in turn, will increase pressures on both the natural environment and on the relatively small, but highly vulnerable, Amerindian population (estimated to be on the order of 5,000). While it may be impossible to prevent all negative impacts of the program on the environment and indigenous population, I think that components aimed at minimizing these impacts must be included in any projects submitted to the Bank for possible financing. In your talks with Minister Delfim you may wish to express the Bank's concern with the environmental implications of the program and to request his support for the inclusion of such environmental components in projects to be submitted to the Bank for possible financing. You may similarly wish to raise the Amerindian question, reiterating the Bank's insistence that projects submitted for Bank financing include components directed at protecting Indian land rights. Our recommendations on these subjects, which are detailed in a recent memorandum from Messrs. Lerdaun and Skillings (Attachment 7), are summarized below.

Environmental Issue

14. With regard to the environment, our general objective would be to ensure, to the extent possible, that the patterns of land use associated with the proposed highway and agricultural development projects are compatible with the region's fragile ecology.

15. We intend to achieve this objective through three specific activities. First of all, as part of our assistance in preparing the agricultural projects, we would help select production systems that will least harm the delicate soils of the region. It should be noted, in this regard, that there already exist, in Brazil (at EMBRAPA), highly suggestive research results which seem to support the view that suitable cropping patterns and practices can be developed which will avoid soil and other environmental degradation. Second, the Bank would support the Rondonia government's efforts at land-use planning,^{1/} and would encourage the Mato Grosso government to engage in its own zoning exercise. The Federal Government is generally sympathetic to the zoning concept and has already prepared a draft proposal for zoning the Amazon region as a whole. Hence, the Bank would require a covenant in the highway loan documents stipulating the intent that zoning for the area of influence would be completed as soon as possible for use in elaborating subsequent agricultural development projects. Finally, the Bank would promote the effective demarcation and protection of existing forest reserves, perhaps expanding them, as well as other types of forest management (including conservation) policies, all within the context of the overall zoning plan mentioned above. In this regard, a suitable plan of action would be elaborated in collaboration with the national forestry development agency (IBDF), and included as a component of one of the Bank-financed projects. Such a component could include provisions for strengthening IBDF's capabilities in the project area if that is found to be necessary. A Bank mission to identify environmental components is scheduled to visit Brazil in April 1980. Subsequently, commitments would be obtained from the Government for the execution of these components.

Amerindian Issue

16. With regard to the indigenous population, our principal concern is that the expected increase in the migratory flow to the region will increase the incidence of "invasions" of Indian lands by squatters. The Brazilian constitution protects the Indian's rights to his land, and this is reinforced by implementing legislation. However, in practice, the Government has not always been willing or able to enforce this legislation, partly because of the financial and administrative weakness of the federal agency for Indian affairs (FUNAI).

^{1/} The Government of Rondonia is now discussing with the Brazilian Forest Institute (IBDF) a zoning plan for the territory in which 50% of the area would be left in national forest, 20% would be reserved for tree crops, and only 30% for annual crops, pasture or other activities.

17. The Bank has already expressed its concern over the possible negative impacts of the proposed regional development program on the indigenous population. In our letter of November 23, 1979 to Minister of Interior Andreazza (copied to the then Minister of Agriculture Delfim Netto) we recommended that "...the strengthening of FUNAI's operations in areas adjacent to agricultural projects be an essential component of any proposals submitted to the World Bank for possible financing". In a meeting with the Secretary General (Deputy Minister) of the Ministry of Interior held on January 15, 1980, Messrs. Lerda and Skillings were informed that all aspects of that letter were acceptable to the Government. However, Mr. Skillings, who is now in Brazil, was unsuccessful in obtaining further confirmation that Government will accept a FUNAI package, and in fact, was informed that the Government did not wish for the Bank to have any contact with FUNAI. This reversal of attitude seems to indicate that the Government will strongly resist a component intended to safeguard Indian rights and interests.

18. The next step for the Bank would be to gain a closer knowledge of the actual situation in Indian lands (whether demarcated or not) in the area of influence of the highway. At the same time, or shortly thereafter, preparation would begin on a project component -- to be appraised and incorporated into the highway appraisal (scheduled for April 1980) -- containing:

- a) a program to survey, in a specified-time period, all settlements on Indian lands (including Indians that have not yet been contacted) in the area of influence of the highway;
- b) a program to delimit and then demarcate, in a specified-time period, all Indian areas including reservations in the area of influence;
- c) a program to expel, in a specified-time period, all illegal settlers from Indian reservations and to resettle them elsewhere;
- d) a program to monitor and ensure Indian land rights on the demarcated areas; and
- e) a program to upgrade Indian health protection services.

The rationale for this approach is that without full demarcation it will be impossible to either prevent illegal settlements or to establish their illegality.

19. If you share my view, which is also that of my staff, that without adequate safeguards on the environmental and Amerindian issues the Bank should not be associated with this otherwise exciting and ambitious regional development effort, it might be well to make this view known to the Minister.

Land Tenure Issue

20. An additional concern of the Bank related to the proposed Northwest development program is the land tenure situation. While we intend that agricultural projects to be financed by the Bank would be directed solely at small-holders, there exist a number of large landholdings in the proposed project area (principally in western Mato Grosso) which would presumably increase in value as a result of upgrading and paving the Cuiaba-Porto Velho highway. It does not seem probable that the Government would agree to a formal redistribution of these large landholdings, but there is presently under consideration in Congress

a law which would provide for a progressive land tax. If enacted, this tax may provide an incentive for large landholders to sell parts of their land. You may wish to inquire about the present status of the land tax (which would, if enacted, have national implications) and to learn Minister Delfim Netto's views on what the potential impacts of this tax might be on the patterns of land distribution in the Northwest and in Brazil generally.

Power and Water Tariffs

21. Minister Delfim Netto has stated recently on several occasions that the Government intends to make the water and power sectors financially viable as soon as possible. Since your meeting with him in Brasilia he has taken several steps in that direction by approving a 55% tariff increase at the end of November for the power sector and a 35% tariff increase for the water sector in December. However, the former (which followed earlier increases of 37% in January 1979 and 12% in August 1979), while reversing the trend of the past several years when tariff levels declined in real terms, was not sufficient to allow our power sector borrowers to earn a remuneration of 10% in 1979 as envisaged in the Brazilian power sector legislation and in the various agreements we have with Brazil covering our loans for the sector; the 35% increase for the water sector was also too late to have a significant impact on the state water companies financial position for the year, which for most companies was poor. Therefore, the financial position for the water sector as a whole deteriorated substantially in 1979.

22. As a result of the delays in approving adequate tariff increases for both sectors, there was not full compliance in 1979 with the revenue covenants in the Bank loan agreements. As regards the water supply sector, two increases of undertermined magnitude are planned in 1980, the first in February or March and the second in August or September. Regrettably, we have just learned that the draft supplemental letter to the negotiated documents for the proposed Southern States Water Supply Project (loan of US\$130 million to BNH which was to have been presented sometime in February), is now no longer acceptable to the Government because it sets forth specific rates of return which the project companies must achieve in 1980, 1981 and 1982 and the Government is now apparently unwilling to commit itself to specific rates of return. The Government has come back to us with a counterproposal which is now the subject of negotiation. I will brief you orally on the status of these on-going discussions prior to your meeting with the Ministers. As regards the power sector, we have been assured that positive steps to improve the situation will be continued in 1980. In this connection, it was agreed at the recent negotiations for the proposed CEEE (Rio Grande do Sul) Power Distribution Project, that we would receive formal assurances, as a condition for Board presentation, as follows: (i) that the companies will be authorized a remuneration of 10% in 1980, but if, due to exceptional circumstances (e.g., an actual inflation rate higher than assumed) such 10% remuneration is not achieved, the deficit in 1980 remuneration would be fully made up in 1981; and (ii) the accumulated year-end 1979 deficit in remuneration of our power sector borrowers (or beneficiaries) will be fully recovered in three years beginning in 1981, with at least one-third recovered by year-end 1981 and two thirds by year-end 1982. (Attachment 8 provides further details on the assurances to be given.)

23. You may wish to reiterate the importance we attach to full compliance with the revenue covenants in the Bank's loan agreements, and in this connection, to point out that our FY80 program includes three power loans aggregating about US\$300 million and two water supply loans aggregating US\$265 million -- about 60% of our expected FY80 lending program of US\$905 million.

Interest Rates

24. You may wish to refer again in your discussions with the Ministers on the problem of subsidized interest rates, and to the fact that this problem has inhibited our ability to disburse certain loans in the industrial and agricultural sectors, and prevents us from expanding our lending program into areas where a definite role could be played by the Bank (such as small-scale industry and, possibly, Brazil's fuel alcohol program). While Minister Delfim has announced his intention to eliminate agricultural credit subsidies in the future, and has taken certain measures to reduce them (see para. 27 below and para. 12 of Attachment 3), the level of subsidies remains very high. In the case of rural credit in the Northeast and the North (the areas of SUDENE and SUDAM, respectively), credit programs are even more heavily subsidized than elsewhere, with nominal interest rates of only 10%. You may in particular wish to note our disappointment that the changes in interest rate policy announced as a part of the recent economic package did not apply to POLONOR-DESTE (Northeast), for which we have a series of projects in the pipeline, including especially a loan of US\$135 million in FY81 for a Northeast agricultural credit project for small farmers.^{1/} You may wish to say that it is doubtful whether the Board would approve -- or that you would want to propose -- projects where Bank money is relent at 10% when the rate of inflation is over 70%.


25. Because of the disbursement problems which have resulted from the availability of competing credit lines at subsidized interest rates, we have cancelled, as of January 28, 1980, at the request of the Government, US\$50 million out of the US\$85 million loan made in February 1976 for the development banking project with BNDE (representing the approximate uncommitted balance of the loan). Likewise, it was agreed in recent meetings among Messrs. Lerda and Skillings and Minister Delfim, and ex-Minister Rischbieter, that the Government would request cancellation of the uncommitted balance of the US\$83 million loan made in 1976 for a second agro-industries project (about US\$73 million is expected to be cancelled). The US\$7.2 million credit component of our US\$19 million loan to INAN for the nutrition project likewise cannot be disbursed, and the Government has now requested that the amount allocated to this component be reallocated to other existing components, or possibly new components to be agreed with INAN. Minister Delfim is aware that any new application of funds not specifically provided for in the loan agreement would be subject to the approval of our Executive Directors.

