Board Meeting of June 12, 1997  
Statement by Andrei Bugrov

Brazil - Country Assistance Strategy

The new Brazil CAS is a well prepared and comprehensive document which does credit to its authors. We are satisfied that it correctly addresses the key problems facing the Government of the country at this time. The warm support for the CAS document expressed by Mr. Portugal in his written statement further demonstrates that this is in fact a joint strategy fully owned by the country’s authorities and therefore it has a strong chance to be successful.

We are pleased to note major improvements in the macroeconomic situation in Brazil. This positive change is in part due to a favorable external environment but in a great measure it also represents a success of the Government policy. Likewise, the impressive improvements in the Bank Brazil portfolio owe much to a better overall situation but this is also a result of persistent joint efforts of the Bank and the Government.

At the same time, many problems persist. Among the most acute are high public sector deficit and domestic and international debt, the need to strengthen the financial system, and persistently high levels of poverty and income inequality. The Bank Group strategy in Brazil addresses all of these issues through a variety of instruments, using both lending and non-lending services in order to achieve maximum impact.

Focus on Social Issues

The core of the proposed Bank strategy concentrates on the support for social development. We agree with this choice of emphasis for two important reasons. First, addressing poverty and investing in human capital is an essential task facing the Brazilian authorities and an important component of sustainable growth. Second, the Bank is well placed to assist the country in this matter and following this strategy would correspond to the Bank’s comparative advantage as an international development institution. Therefore, we agree with the analysis presented in the CAS and endorse the focus on improving the performance of education sector and investment in human capital development as a good strategy for sustained growth in the 21st century.
The focus on poverty alleviation and reducing inequality is also well justified both from the point of view of achieving long-term sustainability of economic growth and as an efficient strategy for the World Bank involvement. We are satisfied that the results of the recent Poverty Assessment were well incorporated into the CAS document, in particular, the choice of education sector as the basis for development cooperation corresponds to the finding that the probability of being poor is inversely related to the level of education. At the same time, it is clear that the causality in this relationship runs in both directions, and ensuring broad access to good basic education would not in itself solve the problem of poverty; a more comprehensive approach is needed if the issue is to be resolved.

The problem of poverty and persistent high inequality has a regional perspective that cannot be ignored. The Bank program of dealing with individual States would improve equity and help redress regional imbalances.

**Regional development**

As I mentioned above, one of the major risks which remains is the high level of fiscal deficit, especially on the sub-national level. We have already expressed our concern about this problem on a number of occasions, and of course the Brazilian government is well aware of it as well. We need to ensure that the Bank treads carefully in this precarious situation and does not increase the risks by increasing the debt burden unnecessarily.

The issue of lending to sub-national governments raises a number of questions. First of all, while the Bank envisages lending operations in individual States in Brazil, it still requires a federal guarantee to cover such loans. In practical terms, what is the difference between such an arrangement and a more traditional loan to the Ministry of Finance which is then on-lent to provincial governments? Perhaps the time has come to discuss the possibility of accepting sub-national guarantees for this type of operations. Another question which comes to mind in the case of Brazil is the fiscal terms on which such loans are provided to the State governments. We had an earlier discussion of the Mexican case where any resources that a State receives from a World Bank loan are fully offset by an equal reduction in the federal transfer. It would be interesting to know what happens in Brazil because the nature of this arrangement would have an important bearing on the fiscal implication of State-level projects.

More generally, I look forward to a Board discussion of lending to sub-sovereign governments, a broader strategic issue of which Brazil is a bright example. This issue is highly pertinent to more than one larger borrower and it is important for the Bank to develop some kind of a framework in this respect.

One last point on regional operations. The general theme of selectivity in the Bank’s approach to the choice of regional projects seems highly appropriate in a country as large as Brazil. While it is clearly prudent, given the already high level of indebtedness, to offer loans only to the states which have better macroeconomic situation and stronger performance on previous projects, we must be aware of the possible side effects of such an approach. We read in the report that regional disparities have been widening since 1994 “as the richer regions have
taken more advantage of enhanced growth opportunities under the *Real Plan*”. Favoring better-off states in Bank lending would probably exacerbate the regional disparities even further. One possible solution is to ensure that the projects carried out on the federal level are biased in favor of the poorer states.

**Co-ordination with IFC**

We welcome a strong link between the assistance strategies of the two organizations, this is clearly the way forward. In particular, we strongly support the initiative of joint Bank and IFC participation on selected projects, especially in areas such as infrastructure where private sector involvement is being pioneered. The benefits of such an experience could transcend the boundaries of one country and we would like to know more about any progress in this field. The vision of the Bank as a knowledge institution implies spreading successful know-how to wherever it may be applicable. In this particular case I am thinking of transition economies where private sector involvement is making its early steps in many sectors. The experience of IFC could be invaluable, yet many projects would not be possible without the government involvement (e.g. due to externalities) which justifies the IBRD involvement. In such instances joint Bank-IFC projects may have a great future.

In conclusion, I would like to repeat our support for the proposed CAS and with the Brazilian authorities every success in attaining the outlines objectives.