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FISCAL ADJUSTMENT IN THE STATE OF BAHIA

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TABLE OF CONTENTS

• FOREWORD
• INTRODUCTION
• CHAPTER I - GENERAL INFORMATION
  1. A BRIEF VIEW ABOUT THE BRAZIL’S REAL PLAN AND ITS EFFECTS
  2. THE ASIAN CRISIS AND BRAZIL’S RESPONSE
  3. REPERCUSSION OF THE FEDERAL GOVERNMENT PACKAGE IN BAHIA.
  4. GENERAL ASPECTS OF THE STATE OF BAHIA
• CHAPTER II - THEORY
  1. FISCAL FEDERALISM
  2. FISCAL CRISIS OF THE STATES
  3. PROCESS OF FISCAL ADJUSTMENT
    • CHAPTER III - FISCAL ADJUSTMENT IN THE STATE OF BAHIA
  1. THE BEGINNING OF THE CURRENT ADMINISTRATION:
     - Goals
2. MEASURES ADOPTED BY THE STATE GOVERNMENT IN ORDER TO CUT THE PUBLIC SECTOR'S FISCAL IMBALANCE

2.1. REVENUE

2.1.1. Overview

2.1.2. F.P.E-State Participation Fund

2.1.3. ICMS - Tax on circulation of goods and services

2.1.4. Measures adopted to increase revenues

   1. Fiscal Area:

   A) PGM- Planejamento e Gerenciamento de Mercado

      A. PROMOSEFAZ - Programa de Modernização da Secretaria da Fazenda

   1. Financial Area:

      A. SICOF - Sistema de Informações contábeis e financeiras

2.2. EXPENDITURE

2.2.1. Overview

2.2.2 Personnel Expenditures

2.2.3. Investment and Outlays

2.2.3.1. OUTLAYS

2.2.3.2. INVESTMENTS

2.2.4. Measures adopted to reduce expenditures

2.3. PUBLIC DEBT

2.3.1. Main contracts since 1994

2.3.2. Composition of the Debt Balance 1994-/97


2.3.4. Debt Balance as Guarantee

2.3.5. Expenses of debt (service)

2.3.6. Debt Intaking Capacity

2.3.7. Swap of the Bonds Debt

2.3.8. PRESENT SITUATION OF THE DEBT
2.3.8.1. Retaking Access to Multilateral Organizations

2.3.8.2. Debt in Adjusted Profile

2.3.8.3. Inexistence of "Aros" (Anticipated Budgetary Income)

2.3.8.4. Inexistence of Default

- CHAPTER IV - PRESENT SITUATION OF THE STATE

  1. RESULTS

2. PROJECTIONS: 1997-2000

2.1. REVENUES

2.2. EXPENDITURES

2.3. INVESTMENT PROGRAMS

2.4. SOCIAL SECURITY AND PENSION LIABILITY FUND

2.5. PROGRAM OF FISCAL INCENTIVES

- FINAL REMARKS

- REFERENCES

FOREWORD

The objective of this paper is to explain the fiscal and financial adjustment in the state of Bahia since the beginning of the former administration in 1991. To this achievement, it’s important to understand the situation of Bahia in a general context of Brazil and analyze the specific case of Bahia in terms of revenue, expenditure and public debt: what has already been done and what will be done in the next years.

In so doing, I try to fulfill my initially mentioned intention. I must point out that most of the data presented here has already been published in proper journals and official documents. The selection of tables and graphs included here followed careful criteria in order to avoid a very long document. This time I leave all considerations and conclusions to the readers.

INTRODUCTION

With the end of the "lost decade -", as the 80s are called, Brazil has entered the nineties driven towards promoting profound change in its development standards. The frustrated stabilization attempts and the lack of state investment possibilities pointed the way towards opening up the economy to the foreign market and becoming less dependent of state protection and investment. Global pressure towards a productive restructuring hit a country already distinguished by its huge structural differences and induced new regional unsteadiness, calling for a new public intervention model.