26. Subsidized credit has become one of the most important and distinctive features of the Brazilian financial system. In 1978 the annualized flow of credit subsidies amounted to some US\$9 billion, equivalent to approximately 5.5% of GDP and 54% of federal revenues; over one-third of the outstanding balance of loans to the private sector was highly subsidized. These credit policies, in conjunction with the present capital market structure, contribute importantly to the current inflation, significantly distort resource allocation among borrowers, and weaken the conventional policy instruments for controlling the level of economic activity.

^{1/} I would like an opportunity to discuss the proposed Northeast credit project with you before the meeting.

27. The package of economic measures announced by the Government in December included a reformulation of the calculation of financial charges ostensibly intended to reduce credit subsidies, or at least to prevent them from growing automatically with the rate of inflation. Thus, henceforth, financial charges for administered credits are to be calculated as some fraction of the change in the ORTN index (the monetary correction index applied to government bonds) in the immediately preceding December-December period, plus a nominal interest rate ranging from 2% to 7%. Different types of credits will carry different correction factors and interest rates. For the period ending December 1979, the ORTN adjustment was 47.19% (compared with actual inflation of almost 80%), and the percentages of this figure to be applied to new credits range from 40% to 70%. Application of the above formula, therefore, will result in total financial charges ranging from 21% to 39% in 1980, which are still likely to be highly negative in real terms, and the level of subsidization will still depend on the rate of inflation. Adding to the uncertainty regarding the Government's intentions to reduce interest subsidies over time, Minister Delfim has recently announced that the ORTN adjustment for 1980 will not exceed 45%. As mentioned above, the areas of SUDENE (POLONORDESTE) and SUDAM are exempted from these measures, and nominal interest rates of 10% without monetary correction continue in these areas.

FEPASA

28. FEPASA, the Sao Paulo State Railway Company, is the beneficiary of a Bank loan (1171-BR) of US\$75 million of which US\$48.4 million had been disbursed as of February 6, 1980. The financial situation of FEPASA is unsatisfactory in spite of the fact that from administrative and management points of view, FEPASA has made good progress in the past two years. The major causes of the company's present financial situation is the failure of the Sao Paulo State Government to: 

- i) provide the "normalization" payments to compensate the railroad for economically justified, but financially unprofitable service such as the suburban passenger services;
- ii) reimburse the railroad for persons still on its payroll who are state government employees but who are not working at FEPASA;
- iii) provide the local counterpart funds needed to carry out the project in a timely manner; and
- iv) deal with FEPASA's excessive debt burden.

For these reasons, FEPASA has had to resort to very costly, short-term commercial bank financing.

29. Following the recommendation of the Problem Projects Review in December, Mr. Lerdaun informed Minister Delfim Netto in a meeting in Brasilia in January of 1980 that the Bank would be forced to suspend disbursements unless a satisfactory solution to FEPASA's financial problems would be found soon.

February 14, 1980

Minister Delfim said that he wished to avoid the suspension of disbursements if possible, and asked for a little more time to resolve the problem. We understand that Minister Delfim intends to raise the matter with you, and that he may be bringing plans with him for FEPASA's recapitalization. You may wish to reiterate the difficulty we would have in continuing disbursements unless the problem is resolved.

Attachments

cc: Messrs. Stern
Lerdau, LC2
van der Meer, LCP
Pfeffermann, LCNVP
Levy, LC2
Skillings, LC2 (o/r)
Koromzay, LC2

DKoromzay:nps/nev/smn

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OFFICE MEMORANDUM

TO: Memorandum for Record

DATE: October 29, 1980

FROM: Robert F. Skillings, Division Chief, LAC II

SUBJECT: Mr. McNamara's Meeting with Brazilian Delegation

1. Mr. McNamara met with the Brazilian delegation to the Annual Meeting at 9:00 a.m., Monday, September 29. Present on the Brazilian side were the Minister of Finance, Ernane Galveas; the President of the Central Bank, Carlos Langoni; the Secretary General of the Secretariat of Planning in the Presidency, Jose Flavio Pecora; the Secretary of SUBIN, Minister Jose Botafogo Goncalves; and the Director of the External Area of the Central Bank, Carlos Serrano. Present for the Bank were Messrs. Stern, Ardito Barletta, Lerda, Koch-Weser and Skillings.

2. The discussion was entirely devoted to the current economic situation. The Minister of Finance referred to the continuing deficit in Brazil's balance of payments, but said it was being reduced a little as a result of better control over imports. The rate of expansion of exports was very fast -- the highest in the world. Total exports in January - August 1980 were 32% higher than in 1979 (in dollar terms, apparently) and the rate of expansion of manufactured exports was 40%. Petroleum imports would amount to \$10 billion this year, offset to a small extent by exports of gasoline which, however, was now difficult to sell in the world market. Non-petroleum imports were higher than expected, and therefore there would be a deficit of around \$2 million in the trade account in 1980. To the extent possible imports were being financed on credit -- up to 7 years. The volume of import licenses issued by CACEX had been reduced in real terms. Petroleum imports, which had been coming in at the rate of \$1 billion per month from January to May had fallen to \$800 million a month. In 1981 the intention was to keep oil imports at no more than \$700 - \$800 million a month. There would be a deficit on interest and other service payments of \$9 billion in 1980, bringing the current account deficit to \$11 billion. Total financing requirements (apparently, net of \$7 billion of amortization payments) were \$12 billion in 1980, of which \$8.5 billion had been borrowed up to September 15.

3. The Minister felt that borrowing performance had been satisfactory given the fact that the market had been virtually closed from January to March 1980 -- while the Government coped with rumors in the market of further devaluation. The Minister felt that there would be no liquidity problem to the end of 1980. He said, however, that inflation continued to be a serious problem. He expected that by the end of the year the wholesale price increase would have reached 100% (January to December) and the cost of living 80%. The general price index was somewhere in between (the general price index is weighted to the extent of 60% by the wholesale price index, 30% by the cost of living index, and 10% by an index of construction prices).

4. The Minister said that prices were "resisting" strenuous government efforts to restrict aggregate demand. The central government budget

October 29, 1980

for 1981, now sent to Congress, would show a surplus. The expenditures of public enterprise were the main source of disequilibrium. Mr. McNamara commented that this was evidence of poor central control. The Minister acknowledged this but said that Minister Delfim Netto was now firmly decided to restrain the expenditures of the more than 500 public companies. All of them were now required to present their budgets for approval to the Planning Secretariat and were not allowed to initiate new plans if funds were not available. Some projects being discussed with the Bank might have to be postponed and many others put on the shelf. Priority would be given to projects which would help the balance of payments. Several of these would bear fruit soon. For example, imports of steel formerly amounted to \$1.7 billion a year. Now there was an export balance. Brazil also was exporting \$400 million a year of pulp and paper. The capital goods industry, which had excess capacity, was also exporting well.

5. The Minister described the steps being taken to tighten fiscal and monetary policy. Collections on the corporate income tax had been advanced. There was a 45% limit on types of credit amounting to about half of the commercial banks' lending. The other half was not restricted, in order to encourage the banks to borrow abroad. The Government was giving priority in allocating credit to exporters and to agriculture. The Banco do Brasil was being tightly controlled and interest rates were being increased. A 15% tax on imports and a 6.9% tax on credit had been introduced, the funds thus derived being used to cover subsidies. One-year treasury bills were now yielding 45 - 46%. Ceilings of 40% on devaluation and 45% on monetary correction had been instituted in an effort to brake inflationary expectations. Actual movements had been a little greater, and higher adjustments were planned in 1981. For January 1981 monetary correction was fixed at 45%, or 69% on an annual basis. It was expected that in 1981 inflation would amount to 60%, as measured by the cost of living index, down from 80% in 1980.

6. Mr. McNamara expressed concern about the strongly negative interest rates being applied in many official credit programs which were adversely affecting some of the programs which the Bank was financing. Mr. Langoni said that the Government was gradually moving to raise interest rates to a more realistic level. In agriculture they had moved from a fixed nominal interest rate to a system with monetary correction. Unfortunately this had been accompanied by an increase in the rate of inflation so that the real interest rates charged were even more negative than before. The Government hoped, however, to eliminate gradually the subsidy on agricultural credit over the next two years, by raising the level of monetary correction, at the same time bringing down the rate of inflation.

7. Mr. Langoni was hopeful that the restrictive monetary and fiscal policies applied in 1980 were about to give good results. Up to July there was a fiscal surplus of Cr\$100 billion, compared to only Cr\$2 billion in the 1979 period. The rate of expansion of the money supply had declined from 84% in May to 70% in September and he expected it would be reduced

October 29, 1980

further, to 60%, by the end of the year. Agricultural credit in the Northeast, where a fixed rate is still applied on some programs, amounted to only 10% of total agricultural credit [the implication being that this was not a serious problem for monetary management].

cc: Mr. McNamara's Office (3)
Mr. Stern
Mr. Ardito Barletta
Mr. van der Meer
Mr. Lerda
Mr. Pfeiffermann
Mr. Levy
Brazil Division

RFSkillings:glw

OFFICE OF THE PRESIDENT

Meeting with Dom Helder Camara, Bishop of Recife, Brazil, December 10, 1980

Present: Mr. McNamara, Dom Helder Camara, Messrs. Wright, Presbyterian Minister, Thomas Quigley, Latin American Adviser for U.S. Catholic Conference, Barletta

Dom Helder expressed his greatest confidence in the work and efforts of Mr. McNamara in front of the very complex problems which have to be addressed. He said that he is not an expert, but rather a shepherd. He added that he has read a number of Mr. McNamara's speeches and several Bank reports and he expressed his admiration, telling Mr. McNamara that his greatest merit has been to change the Bank to address the poverty issue in the world. He said, however, that he had the impression that perhaps the concern with poverty should be balanced with the realization that it is not possible to obtain everything at the same time. Some times there can be too much demand on governments and this may help the authoritarian governments, dictatorships, in spite of the best of intentions. He added that, in Latin America in particular, the actions of the World Bank can be easily exploited against the movements of workers, students and others. He said that today the Church has a human duty and it has to denounce the injustices and to encourage the promotion of the human being. He concluded on this point by expressing his greatest concern with the problem of ensuring stable governments.