The opening of the economy and the constant change in economic policy have affected regional economies in various ways. With distinct structures and diverse development stages, the states have been affected according to their degree of modernization, productive structural arrangements, degree of dependence on state protectionism and investment, trade relations to the foreign market, etc.
The Government’s financial and fiscal crises have caused a decline in state investment, even though there are variations in rhythm and impact among different states. The current decentralizing of social policies, although inspired by the best democratic intentions and initiated by the 1988 constitution, may heighten these regional differences, if local management methods are not taken into view.

All factors put together threaten the poorest regions of the country, which are more dependent of public funds and have less resources than are currently demanded by our information society. Although decentralizing was initiated in the Northeast region by uncoordinated measures, disconnected from any regional development plan, its effect can be observed throughout the statistics tables for the period between 1975-85. Data from the 90’s point to the opposite direction, showing that the process has short endurance and threatens to annul all efforts spent in favor of a fairer society.

Few but extremely valuable efforts in understanding regional dynamics do not always consider recent factors related to Bahia’s economic growth. Having more than 30% of the northeastern region’s GDP, Bahia still has decisive influence over the region’s group actions. Thus the need to adequately understand what factors determine its evolution, similarities and above all, all specific items which connect Bahia to the other northeastern states.

The purpose of this paper is to present in an ordered and coherent fashion updated tables and information about the most recent evolution in the state of Bahia’s economy. It will be presented in 4 chapters as showed below.

In order to explain Bahia’s situation, first of all it’s necessary to identify the current situation of Brazil. Thus the first chapter presents a brief view of the Real Plan and the Asian crisis.

The second chapter contains some theory definitions and concepts such as: "fiscal federalism"; the fiscal crisis and how the states have responded to the fiscal crisis; fiscal adjustment and why, when and how much it is necessary.

The third chapter describes the program of the Fiscal adjustment in the state of Bahia, explaining how the process took place, the situation in the beginning of the current administration and what measures have been undertaken in order to restore the state public sector financial balance. It will be presented in 3 approaches: revenue, expenditures and public debt.

The last chapter describes the results of the implemented program, the present situation and the projections until the year 2000.

**CHAPTER I - GENERAL INFORMATION**

1. A BRIEF VIEW ABOUT THE BRAZIL’S REAL PLAN AND ITS EFFECTS

The Real Plan, which represented a mark to Brazil, has three main objectives:

- inflation on a downward trend (low inflation induces higher economic efficiency and has a clear role in better income distribution);

- long-term sustainable growth in output, investment, employment and productivity (this requires important structural changes, which are under way); and

- steady and substantial reduction of social imbalances (which includes the incorporation of an increasing number of people to the consumption market of private and public goods and services).

Almost four years after the Real Plan was launched, it is still in place and the country’s leadership is now preparing to lead Brazil into the 21st Century. Brazil’s financial system may be said to have undergone a number of important changes.
According to Mr. Melvyn Levitsky - American Ambassador in Brazil-, one of the best explanations he had heard about the Plan came from an tire repairman in Manaus. He asked him about how things were going under the new currency and the resultant dramatic drop in inflation and the poor man said: "We used to throw these centavos away. Now we hold up the coins because we can buy a beer with them". It represents a practical sense of the impact reform was beginning to have on public attitudes about the plan.

Thus, with the stability derived from the Real Plan, Brazil has entered into an expansion cycle. Nevertheless, some international crisis, such as the Asian crisis, can affect Brazil’s growth

2. THE ASIAN CRISIS AND BRAZIL’S RESPONSE

The financial crisis in Asia in 1997 set off waves of turbulence in currency and equity markets that surpassed the "Tequila" effects in the wake of the 1994 devaluation of the Mexican peso. The crisis first spread to East Asia where the contagion set off a string of devaluation’s and stock market collapses in neighboring countries. As the problems intensified, the currencies of other Asian countries, including Hong Kong and South Korea, came under speculative pressure. Outside the region, Argentina, Brazil and Russia were among the economies to suffer sharp declines in their equity markets, and periodic bouts of speculation against their currencies. After the dust settles in currency markets, many of these countries will also be left with serious banking sector problems.

The Brazilian government is extremely conscious of the fact that the country is part of a globalized economy. Although it can benefit from the positive impacts, it must also protect itself from the eventual costs. The crisis in Southeast Asia unleashed a flood of speculations in diverse economies, including the Brazilian one, leading to some capital flight. It is important to point out that Brazil’s level of foreign reserves has been high throughout the Asian crisis.

To minimize the effects of the crisis, the government firmly announced a series of measures intended to retain capital invested in our country as well as measures to generate fiscal gains. This will be achieved via the reduction of expenditures and the increase in revenues on the order of 20 billion dollars.

In short, the comprehensive measures approved by the National Congress were:

- increase of the internal interest rate to attract external capital and contain internal demand;
- reduction of public expenses by 15% in 1998, including payroll cuts for 1998 and the dismissal of more than 30,000 civil employees;
- increase in individual income taxes (selective for different income brackets);
- increase in IPI(Tax on industrialized products) on automobiles and alcoholic beverages;
- more restrictive funding for states and municipalities;
- introduction of initiatives to reduce imports and on the other hand, to increase exports;
- administrative reform, including the end of employment stability breakdown for public employees.

The opinions about the Brazilian government’s response to the crisis varied. Some people understood that the reaction was stronger than the potential risk of the return of the inflation. But the government had to be severe.

According to North-American economist Albert Fishlow from Council on Foreign Relations and Harvard University, the fiscal package announced from the Federal government in response to Asian crisis showed that Brazil is headed in the right direction. He said that he believes that Brazil will overcome the difficulties. He also has a positive future vision for Brazil. He forecasts that the Brazilian economy will have a sustainable increase of 6% a year after the year 2000.
According to the International Monetary Fund in its document about Brazil, the Directors commended the authorities for their quick and decisive policy response to the strong pressures on the real in late October. They noticed that those actions—the doubling of interest rates and the quick passage of a strong fiscal package—had played an important role in limiting the contagion effects from the Asian turmoil in Brazil and the rest of Latin America. The directors stressed that the steady implementation of the fiscal adjustment measures, the early passage of the pending structural fiscal reforms, and prudent monetary policy would be essential to ensure a sustained reduction of the current account deficit, minimize Brazil’s vulnerability to the continuing volatility in international financial markets, and realize its full economic potential.

The Directors also noted that the implementation of the authorities’ fiscal policy package as envisaged, together with the use of most of the privatization receipts for debt reduction, would facilitate a decline in the overall public sector deficit and debt and, therefore, a further sustained reduction in interest rates during the course of the year. They stressed the importance of fiscal consolidation as a means of continuing to raise domestic savings. They also emphasized the importance of resisting spending pressures that might arise during a year of general elections, and welcomed the authorities’ readiness to adopt additional measures if needed.

3. REPERCUSSION OF THE FEDERAL GOVERNMENT PACKAGE IN BAHIA

In the case of the state of Bahia, the fiscal package of measures are likely to have little impact precisely because of the state’s fiscal adjustment of the state.

Bahia, as part of the federation, is able to claim financial equilibrium. Thus, some of the measures mentioned above have been in practice in the State of Bahia since 1991. Examples include:

- reduction of the administrative structure such as the elimination of businesses and agencies through buyouts and mergers;
- reduction of personnel expenses and keeping of these expenses compatible with its capacity to pay;
- implementation of the privatization policy and outsourcing of public services allowing the state to return to its real business;
- prompt payment to contractors, suppliers and service providers, making it possible to reduce government program costs.