Mr. McNamara said that one of the problems which the Bank has to face is that it cannot act against established governments. There is the well-known argument that the money which the Bank lends to Brazil may be strengthening the Government. He expressed that there are several situations around the world which are much worse than Brazil's situation, e.g., the strong criticism expressed to the Bank for lending to Chile's Pinochet Government. He reaffirmed, however, that the Bank is not allowed to get into politics. The major question, he said, is whether the Bank should withhold its money to those countries, when it helps the poor even though it may also help the rich. Dom Helder said that he understood this argument but, in so many instances, the money may be used in a manner very different from what it is intended for. Mr. McNamara said that, if this were the case, the Bank does have the means of controlling and correcting the final use of the funds it lends to the government.

Dom Helder then raised another problem which is that of the relationship with developed countries. He mentioned the argument that one of the reasons for financing the developing countries is because the developed countries are afraid of the population bomb. He mentioned instances where the Bank could be accused of financing projects where there is sterilization of women against their will. He added that the Church understands the problem of families very clearly, and it must face this difficult problem. Mr. McNamara commented that, if indeed there were occasions where the Bank would be supporting involuntary sterilization of women, it would be very wrong.

Dom Helder turned to the problem of the financial situation of Brazil which he described as very bad. He mentioned that the rate of inflation is now more than 100% annually, in spite of the fact that the country's economy is run by an authoritarian regime. He mentioned that the Bank is helping finance the development of an alcohol program, meant to alleviate the problem of high oil-import bills. He said, however, that he did not agree with the policy of international competitive bidding in the alcohol industry and in other sectors which he said basically favors multinational corporations. He further added that, in general, the Government leads the country more and more into the hands of the multinationals and into increased dependence on high technology. He said that moral pressures must bring changes in this situation. He also said that his impression is

that the Bank could be accused of helping create wealth for very small groups of people by increasing poverty for extremely large groups of population. Mr. McNamara said that he disagreed with what the Bishop had said, since he did not believe that the economic work which the Bank helps finance supports the existing political structure. He explained that in fact, in his view, it is the opposite which happens. He emphasized that the Bank's policy is to raise the productivity of the poor and to ensure that they have appropriate access to basic services. He argued that, in this process, they acquire political strength which they did not have before. On the issue of international competitive bidding, Mr. McNamara explained that ICB is designed not to strengthen the multinationals, but rather to ensure that a country can get the required equipment at the lowest possible price. He then said that, on high technology, he agreed with Dom Helder. He argued that technology should be labor-intensive rather than capital-intensive. He mentioned that, when he visited Recife some ten years ago, SUDENE was helping finance some industrialization programs with the fiscal incentive program. He said that he had looked at the capital cost per job created, which was extremely high, at about \$80,000. The result is that it produced very few jobs, and the reason for this was because the cost of the capital was extremely low, in view of the high amounts of subsidies.

Dom Helder then said that, when he thinks of structural changes, it is not only political changes which he has in mind. He reaffirmed his impression that the Bank may contribute towards creating wealth only to very small groups. Mr. McNamara repeated that this is exactly what the Bank tries to avoid. He told Dom Helder that one-third of the Bank's lending program is for agriculture and rural development projects designed to benefit the low-income groups in the various countries.

Dom Helder then told Mr. McNamara that he should continue his good work and he said that the developing countries needed his collaboration. He concluded by reminding Mr. McNamara that people are human beings before being experts.

cc: Mr. Barletta

OL
December 19, 1980

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
(through Mr. Ernest Stern) *ES*

DATE: December 9, 1980

FROM: Nicolas Ardito Barletta *NAB*SUBJECT: BRAZIL - Visit of Dom Helder Camara

1. Dom Helder Camara, Archbishop of Olinda and Recife, will be calling on you tomorrow (Wednesday) at 5:30 p.m. for a courtesy visit. He is in the U.S. on a 10-day tour at the invitation of the Disarmament Program of the Riverside Church. He spoke at an evening for peace in New York along with Olaf Palme, Studs Terkel, and others, and will be in Washington for Human Rights Day (Wednesday, December 10). We understand his main purpose in meeting with you would be to discuss the broad field of social and economic development.

2. Dom Helder, 71 years old, is one of the foremost churchmen of Latin America. He has been an outspoken champion of social justice and the cause of the poor. Among other social mobilization efforts, he formed grass-roots organizations known as Ecclesiastical Base Communities which carry out self-help work in urban and rural areas. Denied press coverage during part of the 1970s, he returned to national prominence last summer when the Pope met with him in Recife. He has been honored with Norway's People's Peace Prize and an honorary doctorate from Harvard.

3. The Archbishop has received several Bank staff members in recent months in Recife for discussions on rural and urban poverty programs. He is committed to the local community unit as the means for change. He has expressed admiration for the Bank's antipoverty policies, but has complained of local political interference in the execution of Bank projects in Recife.

4. Dom Helder will be accompanied by Reverend Jim Wright, a Brazilian minister supported by New York Presbyterians, who may help in interpreting. The Archbishop's English is reputed to be very good, though.

DMBovet:smn

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OFFICE MEMORANDUM

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TO: Mr. Robert S. McNamara
(through: Mr. Ernest Stern) *ED*
FROM: Nicolas Ardito Barletta *AB*

DATE: February 20, 1981
*Outline for Feb 24 by*SUBJECT: BRAZIL - Visit of Minister of Finance Galveas

1. The Brazilian Minister of Finance, Mr. Ernane Galveas, is coming to see you on February 24. He has told members of our staff that there are no special points he wishes to raise with you, but that he would be glad to talk about Brazil's current economic situation. We do not have any particular points that we suggest that you raise with him.

2. Since November, the Government has turned from policies for controlling inflation by tampering with the symptoms, to more fundamental control measures. These more recent policy changes are described in the attached memorandum from Mr. Sweeney. They include:

- (a) declaration of exchange rate adjustments;
- (b) removal of the artificial limit on domestic monetary correction;
- (c) increasingly tight control over public expenditures and monetary expansion; and
- (d) the freeing of interest rates by the commercial banks.

Interest rates charged on industrial credit by official lending institutions have been increased, but there are still heavy subsidies on agricultural credit. These, together with the liberal wage policy and the fiscal deficit, are probably the main reasons for the continuing high rate of inflation (110% in 1980). The Government, nevertheless, expects that the rate of inflation will soon start coming down as a result of its tighter fiscal and monetary policies.

what are these

3. The campaign by the international banking community urging Brazil to go to the IMF is continuing and, although we have no direct knowledge of this, it is possible that the main purpose of Minister Galveas' visit to Washington is to hold discussions with the IMF.

4. We expect to be able to make lending commitments of over \$800 million to Brazil in FY81, assuming approval of the \$90 million Urban Transport loan just negotiated, a \$175 million Water Supply and Sewerage loan for which negotiations will start on February 23, a loan of up to \$250 million for fuel alcohol, which we expect to negotiate in March, and loans of \$55 million for agricultural research and \$25 million for rural development toward the end of the fiscal year.

5. If Brazil were to reach agreement on an extended facility from the IMF, the stage could be set for a structural adjustment loan from

Mr. Robert S. McNamara

- 2 -

February 20, 1981

the Bank. A possible alternative, which might go forward even if an SAL is not possible, is a sector loan for financing Brazil's export drive. Attached is a memorandum which I have addressed to Mr. Stern on this subject.

Attachments

cc: Messrs. Lerdau, LAC II
van der Meer, LACP
Skillings, LAC II

RFSkillings:glw

OFFICE MEMORANDUM

TO: Mr. Nicolas Ardito Barletta
(through Messrs. Lerdau and Skillings, LC2)

DATE: January 26, 1981

FROM: Jack Sweeney, LC2DA

SUBJECT: BRAZIL - Further Announcements on Brazilian Economic Policies for 1981

1. In December the Brazilian National Monetary Council (CMN) approved a series of measures intended to strengthen monetary policy, reduce somewhat the credit subsidies to agriculture, and improve the balance of payments. These measures reinforce the policy changes announced in November eliminating the ceilings on exchange rate adjustment and monetary correction, liberalizing interest rate policies for commercial banks, and relaxing price controls. There are some important differences in the announced interest rates and those described in Fred Levy's December 12 memorandum to you based upon information which Brazilian authorities had given him at that time. These are described below (para. 6).

Monetary Budget

2. Increases in the money supply and the monetary base are to be limited to 50% in 1981 ^{1/}. The total expansion of credit by each official and private financial institution as well as the Bank of Brazil is limited to 50%. Excluded from these limits, however, are production credits for agriculture and export industries, and commercial and investment bank operations which repossess funds borrowed abroad or obtained under current government programs from official financing institutions. Also excluded are loans for social and low-income projects by the National Housing Bank and the Federal Savings System (Caixa Economica Federal) and loans to rural cooperatives where at least 70% of the members are small producers. Including the projected impact of these exclusions, the expansion of internal credit is expected to total 56%.

3. Commerce and industry were the sectors most constrained by the credit limits in effect in 1980, although given their growth rates in that year, financing from other sources probably helped to offset those limits. The impact on Brazilian producers in 1981 will be softened by the fact that financial institutions are now required to channel 70% of their loans to Brazilian nationals and companies as compared with 60% previously. (This does not include the relending of funds borrowed abroad.) Until reaching this average level banks must channel at least 80% of their new lending to Brazilian borrowers. Small and medium industries will receive preferential treatment both in terms of favorable interest rates (40-45%) and an increased share of lending from small- and medium-sized commercial banks beginning in March 1981. Clearly, multinational companies will have to depend more heavily on external financing to meet their needs.

^{1/} This compares to similar targeted increases of 50% for the money supply and the monetary base in the 1980 Monetary Budget. Although we do not yet have final figures for the year, both of these targets probably were exceeded by a large amount. Between November 1979 and November 1980 the money supply expanded by 74% and the monetary base by 73%. Nonetheless, monetary policy has been contractionary as these figures are well below inflation.

4. In order to help reduce the expansionary impact of those categories of credit excluded from the overall limits (para. 2) in the Monetary Budget, in addition to higher interest rates and the increased role of commercial banks in the agricultural sector (para. 6), direct subsidies for petroleum and wheat consumption are to be "drastically" reduced. Also, the Federal Savings System is expected to deposit Cr\$100 billion into the Central Bank to be used for credits to the export sector and the Bank of Brazil is expected to absorb Cr\$80 billion in liquidity through the sale of certificates of deposit (recibos de depositos bancarios).

Fiscal Management

5. Further steps have been taken to rationalize public sector budgeting and control. Beginning in 1981, the Treasury budget will include transfers to the minimum price support program, buffer stock financing and the budgets of the Cocoa Commission (CEPLAC) and the Coffee Institute (IBG), which were formally handled through the Monetary Budget. (Outlays for public debt service, the wheat subsidy, and certain other consumer subsidies were included in the Treasury accounts for the first time in 1980.) Commercial banks can no longer renew credits, guarantees, or leasing agreements for state enterprises, autarkies, and state and local governments without prior approval from the Planning Ministry (excluding the relending of funds borrowed abroad). These measures further strengthen the control of the Planning Ministry over public spending and decrease the development banking responsibilities of the Central Bank.

Interest Rates

6. Interest rates on agricultural production credits (custeio) have been raised to 35% in the North and Northeast, and 45% in the rest of the country as compared to an average of 27% and 30%, respectively in 1980. However, interest rates for POLONORDESTE and POLOAMAZONIA will be increased only from 10% to 12% (and not to 25% as the Brazilians had previously indicated). Under the new guidelines, small farmers can borrow up to 100% of the financing they need for production, investment and premarketing, while medium- and large-scale farmers will be limited to 80% and 60% respectively. Previously all farmers were eligible for 100% financing at the official rates. The effective interest rate will thus be somewhat higher than the official rate for medium and large farmers, and the demand for credit should consequently be somewhat more restrained than in 1979 and 1980, assuming no further acceleration of inflationary expectations. A larger proportion of the credit is to be provided by commercial banks (rather than the Central Bank or Bank of Brazil) as a consequence of an increase of the proportion of demand deposits they are required to direct to agriculture from 15% to 20%. This should also serve to reduce slightly the monetary impact of agricultural credit.

7. Interest charges under PROALCOOL were increased from 25% to 45% in the Northeast and from 25% to 55% in other regions. Most credits for marketing and investment activities as well as for the purchase of chemical and mineral fertilizers, which were heavily subsidized in the past, are henceforth to carry market interest rates. It was also announced that interest rates on loans for the production of manufactured exports would be raised to 35% as compared to 24% previously.

8. Even with the increase in nominal interest rates, agricultural credit subsidies will continue to be very high and sensitively related to the rate of inflation. A calculation of how the proposed changes would affect real interest rates under different inflation assumptions is shown in the table attached at the end of the memorandum.

Balance-of-Payments Measures

9. The financial operations tax on imports has been raised from 15% to 25%. In addition, no state enterprise is to be allowed to import more this year than in 1980. The CMN announced special fiscal incentives (reduction in taxes on remittances abroad and purchases of foreign exchange) for "leasing" (as opposed to purchasing) foreign capital goods. This resolution goes into effect immediately. Liberalized regulations for foreign exchange contracts with exporters (allowing them to make such contracts up until 10 days after shipment) were also announced, effective May 1, 1981.

Price and Tax Increases

10. The Special Secretariat for Supply and Prices (SEAP) also announced price increases for a number of products, effective in January. These included (with average % rises in parentheses) telephone services (25%), beef (8%), bread (18%), milk (13%), and cigarettes (40%). Tariffs for water and sewerage services will also be elevated in some states during January, although details were not specified. Additionally, the Interministerial Council on Pricing (CIP) announced that prices for tractors, highway building equipment, motors, auto parts, and smelted and foundry products would be freed from its control.

11. The highway tax on new automobiles was raised by 55% to between US\$210 and US\$610 (at the current exchange rate), depending upon the size of the engine. However, this levy was reduced by 5% for alcohol-powered cars which will continue to receive preferential tax treatment so as to stimulate their increased use.

Conclusions

12. We do not yet have sufficient detail from the monetary budget for 1981 to judge its consistency with our macroeconomic and balance-of-payments projections and its potential impact on inflation. The steps taken are generally in the right direction. The movement toward more market-determined interest rates in the commercial sector should help draw deposits back into the formal banking system, thereby reducing the availability of credit from sources outside of the control of the monetary authorities. The transfer of additional items from the monetary budget to the treasury budget may also enhance control over public sector expenditures. Although the Government's indicated intention of adjusting official interest rates semi-annually with a view to reducing the implicit subsidy should eventually help to restrain the demand for official credit, it is likely to remain high because of continuing negative real interest rates. This continues to be a major problem of macroeconomic management.

13. The announced balance-of-payments measures represent a double-pronged effort to strengthen the trade account. Increased availability of credit to the export sector is intended to help promote a continued rapid expansion of manufactured exports which is critical to reducing the country's debt servicing problems over the next few years. The actions taken to constrain imports are less auspicious, because they add to already high barriers. While they may provide temporary balance-of-payments relief, maintaining them for an extended period of time could contribute to increased distortions in resource allocation and generally reduce the international competitiveness of the industrial sector.

cc: Messrs. Levy, LC2
Carter, LC2
Senner, LCP
Crowe, LCP
Gelb, DRC
Brazil Division

PROPOSED CHANGES IN INTEREST RATES^{a/}

Credit Program	Current Average Interest Rates-% ^{b/}		Proposed Interest Rates-% ^{c/}		Estimated Average Implied Real Interest Rates-%					
					1980		1981		1981	
	North-Northeast	Other Regions	North-Northeast	Other Regions	(90% Inflation) North-Northeast	(90% Inflation) Other Regions	(90% Inflation) North-Northeast	(90% Inflation) Other Regions	(70% Inflation) North-Northeast	(70% Inflation) Other Regions
Agricultural production credits <u>d/</u>	27	30	35	45	-33	-32	-29	-24	-21	-15
Agricultural investment and marketing <u>d/</u>	30	33	57	63	-32	-30	-17	-14	-8	-4
POLONORDESTE production credits	10	n.a.	12	n.a.	-42	n.a.	-41	n.a.	-34	n.a.
Financing for production of manufactured exports	24	24	35	35	-35	-35	-29	-29	-21	-21
PROALCOL <u>d/</u>	22	25	45	55	-36	-34	-24	-18	-15	-9

a/ Deflation of nominal interest rates was calculated using December - December inflation figures whereas average monthly rates of inflation would be more appropriate. In either case real interest rates would remain negative.

b/ Arithmetic average of rates charged small, medium and large producers.


c/ These are nominal rates charged on official credits. In the case of agricultural credits the effective cost of borrowing for medium- and large-scale producers will be greater because of the increased contribution of their own funds. As noted in the text whereas small farmers can obtain 100% of the funds they require, medium- and large-scale farmers (on the basis of income) are limited to 80% and 60% of their requirements respectively.

d/ Interest rates for these activities in 1980 were tied to movements in the ORTN index but in effect were fixed in nominal terms in view of the prefixation of the ORTN index. Under the new system they will be fixed formally at specified nominal levels.

OFFICE MEMORANDUM

TO: Mr. Ernest Stern

DATE: February 20, 1981

FROM: Nicolas Ardito Barletta SUBJECT: BRAZIL - Possible Loan for Import/Export Sector

1. We have now held preliminary discussions with the Brazilian Government about a possible import/export sector loan along the lines set out in my memorandum of November 11, 1980, and subsequent discussions with you. Briefly, the foreign exchange proceeds of the loan would finance the import content of manufactured exports, while the cruzeiro counterpart would be used to help finance Brazil's program of export credits for capital goods and construction and consultancy services. It would be a sine qua non to obtain policy commitments on interest rate policy, an exchange rate policy that assures the competitiveness of exports, and on steps to reduce and rationalize trade barriers. The Brazilians reacted positively to the idea of the loan, and we have, therefore, defined the package a little more precisely. I would like to have your reaction before we undertake the more detailed work and policy discussions that would be necessary to put the project together.

2. I would like to note, however, that, as you will recall, the present scheme arose out of discussions of what sort of special action might be appropriate for the Bank in the present situation, on the assumption that a Brazil-Fund EFF Agreement was not possible. As time goes on, this assumption is becoming more questionable. I see at least a possibility of an agreement with the Fund. In that case, an SAL would probably be preferable to the scheme outlined in this memo; I would think, however, that in that case we have to think in even larger numbers, say US\$2 billion. In the meantime, however, I would like to pursue the scheme already discussed with you, and the remainder of this memo is devoted to the subject.

Present Policies and Loan Objectives

3. For two decades after World War II Brazil pursued a strategy of industrialization through import substitution. This was followed by a period of trade liberalization which lasted until 1973, when protection levels were raised in response to balance-of-payments pressures. At that time the country was still in the midst of an extraordinary economic expansion which had begun in 1967. In an effort to maintain a high growth rate despite the sharp deterioration of the terms of trade, the authorities resorted to tightened import controls and increased external borrowing to close the resource gap. One result was an acceleration of inflation. In the second half of the decade a somewhat overvalued cruzeiro, combined with generous fiscal and credit subsidies, created increasing distortions of resource allocation in the economy.

4. The Brazilian authorities have repeatedly indicated a desire to move toward a more open system over the past two years but have stated that they were inhibited by short-term economic difficulties. In January

1979 a program was announced for the gradual elimination of tax rebates to exporters and the prior requirement for imports, compensated by an acceleration of the crawling peg. Further immediate liberalization was prevented by a sharp reduction in agricultural exports and a rise in agricultural imports, which resulted from declines in domestic harvests, and by another large rise in petroleum prices. However, in December a 30% devaluation of the cruzeiro, prompted by the deteriorating balance of payments, made possible the elimination of certain tariff exemption schemes and the immediate phase-out of the excess rebate to exporters as well as the prior deposit requirement.

5. These measures were potentially an important step toward opening the economy, but in January 1980, the need to reduce inflation had become an overriding priority, and as part of a package to reduce inflationary expectations, it was announced that the rate of devaluation for the year would be limited to 40%. As balance-of-payments pressures mounted, a 15% tax was levied on purchases of foreign exchange for imports, and ceilings were placed on imports by public sector entities. At mid-year the Government renewed its commitment to limit devaluation for the ensuing twelve-month period, despite the real appreciation of the cruzeiro that was occurring.

6. Although exports continued to grow, it was clear by mid-1980 that the overall strategy to control inflation was not working, and that its continuation could begin to impede exports. Beginning in November, then, the prior policy of relating the pace of devaluation to the difference between Brazilian inflation and that of its major trading partners was restored. In December, in a further effort to restrict imports, the tax on purchases of foreign exchange for imports was elevated from 15% to 25%.