4. GENERAL ASPECTS OF THE STATE OF BAHIA

The state of Bahia represents a synthesis of the Brazilian potentialities and contradictions. In the last two decades, Bahia registered an economic growth rate (GDP) above the national average and expanded its participation in Brazil’s manufacturing industry. This trend will show an increase on a mid and long term basis, not only as a result of planned enterprises but mainly due to the state’s natural tendency for growth.

Bahia has the following general characteristics:

- area: 567,000 Km²;
- population: 12.6 millions - 4th state in Brazil (source: IBGE, 1996 Population count);
- municipal divisions: 415 municipalities;
- GDP: 33.6 US$ billions in 1997, corresponding to approximately 5% of National GDP and 6th economy in the country.

If the programmed investments show Bahia’s big economic potentialities, that’s necessary to recognize its huge deficiencies in the social area resulting from the inflation and short index of economic growth of the country.
The typical government attributions have been faced vigorously and patiently by the previous and actual government.

This conjunction of factors created the ideal environment for new national and international investments. The scenario changed. We neither live in a closed economy nor we can just count on public investments. Even the universal economy changed. The followings facts mustn’t be forgotten by a conscious administrator:

- globalization of the economy;
- advance of the technology and new organizational models, which changed the competitive requisites; and
- restructuring of the regulatory systems of different countries including privatization, deregulation etc.

The Brazilian economy and Bahia’s economy are trying to adapt to the new model.

During the last 16 years (1980-1996) Bahia’s economical growth overcomes the national average. Contrary to what is commonly observed in national sphere, the 80’s were not a lost decade to the state of Bahia - during this decade, the state’s GDP grows 27% and its per capita income increases by 3.7%.

Graph 1: GDP BAHIA x GDP BRAZIL

According to Dr. Paulo Souto- Governor of the State, Bahia anticipated the Brazil’s reform. Since 1991, the state has undertaken an adjustment process, which allowed not only the equilibrium of the personnel expenditures but also the restoration of its credibility amongst national and international financial institutions.

CHAPTER II - THEORY

1 - FISCAL FEDERALISM

The federal system was created with the intention of combining the different advantages which result from the magnitude and the smallness of nations.

Alexis de Tocqueville, DEMOCRACY IN AMERICA

According to Wallace E. Oates, in his book Fiscal Federalism, "the functions of the public sector are to ensure an efficient use of resources, to establish an equitable distribution of income, and to maintain the economy at high levels of employment, with reasonable price stability. What form of government promises the greatest success in resolving the allocation, distribution and stabilization problems? Centralized, decentralized or one which combines the advantages of these two polar forms?"

Federal system there exists both a central government and a subcentral government units, each making decisions concerning the provision of certain public services in its respective geographical jurisdiction. Each level of
government, rather than attempting to perform all the functions of the public sector, does what it can do best. Complementing these operations, subcentral governments can supply those public goods and services that are of primary interest only to the residents of their respective jurisdiction. Thus the answer about the best form of government is, in economic terms, be described as the FEDERALISM.

Kenneth C. Wheare defined federalism as "the method of dividing powers so that the general and regional governments are each, within a sphere, co-ordinate and independent."

2. FISCAL CRISIS OF THE STATES

States play a vital role in our federal system. States and local governments actually provide most of the services that people use.

States have a structural deficit when the revenue produced by their current tax system (along with revenue from other sources) is insufficient to allow them to maintain the existing level of services. Whether or not a state has a structural deficit depends on many factors: the nature of its tax system, the rate of economic growth, federal policies, state spending practices, inflation etc.

Analyzing how the states coped with serious fiscal problems, it’s important to point out that:

- The state fiscal crisis is usually caused by a combination of factors. While some are beyond the control of state officials, others are the legacy of misguided policies pursued in the 80s;

- Faced with a prospective deficit, states have many more choices than merely raising taxes and cutting spending; and

- Federal aid increased sharply in the early 1990s, providing a big help to state budgets.