7. The pattern of incentive and exchange rate policies which Brazil has followed in recent years has not been compatible with the longer term goals of strengthening the competitiveness of the industrial sector and promoting sustained export growth. The desired move toward liberalization has continually been undercut by the tendency to meet short-term economic problems with ad hoc market interventions. This tendency will be difficult to repress in the face of ongoing balance-of-payments pressures. Brazil needs to make fundamental policy adjustments to assure the long-term competitiveness of its economy. At the same time, with imports already tightly constrained, Brazil's ability to maintain external creditworthiness, while sustaining a reasonable rate of economic growth, depends crucially on the continued rapid expansion of manufactured exports.

The Proposed Loan

8. The Bank could be of material assistance to Brazil in resolving the conflict between its long-term development objectives and the short-term policies perceived necessary for coping with its short-run difficulties. With regard to the immediate balance-of-payments problem, the proposed loan would contribute to the expansion of exports directly by: (a) helping to finance imports of components and materials necessary for the production of goods that will subsequently be exported; and (b) helping to finance Brazilian exports of capital goods and construction and consultancy services. The foreign exchange derived from the loan would be applied to

the imports described in (a) above. The cruzeiro counterpart, generated by sales of foreign exchange to importers, would be lent to the providers of the goods and services described in (b) above, in order to enable them to extend credit terms to their foreign customers. The loan would be contingent, however, on policy adjustments with regard to the exchange rate, the trade regime and credit and fiscal incentives consistent with greater longer term industrial efficiency.^{1/}

9. What is proposed is a loan of US\$1.5 billion, made in three tranches approximately one year apart, each of them subject to progress in achieving the agreed policy adjustments, and each subject to the approval of the Executive Directors. Approximately half of this amount would replace loans in the existing lending program with chiefly resource-transfer characteristics, while the other half would be additional. This would mean lending about US\$1.52 billion in FY82, instead of the US\$1.02 billion now programmed.

The Policy Package

10. First Tranche. The first tranche of the loan would be conditioned on an agreement with the Government on: (a) a statement of objectives with respect to the rationalization of domestic incentive policies and the opening of the economy to world market forces; (b) terms of reference for a study, financed under the loan, of trade protection, and the fiscal and financial subsidies affecting resource allocations in the industrial sector; (c) a commitment to preserve the competitiveness of Brazilian exports by not allowing the real value of the cruzeiro (as measured by specified price indices) to appreciate above a specified ceiling for more than a certain number of consecutive months or from one quarterly average value to the next ^{2/} (as noted above, Brazilian authorities announced at the end of 1980 that henceforth the exchange rate will be adjusted in line with the difference between domestic and external inflation); (d) an obligation to review the agreed exchange rate ceiling if deemed necessary by the Bank in light of balance-of-payments developments; and (e) some immediate concrete action to reduce industrial protection and/or rationalize industrial incentives -- e.g., modification of the present heavy subsidy on export production credit (see para. 17 below). Although this subsidy probably could not be phased out all at once, Minister Delfim has already indicated he might be prepared to modify the terms of this credit with principal adjusted in line with exchange rate movements plus a small nominal interest rate.

^{1/} Were Brazil to undertake even broader changes in economic management to bring down the rate of inflation substantially and improve credit and pricing policies especially in agriculture, a somewhat larger structural adjustment loan, stretching over a longer period and with greater additionality, might be more appropriate. The Government's willingness or ability to make these more drastic changes is not yet in sight, however, and for the time being a more limited import-export sector approach seems appropriate.

^{2/} Details would be worked out in consultation with the IMF.

This would be a major improvement. Action on the other types of industrial credit does not appear to be necessary at present.^{1/}

11. Second Tranche. The second tranche would only be presented to the Board once: (a) an agreed program were prepared for gradual trade liberalization and incentive rationalization on the basis of the findings of the first-tranche study. ^{2/} (This program would contain a schedule for tariff reductions and an evening out of the structure of effective protection, perhaps over a three to five year period. It would also include the reduction of existing non-tariff import barriers, including the financial operations tax on imports, and a commitment not to replace them with others); (b) a timetable was agreed for reducing credit subsidies to exporters (and a commitment that no new interest rate subsidies would be introduced in the industrial sector) and for the reduction of fiscal incentives for industrial export promotion and investment; (c) specified first-phase measures were taken in accordance with the agreed programs; and (d) a new exchange rate commitment were undertaken in light of the balance-of-payments developments and measures taken during the first tranche period.

12. Third Tranche. Before sending the third tranche to the Board, the Bank would undertake a review of progress under the second-tranche programs to confirm that the country was adhering to the agreed measures and timetables on tariff and non-tariff barriers, credit subsidies and fiscal incentives and that no new protective practices had been introduced. Presentation of the third tranche for Board approval would be delayed until shortfalls, if any, had been overcome. The exchange rate commitment would also be renewed, incorporating any change in the agreed ceiling rate deemed appropriate in the light of balance-of-payments developments and the policy changes effected.

Loan Mechanism

13. Financing of Import - Content of Exports. Insofar as possible, the loan would be managed through mechanisms already existing in the Brazilian system. As regards the identification of imported components

^{1/} Most longer term industrial credit is provided by the National Development Bank (BNDE) and its associated institutions whose purpose is to encourage the development and diversification of the manufacturing industry and promote industrial decentralization. With the exception of a few special programs such as the alcohol program, official lending to the industrial sector now carries full monetary correction plus a small nominal interest rate. This appears adequate provided that the Government carries out its intention, recently announced, of bringing monetary correction into line with movements in the consumer price index.

^{2/} The Government could be working on this program while the study is in progress, and it should be fairly well developed by the time the study is completed.

and materials to be financed, use can be made of the screening mechanism which already exists in a "drawback" system, under which importers are able to bring components and materials into the country without payment of duty on condition that they be incorporated into the manufacture of goods that will subsequently be exported. Alternatively -- or additionally -- use might be made of the "BEFLEX" system, whereby industrial projects -- either new projects or expansion of existing ones -- are allowed to import equipment, materials, components, and spare parts duty free, and also to enjoy an income tax holiday of up to 10 years, on the portion of their profits derived from exports, on condition that an agreed proportion of their output would be exported.^{1/} It would be a relatively simple extension of the present BEFLEX program to provide documentation necessary for the disbursement of a loan for imported components and materials entering through exports. Whatever systems for disbursing the loan is chosen, we would establish a system of monitoring (through the documentation to be submitted with withdrawal applications and records to be reviewed by supervision missions) to ensure that our funds were being used for their intended purpose.

14. The Minister of Planning has suggested that a simpler method of disbursing the loan would be to estimate the proportion of various imported materials which go into the manufacture of goods that are later exported: e.g., x% of copper imports, y% of lead imports, etc. It would be difficult, however, to make reliable estimates of those percentages -- the only input-output table that exists for the Brazilian economy was prepared in 1975 on the basis of 1970 data, and is not sufficiently disaggregated for the purpose which we would want to put it. Thus, the Bank could not be as certain as under the other mechanisms proposed that the proceeds of the loan would be used in the manner intended.

15. Further field work would be necessary to decide the relative merits of using the drawback or BEFLEX mechanisms and to determine whether some modification of them might be necessary for our purposes. In either case care would have to be taken to avoid a system in which the Bank loan would merely replace existing foreign commercial bank financing, which the Brazilian Government is at present encouraging importers to employ whenever possible. This problem could be overcome by linking disbursements from the loan to reimbursement of the short-term commercial bank credit that finances initial imports.

^{1/} Under the BEFLEX system, about US\$500 million of equipment, components, and materials were imported in 1980, and on the basis of recently approved new agreements, this amount is expected to increase over the next few years. The BEFLEX program is sometimes thought to benefit mainly multinational companies. In fact, of the 89 BEFLEX agreements approved up to November 1980, 51 were with Brazilian-owned companies and 38 multinational companies, although the aggregate of investments (and probably imports) of the multinational companies was somewhat greater than the investments of the Brazilian-owned enterprises. Since no lending of Bank resources to BEFLEX beneficiaries is involved, there should be no objection to our working through this mechanism. However, the Government may have image-related concerns nevertheless.

16. Financing of Capital Goods Exports. The cruzeiro proceeds from the sale of foreign exchange to importers would be placed in a special fund to be used for loans to exporters of capital goods and construction and consultancy services, who are required to extend credit terms to their foreign customers in order to be competitive with exporters from other capital goods producing countries. Brazil already possesses a mechanism for financing such exports, the Fundo de Financiamento da Exportacao (FINEX), managed by the foreign trade department of the Bank of Brazil (CACEX). The mechanism of this fund has not so far been studied in detail. Our objective would be to supplement Brazil's own resources and those of foreign commercial banks now employed in export financing. The value of exports of capital goods and services is believed to be in excess of US\$1.5 billion per annum. It would be the intention to arrange that the Bank's funds revolve several times during the 15-year life of the loan. At present, capital goods are being financed with a maturity of up to eight years (or even longer in special cases). One possibility would be for the counterpart of the Bank loan to finance, say, the first four years of these maturities, with Brazilian resources financing later maturities. As in the case of the import financing referred to in paras. 13 and 15 above, further detailed investigation of the mechanics of the system would be necessary. At present Brazil's export credits bear interest at 7-1/2% or 8%, with the difference between this and the market cost of money paid by FINEX to the lending institution as a subsidy. It would be difficult to alter this system if Brazilian exports are to be offered on competitive terms.

17. Financing the Production Cycle of Exports. Brazil's present mechanism for financing the expansion of manufactured exports includes a special production credit scheme operated by the Central Bank and CACEX. Under this scheme, firms engaged in production for export may borrow a large proportion of the production costs of the exports for periods of up to 360 days and at a highly subsidized interest rate (24% per annum without monetary correction until recently; now 35%). It is not proposed that the Bank loan be involved in financing this system which is expected to provide credits of about Cr\$250 billion in 1981. However, as part of the policy package the Bank should seek that this subsidy element in the credit program be reduced and rationalized.^{1/}

Conclusion

18. The loan would encourage Brazil to expand the export capacity of its manufacturing and services sector in the short term by assuring an adequate supply of finance for manufactured exports, both foreign exchange to meet import needs, and cruzeiros to permit export credit financing, and in the long term by providing impetus for the gradual

^{1/} We will also want to investigate the mechanism applied here for identifying companies engaged in export, and the amount of their exports, for possible building into the disbursement system for the proposed loan.

opening of the industrial sector to foreign competition thus promoting the efficiency and enhancing the competitive position of Brazilian industry. The sum total of these efforts should significantly assist Brazil's adjustment to its difficult balance-of-payments situation.

cc: Messrs. Lerdau, LAC II
van der Meer, LACP
Pfeffermann, LAC
Glaessner, LACP
Renger, LACP
Skillings, LAC II
Levy, LAC II
Simon, LACP
Sweeney, LAC II

JSweeney/FLevy/RFSkillings:cdr/nev

OFFICE MEMORANDUM

TO: Memorandum for the Record

DATE: May 8, 1981

FROM: Dennis Koromzay, LC2 SUBJECT: BRAZIL - Carajas Iron Ore Project -
Meeting with CVRD President, Dr. Eliezer Batista da Silva

1. Mr. McNamara met on Monday, April 27, 1981, at 12:00 noon, with Dr. Eliezer Batista da Silva, President of Companhia Vale do Rio Doce (CVRD). Also present from CVRD were Mr. Franca Pereira, Vice President, Mr. Jose Ditzel, Marketing Director, and Mr. Samir Zraick, Financial Director. Present from the Bank were Messrs. Ardito Barletta, Lerdau, Lafourcade and Koromzay. The following is a summary of the discussion.

2. Dr. Batista made a general presentation of the Carajas project, setting it in the context of the Government's plans for the development of the greater Carajas region (the so-called "Grande-Carajas" program), which includes, in addition to the iron ore project, copper, gold, bauxite/aluminum, ferronickel, ferromanganese, pig iron, tin, reforestation, and agricultural development projects in various stages of preparation. Dr. Batista mentioned in particular a bauxite/alumina project being prepared by Alcoa (at Trombetas and at Sao Luis) with a target production of three million tpy of alumina and 300,000 tpy of aluminum, which was at an advanced stage of preparation (initial production by 1984/85). While the Carajas iron ore project had been evaluated and found to be economically justified independently of any other development in the region, the railway/port infrastructure for the mining project would also provide the infrastructure for the other projects to be developed as a part of the Grande Carajas program. The estimated economic return on the Carajas iron ore project alone (around 12%) therefore greatly understated the benefits which the project would bring to the Brazilian economy.

3. Dr. Batista made reference to the Carajas iron ore purchase contracts which had recently been signed with European and Japanese steel mills, totalling some 25 million tpy. Mr. McNamara asked whether these contracts included a fixed pricing formula, and what the duration of contracts was. Dr. Batista and his colleagues responded that the contracts were for a term of 15 years, at a price to be agreed upon each year with reference to the market price. Mr. McNamara asked whether in fact this did not amount to a contract which could be avoided from year to year. Dr. Batista and his colleagues stated that it did not, because the parties would be bound according to an established market price. Moreover, the contracts included a "novel" feature that up to 80% of the ore purchase commitment would be in the nature of a "take or pay" commitment and could not be avoided even in the case of "economic difficulties" of the buyer. Dr. Batista added that he considered the signing of these contracts, in the presently depressed situation of the steel industry, represented a strong vote of confidence for the project.

May 8, 1981

4. Mr. McNamara noted the large financial contribution which would be required for the project from local sources, and asked whether these would be available in the amounts and when needed. Dr. Batista responded that the Government considered the Carajas project of the highest priority, that the project had been approved personally by President Figueiredo, and that it was the only new major project which has been or would be approved for the next several years. The major part of these local resources (US\$1.0 billion) would be coming from BNDE/FINAME, which had already given a commitment to provide them. Dr. Batista had no doubt that the necessary resources would be forthcoming.
5. Dr. Batista made reference to the fact that the equity in the project (other than IFC) would be 100% Brazilian, and that the financing plan included an intention to issue in the Brazil capital market about US\$100-150 million equivalent in convertible debentures or redeemable preferred stock.
6. Dr. Batista reiterated the importance which CVRD and the Government attached to the Bank's participation in the project, not so much for the size of its financial contribution, but because they considered that the Bank's participation would be essential to mobilize the participation of the other external lenders.
7. Dr. Batista also referred to CVRD's awareness that adequate project implementation arrangements would have to be made in view of the size and remote location of the project, and the sensitivity of the project's rate of return to slippage. Studies of project management and organization were now in progress and a specific project implementation plan would be furnished to the Bank by the end of May, prior to the Bank's preappraisal mission now scheduled for June/July.
8. Dr. Batista requested the Bank to support the project, and asked what might be the earliest time that a Bank loan for the project could be approved. Mr. Ardito Barletta replied that, provided the on-going studies on project scope, capital costs and implementation plans are furnished to the Bank by end of May, the preappraisal mission could proceed in June, and assuming no major problems arose, an appraisal could be considered for September 1981 (this would imply that the loan proposal could be presented to the Bank's Executive Directors possibly at the end of the first quarter of CY82 or sometime during the second quarter of CY82). In conclusion, Mr. McNamara expressed his support for the project, stating that it was "a very exciting project".
9. The meeting ended at about 12:30 p. m.

Cleared with and cc: Mr. Lafourcade, EXC

Messrs. Stern, Ardito Barletta, Lerdau (LC2), van der Meer (LCP),
Fuchs (IPD), Jennings, Newman (LCP), Ms. Haug, Mrs. Oakes-
Smith (IPD), Messrs. Skillings, Incer (LC2), Paul (IFC)

DKoromzay:nps

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
(Through Mr. Ernest Stern) *ES.*

DATE: April 24, 1981

FROM: S. van der Meer, *SM* Acting Regional Vice President

SUBJECT: BRAZIL - Briefing Notes for Meeting on April 27, 1981
with Dr. Eliezer Batista da Silva, President of CVRD
Re: Proposed Carajas Iron Ore Project

This is special pleading for a project which looks OK but is still in the early stages of processing. We will, of course, help with cofinancing but no special treatment is warranted.

1. You have agreed to meet with Dr. Eliezer Batista da Silva, President of the Companhia Vale do Rio Doce (CVRD) at 12:00 noon on Monday, April 27. Dr. Batista will be accompanied by Mr. Franca Pereira, Vice President of CVRD, and Mr. Samir Zraick, CVRD Financial Director. We understand that the purpose of their visit is to brief you on the current status of the Carajas project, and to present CVRD's formal request for Bank assistance for this project. Following your meeting, Messrs. Lerda and Fuchs will host a luncheon. The Brazilians will meet with Mr. Wuttke in the afternoon.

2. The Carajas project consists of a 35 mtpy open pit integrated mining development in the "Serra dos Carajas" (in the southern part of the State of Para), a deep water port at Ponta da Madeira (near Sao Luis in the State of Maranhao) with capacity to handle vessels up to 280,000 dwt, and an 890 km railway line connecting the mine with the port. The project is expected to be commissioned by 1985, with an initial production of 15 mtpy, increasing to 25 mtpy in 1986 and 35 mtpy in 1987. Total project cost is estimated at US\$3.5 billion (not including interest during construction). The current CPP recommends a Bank loan of US\$300 million for this project in FY83.

3. Attached is a recent Back to Office Report on the project dated March 25, 1981, to which is attached the initiating Project Brief. As noted in the attachment, the principal issues relate to the need for strengthening CVRD's overall project management capabilities which are especially critical to a project of this size and remote location, and the size of the Government contribution which will be required for the project (on the order of US\$800 million in loan funds through BNDE and FINAME, and an additional US\$260 million in new equity for CVRD). The Government may have difficulty, in view of current resource constraints, in mobilizing the necessary resources.

4. CVRD's financing plan (summarized at p. 8 of the Project Brief) assumes, in addition to a US\$300 million World Bank participation, a US\$50 million IFC participatin (of which US\$25 million for IFC account), US\$100 million in export credit financing not yet identified, US\$146 million in short term facilities (acceptance credits for pre-export financing), and US\$845 million in import-related loans from official sources (Japanese Ex-Im Bank, EEC, KFW, DEG). The status of these various external financing sources remains to be clarified.

5. CVRD has made good progress in obtaining long term commitments for the purchase of iron ore from Carajas, with signed contracts with Japanese and European steel mills totalling 19.9 mtpy. CVRD expects to

Low term return 112

04/27

sign commitments for an additional 4.85 mtpy shortly which would result in approximately 71% of the initial capacity of 35 mtpy being committed by the time of appraisal.

6. CVRD is extremely anxious to accelerate Bank processing. We have scheduled a preappraisal in June/July and appraisal in September, which would allow for a loan presentation in FY82. The timing of the preappraisal is linked to the completion of two on-going studies on project scope, capital costs and implementation plans by a Brazilian consulting firm, Industrial Engineering Services (IES) and CVRD/AMZA (recently merged parent company and project subsidiary). These studies which could result in significant modifications in the railroad component in particular, are scheduled for completion in June.

7. CVRD is also expected to request the Bank to assist in lining up support for potential co-lenders, possibly by inviting the co-lenders to a meeting in Washington. I would recommend agreeing to do so on the basis of satisfactory findings of the June preappraisal mission.

8. We have two on-going loans with CVRD subsidiaries: Loan No. 1411-BR, for the VALEFERTIL Phosphate Fertilizer project (US\$82 million approved in April 1977); and Loan No. 1660-BR, for the VALESUL Aluminum project (US\$98 million approved in March 1979). The VALEFERTIL project has been successfully completed, and was recently transferred to a PETROBRAS subsidiary. The VALESUL project is proceeding with no major problems, but a delay of six months and a cost overrun of 10% is expected.

Attachment

Cleared with and cc: Ms. Haug, IPD

cc: Messrs. Ardito Barletta (o/r)
Lerdau, LC2
Fuchs, IPD
Skillings, LC2
Koromzay, LC2

DKoromzay:nps

OFFICE MEMORANDUM

TO: Mr. Robert S. McNamara
Through: Mr. Jean Baneth, Acting Director, EPD *JB*
FROM: Enzo Grilli, Chief, EPDCE *EG*.

DATE: June 5, 1981

SUBJECT: International Coffee Agreement: Its Main Features and Current Situation

1. The International Coffee Agreement (ICA), 1976, which entered into force on October 1, 1976, for a period of six years, is one of the few international commodity agreements in operation. It is the successor to the International Coffee Agreement, 1962, the first coffee agreement which had as its members the majority of coffee exporting and importing countries.

2. The main objectives of the current International Coffee Agreement are to balance world supply and demand in the short term, assure adequate supplies in the longer term, and avoid excessive market price fluctuations. Export quotas are the principal instrument adopted to achieve short-term market balance. Other activities include collection and publication of coffee statistics, consumption promoting activities and analysis of the economics of coffee production and distribution. Membership covers almost 100% of exporting countries and close to 90% of importing countries. Important non-member importing countries are Eastern European countries, the USSR and some countries in North Africa and the Middle East. Consumer and producers have as blocks equal votes (1000 each) in the Executive Board of the Agreement. Within each block, votes are allocated on the basis of the relative importance of each country as producer or consumer of coffee.

06/05
3. Export quotas are applied when the composite indicator price (a weighted price of various kinds of coffee traded, calculated by the International Coffee Organization), drops below a certain level agreed by the members. The global annual quota is set by taking into account mainly the estimated annual consumption and level of inventories of importing members. Allocation of quotas among exporting members is determined mainly by export quantities of each member in recent years.

4. The sharp decline in coffee prices since June 1980 has put considerable strain on the Agreement. The members of ICA decided in September 1980 to introduce export quotas and indicative price ranges to assess the effectiveness of export controls. The initial annual global quota for coffee year 1980/81 was set at 57.37 million bags with the price range of 115 to 155 US cents per pound in terms of the composite indicator price. However, coffee prices have continued to decline since October 1980, and downward adjustments of quotas have been made. At present their total is 54.9 million bags. (Annex Table 1).

5. In recent weeks, the downward trend of coffee prices has resumed and now the composite indicator price is close to the lower end of the price range set by the ICO (115¢/lb.) The 20 day moving average composite indicator price declined by more than 35% between May 1980 and June 1981. Against this background of declining coffee prices, the Executive Board of the ICO is to meet in late June and the Council to meet in early September. Two important items on the agenda are: (i) the renegotiation, extension or termination of the present Agreement which expires in September 1982; and (ii) the setting and allocation of new export quotas for 1981/82 season.

6. Because of dissatisfaction by a number of coffee exporting countries with the way quotas were allocated last October and the attitude of the new U.S. Administration towards commodity agreements, there is some possibility that the Agreement may be terminated next year.

7. A more immediate concern is the question of setting and allocating quotas for the 1981/82 season. Due to a large expected increase in the Brazilian crop (up 25-35% in 1981/82) and demands by a number of exporters, especially those in Africa, to increase their quotas, the members probably will find it extremely difficult to agree on quotas and the price levels at which quota adjustments would be made. If no agreement on the quota can be reached in September, no quota system will be implemented for coffee year 1981/82, and this in turn will increase the possibility of a termination of the Agreement in September 1982.

8. Since the current Agreement does not envisage any centralized stock-holding of coffee, questions related to the possibility of Bank financing of stocks (held by the ICO or by producing countries) would have to wait until the negotiation of a new Agreement.

cc: Messrs. Stern, Baum, Benjenk, Chenery
Mrs. Boskey (IRD)
Mrs. Hughes (EPD)

EGrilli/Takiyama:jmca

TABLE 1
COFFEE YEAR 1980/81
ANNUAL AND QUARTERLY QUOTAS
(60 kilo bags)

Exporting Member	Quarterly quotas				
	Annual quota 1/	Oct.-Dec. 1980 2/	Jan.-March 1981 3/	April-June 1981	July-Sept. 1981
	(1)	(2)	(3)	(4)	(5)
TOTAL	54 932 374	13 561 323	13 043 384	14 517 309	13 810 358
A. Sub-total: Members entitled to a basic quota	52 149 275	12 906 048	12 388 109	13 754 785	13 100 333
Colombian Milds	10 866 140	2 494 081	2 472 059	3 015 000	2 885 000
Colombia	8 932 337	2 011 024	2 071 313	2 425 000	2 425 000
Kenya	1 197 116	317 200	229 916	390 000 4/	260 000 5/
Tanzania	736 687	165 857	170 830	200 000	200 000
Other Milds	13 312 693	3 318 855	3 264 838	3 419 500	3 309 500
Costa Rica	1 379 489	366 471	338 018	337 500	337 500
Dominican Republic	431 677	120 378	123 299	94 000	94 000
Ecuador	1 195 556	344 930	265 626	292 500	292 500
El Salvador	2 117 977	476 841	491 136	575 000	575 000
Guatemala	1 931 284	435 376	550 908	472 500	472 500
Honduras	1 012 947	228 055	234 892	330 000 4/	220 000 5/
India	1 011 891	287 395	218 496	253 000	253 000
Mexico	2 025 890	456 108	469 782	550 000	550 000
Nicaragua	734 767	204 897	209 870	160 000	160 000
Papua New Guinea	644 601	167 894	126 707	175 000	175 000
Peru	826 614	230 510	236 104	180 000	180 000
Unwashed Arabicas	15 377 287	4 085 550	3 369 737	3 961 000	3 961 000
Brazil	14 088 756	3 795 299	3 043 457	3 625 000	3 625 000
Ethiopia	1 288 531	290 251	326 280	336 000	336 000
Robustas	12 593 155	3 007 562	3 281 475	3 359 285	2 944 833
Angola	393 760	136 640	117 120	80 000	60 000
Indonesia	2 946 750	663 430	683 320	800 000	800 000
OAMCAF 6/	(6 173 054)	(1 470 706)	(1 678 230)	(1 709 285)	(1 314 833)
Benin	45 000	45 000	0	0	0
Cameroon	1 473 747	332 144	404 648	416 540 7/	320 415 5/
Central African Republic	204 167	51 042	59 208	53 084 7/	40 833 5/
Congo	35 000	35 000	0	0	0
Gabon	7 500	7 500	0	0	0
Ivory Coast	3 239 171	730 028	889 381	915 518 7/	704 244 5/
Madagascar	898 469	202 492	246 693	253 943 7/	195 341 5/
Togo	270 000	67 500	78 300	70 200 7/	54 000 5/
Uganda	1 976 000	488 000	488 000	500 000	500 000
Zaire	1 103 591	248 786	314 805	270 000	270 000
B. Sub-total: Members exempt from a basic quota	2 783 099	655 275	655 275	762 524	710 025
Arabicas	1 932 433	453 109	453 108	513 108	513 108
Bolivia	102 200	25 550	25 550	25 550	25 550
Burundi	400 000	100 000	100 000	100 000	100 000
Haiti	400 000	100 000	100 000	100 000	100 000
Jamaica 8/	16 000	4 000	4 000	4 000	4 000
Malawi 8/	7 500	1 875	1 875	1 875	1 875
Panama 8/	57 400	14 350	14 350	14 350	14 350
Paraguay 8/	98 000	24 500	24 500	24 500	24 500
Rwanda	480 000 9/	90 000	90 000	150 000	150 000
Venezuela	311 333	77 834	77 833	77 833	77 833
Zimbabwe 8/	60 000	15 000	15 000	15 000	15 000
Robustas	850 666	202 166	202 167	249 416	196 917
Ghana 8/	33 333	8 333	8 334	8 333	8 333
Guinea	83 333	20 833	20 833	20 833	20 834
Liberia	162 000 10/	30 000	30 000	51 000	51 000
Nigeria 8/	98 000	24 500	24 500	24 500	24 500
Philippines	262 500	65 625	65 625	91 875 11/	39 375 12/
Sierra Leone	175 000	43 750	43 750	43 750	43 750
Trinidad and Tobago 8/	36 500	9 125	9 125	9 125	9 125

1/ Initial quota as shown in column (1) of Table 1 of document ED-1017/81 of 6 January 1981 adjusted to reflect the accession of Zimbabwe, the first and second downward adjustments of 1.4 million bags each and the definitive retention of the 2.4 percent conditional parts relating to the quarters October-December 1980 and January-March 1981

2/ See Annex Table 1

3/ See Annex Table 2

4/ 30 percent of annual quota

5/ 20 percent of annual quota

6/ See footnote to paragraph 9 of document ED-1017/81

7/ 26 percent of annual quota

8/ Members which are listed in Annex 1 to the Agreement as exporting less than 100 000 bags per annum are not subject to quarterly quotas. However, in this table, hypothetical quarterly quotas (25 percent for each quarter) have been shown for these Members, except for Benin, Congo and Gabon which are Members of the OAMCAF group for which all matters related to quotas are dealt with in accordance with the provisions of paragraph (2) of Article 6 of the Agreement

9/ Includes a waiver of 120 000 bags distributed equally between the two quarters April-June and July-September 1981

10/ Includes a waiver of 42 000 bags distributed equally between the two quarters April-June and July-September 1981

11/ 35 percent of annual quota

12/ 15 percent of annual quota

COMPOSITION AND VOTING OF THE EXECUTIVE BOARD FOR 1980/81 1/

<u>Exporting countries</u>	<u>Votes</u>	<u>Representing</u>	
Brazil	208	Brazil	(208)
Colombia	156	Colombia	(156)
		Panama <u>2/</u>	(-)
El Salvador	85	Costa Rica	(28)
		El Salvador	(57)
Ethiopia	64	Burundi	(11)
		Ethiopia	(20)
		Kenya	(28)
		Liberia <u>2/</u>	(-)
		Malawi	(5)
		Sierra Leone <u>2/</u>	(-)
		Tanzania <u>2/</u>	(-)
Guatemala	100	Dominican Republic	(14)
		Ecuador <u>2/</u>	(-)
		Guatemala	(45)
		Honduras	(21)
		Papua New Guinea	(20)
		Peru <u>2/</u>	(-)
Mexico	180	Bolivia	(5)
		Haiti	(11)
		India	(15)
		Indonesia	(59)
		Jamaica	(5)
		Mexico	(45)
		Nicaragua	(20)
		Paraguay	(5)
		Trinidad and Tobago	(5)
		Venezuela	(10)
OAMCAF	116	OAMCAF	(116)
Uganda	70	Angola	(13)
		Ghana	(5)
		Rwanda	(10)
		Uganda	(42)
		Zaire <u>2/</u>	(-)
	<u>979</u>		<u>(979)</u>

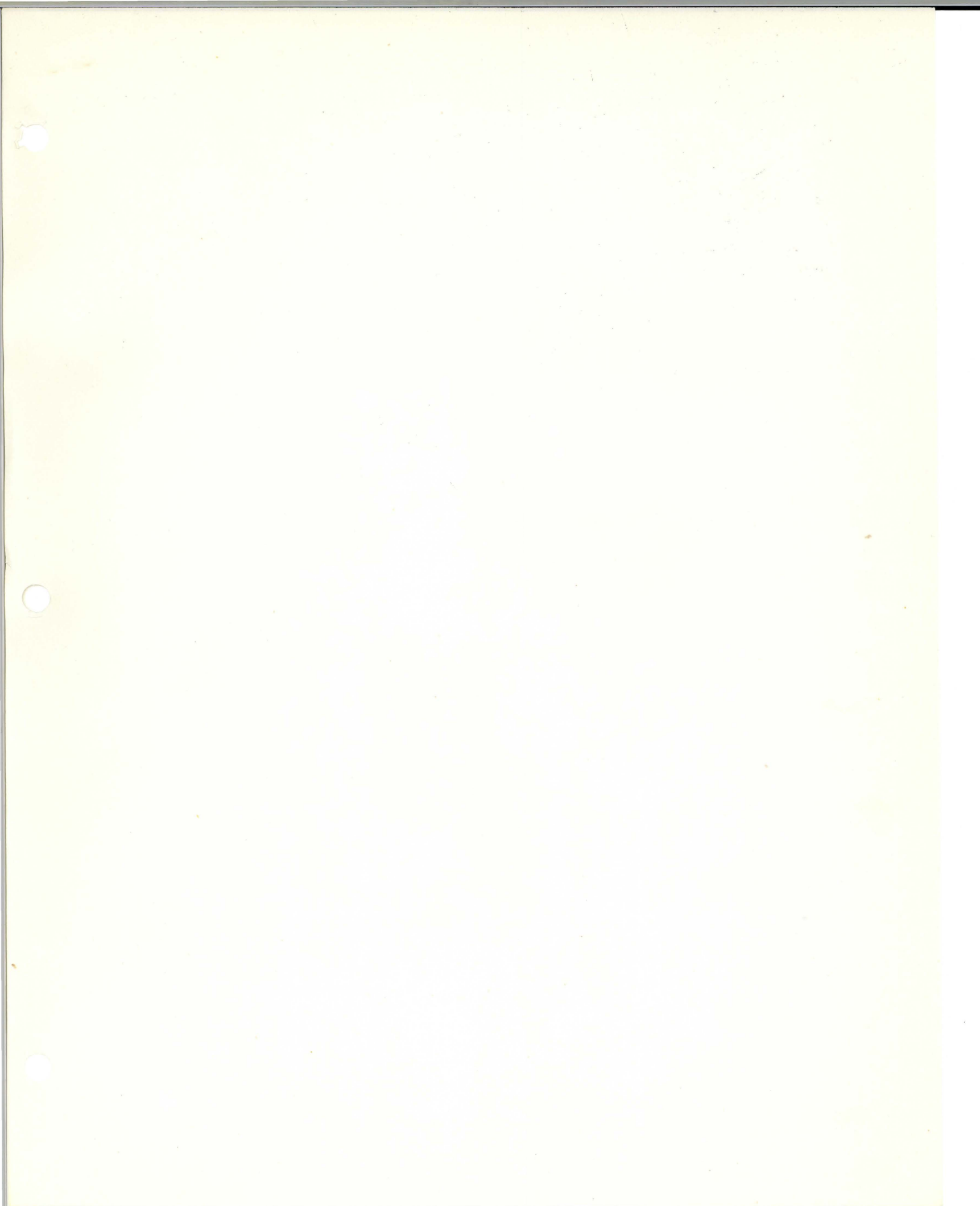
Note: Guinea (7 votes), Nigeria 2/, Philippines (9 votes), and Zimbabwe (5 votes) have not assigned their votes to any member of the Board

1/ As a consequence of document EB-1815/80 Rev. 9

2/ Voting rights suspended

<u>Importing countries</u>	<u>Votes</u>	<u>Representing</u>	
Belgium*	79	Belgium*	(30)
		Netherlands	(49)
Canada	101	Australia	(13)
		Canada	(33)
		Japan	(48)
		New Zealand	(7)
Federal Republic of Germany	127	Federal Republic of Germany	(127)
Finland	90	Finland	(21)
		Hungary	(14)
		Israel	(8)
		Norway	(16)
		Sweden	(31)
		Yugoslavia <u>2/</u>	(-)
France	106	Cyprus	(5)
		France	(95)
		Ireland	(6)
Switzerland	37	Austria	(16)
		Portugal <u>2/</u>	(-)
		Spain <u>2/</u>	(-)
		Switzerland	(21)
United Kingdom	130	Denmark	(21)
		Italy	(62)
		United Kingdom	(47)
United States of America	330	United States of America	(330)
	<u>1 000</u>		<u>(1 000)</u>

* Includes Luxembourg
2/ Voting rights suspended



As I reported to you, at the CPP we agreed to hold lending at \$800m for FY82 and FY83, unless there is significant improvement on poling. The Region was asked to identify the 3-4 highest priority issues and the actions to be taken on them, as a basis for a discussion with Brazil on the scale of our lending.

Not only have we threatened to suspend disbursements (see attached telex) if counterpart funds are not made available, but there will also be no further lending in the power sector (distribution) unless they remedy the tariff default. —ES.

DATE: June 11, 1981

- RFSkillings:nev

ECONOMIC SITUATION AND WORK PROGRAMRecent Experience

1. The Brazilian economy is responding to the stabilization policies adopted in late 1980 and early 1981 to reduce aggregate demand. Preliminary figures of the first quarter of 1981 indicate a slowdown in industrial production, particularly in the capital goods and consumer durables sectors. The 1980 GDP growth rate was still 8% in real terms. The trade deficit during the first quarter has been reduced by two-thirds from the comparable figure for 1980, reflecting both the economic slowdown and further reductions of petroleum imports. Although the immediate impact of some of the measures taken was to boost inflation -- e. g., the liberalization of prices and interest rates -- the expectation is for deceleration in the second semester.

2. A second consecutive good harvest will raise agricultural production to record levels for most crops. Resultant increases of export volumes will more than compensate falling prices of some primary commodities. Production of crops for domestic consumption, especially beans, will increase considerably, helping to alleviate the pressures on the consumer price index. On the other hand, the present wage policy, which provides for semi-annual adjustments at least equal to the increase in the cost of living to a large fraction of the labor force, will make the trade-off between inflation and employment more difficult.

3. The policy shift of late 1980 seems, for the time being, to have alleviated the nervousness that had by then become evident on the part of the private international bankers. Through the first five months of 1981, Brazil has found no difficulties in raising the required external funds in the foreign financial markets, although spreads have risen above 2%.

Economic Policies

4. Fiscal. Phasing out of the earmarked tax system has begun, and the institutional progress made regarding central authorities' control over the expenditures of the public enterprises, combined with considerable restraint in the budget appropriation of the central government, appears to be succeeding in lowering the public sector deficit. There is now, for the first time, a commitment to the preparation of a meaningful multi-year public sector investment program to serve both macro-economic management and priority setting objectives. A program is to be prepared by the end of this year.

5. Monetary. The freeing of interest rates on commercial bank loans to industry and commerce has led to very high real interest rates in those sectors. Tight ceilings are being enforced on commercial bank credit expansion, but financial capital inflows from abroad (the relending of which is

not subject to the ceilings) and the now expected large growth of coffee stocks, among other factors, will make the monetary expansion target of 56% very difficult to meet. Despite an upward revision of the interest rates on administered credits -- primarily for agriculture production -- real rates for these credits during 1981 will not be substantially less negative than those which prevailed in 1980. On the other hand, the real volume of subsidized credit during 1981 will be lower and effective financial costs to borrowers raised as a consequence of requirements that they put more of their own funds into the activities being financed. At the same time, a number of activities -- e.g., marketing and some investment credits for agriculture -- are no longer eligible for subsidized credit. Finally, in accordance with the intentions announced in November 1980, monetary correction is now moving more in line with domestic inflation rates, thus enhancing the attractiveness of financial assets and facilitating monetary management.

6. External Sector. In order to assure the competitiveness of manufactured exports, exchange rate adjustments through the first semester have been roughly in line with the differential between Brazilian inflation and that of its trading partners. To compensate the effects of the real cruzeiro appreciation observed in 1980 and in response to some slowdown of manufactured export growth in the first quarter of 1981, the authorities have reinstituted tax subsidies for manufactured exports, reversing the action taken to eliminate them at the end of 1979. These subsidies are to be phased out by mid-1983.

7. For political reasons there is little likelihood of a change in wage policy, at least before the 1982 elections. This policy, as well as the continuation of interest rate subsidies which tend to push up interest rates in the free market, complicate the difficult trade-offs between stabilization objectives on the one side and industrial output and employment on the other. Nevertheless, the government now appears firmly committed to seeing its stabilization program through. Our best judgment at the present time is that Brazil will probably be able to meet its very high external capital requirements in 1981, without going to the IMF. A further large increase in net borrowing will be required in 1982 before the rate of growth of debt begins to taper off.

Economic Work Program

8. Three major economic studies are scheduled for FY82:

- (a) Industry and Trade Policy Mission. Scheduled to arrive in Brazil in July 1981 to study the system of industrial protection and fiscal and financial incentives to industrial investments and exports and their impacts on sector performance and efficiency.

- (b) State and Local Finance. Also scheduled to arrive in Brazil in July 1981. Will analyze the fiscal problems of state and local governments and its implications for public sector resource allocation with particular attention to the financing of education and health expenditures.
- (c) Public Sector Investment Survey. Being planned tentatively for around March/April 1982. Would review future government investment plans and priorities and analyze their consistency with projected macroeconomic parameters and the resource availabilities to the public sector. Realization of this mission depends on government progress in elaborating a multi-year investment program (see paragraph 4) and completing consolidation of the public sector accounts.

9. Other missions are planned in FY82 to examine selected issues in the education, tree-crop agriculture, transport and health sectors. A grey cover economic memorandum is currently in the print shop; the agricultural policy review has been discussed with the government and is now being prepared for grey cover; the energy sector report is being put in green cover and will be sent to the government shortly for review; the report on the economy of the northwest is about to be published in red cover; and the report of the mission to review rural development in the northeast is currently being drafted.

10. The reports which have been discussed with the government, have been very well received. The northwest report has had a major impact on the shaping of the government's development program for that region. The agricultural policy report, together with last year's capital markets study, is, we believe, playing a role in the government's rethinking of its policy toward subsidized credit.