3. PROCESS OF FISCAL ADJUSTMENT

Fiscal adjustment can be defined as "the way governments can use their fiscal stabilization and structural policies to achieve macroeconomics objectives relating to growth, inflation and the balance of payments. As such, it covers issues related to governments’ taxing, spending and borrowing activities, as well as some fiscal aspects of institutional change."

The focus here is on the broad issues and practical policy options that need to be considered, rather than on the more technical or theoretical aspects of the literature on fiscal policy.

Why may fiscal adjustment be needed?

The need for fiscal adjustment may be seen in the context of the impact of fiscal policy on stabilization and growth objectives, the sustainability of the fiscal policy stance, and the linkages between fiscal and other policy instruments.

In most countries the government sector is directly responsible for a large part of economic activity and, through its spending and resource mobilization, indirectly influences the way resources are used in the private sector. Substantial evidence exists that, in many cases, poor fiscal management has been a major factor underlying such problems as high inflation, a large current account deficit, and sluggish or negative output growth. In such circumstances, fiscal policy is usually at the center of an overall adjustment strategy.

Fiscal adjustment attacks these problems in two major ways: I) through its impact on broad macroeconomics variables, such as the level and composition of aggregate demand, the national savings rate, and the growth of monetary aggregates; and II) through its more microeconomics impact on the efficiency of resource allocation in the economy and the buildup of essential institutions and infrastructure.
An important responsibility of economic policymakers is to ensure the longer-term viability of a noninflationary growth path for the economy. Governments may promote high growth in the short term, while sowing the seeds of future difficulties in terms of an unsustainable growth in public debt or the creation of an unfinanceable future external position. Thus, fiscal consolidation initiatives may be necessary in the short term to prevent the occurrence of an unsustainable fiscal position in the future. These issues may be considered in relation to the current account, government debt and the impact of unfunded liabilities arising from current fiscal policies.

Fiscal policy is one among several instruments by which governments may affect the development of the economy. Fiscal policy, therefore, essentially involves discretionary action.

According to the National Treasury, in order to answer the question WHY MAY FISCAL ADJUSTMENT BE NEEDED, it’s necessary to consider the 4 following items:

a) the need for granting the State conditions to increase its efficiency, to guarantee the improvement of its services, and to provide the population with better living and welfare conditions;

b) the need for ensuring the generation of sustainable primary surpluses in the State, with the simultaneous quality improvement of public spending;

c) the existence of significantly high state debts, whose service has not been sustainably solved on a long-term basis;

d) the implementation of a reform program which includes privatizations, public services granting, and reduction of outlays on personnel;

**How much fiscal adjustment is required?**

Fiscal adjustment policies should be designed within an overall methodological framework that links the implementation of a comprehensive set of policy measures to the achievement of the economy’s objectives for inflation, growth, and external balance. Policy-setting within this framework requires decisions about the appropriate amount and form of fiscal adjustment, including the desired level of the fiscal deficit.

A fiscal adjustment strategy may, in principle, require either a more restrictive or expansionary fiscal policy stance. Large structural deficits, rising government debt and the need to address domestic and external constraints have emphasized the crucial importance of fiscal consolidation in many countries.

**Determining the amount of fiscal adjustment**

The amount of fiscal adjustment needed is usually discussed in relation to the desired reduction in the overall fiscal deficit; often, possible tradeoffs are suggested between the quantity and quality of adjustment measures.

**How should fiscal adjustment be effected?**

Undertaking fiscal adjustment often requires difficult decisions involving increasing government revenue and reducing spending.

Expenditure reductions often tend to be stressed in the initial stages of adjustment, with particular emphasis on cuts in capital spending and current outlays on other goods and services. Cuts in productive capital spending and essential operations and maintenance spending are liable to be damaging to growth. Consequently, countries need to move quickly on structural reforms affecting expenditure, revenue and public enterprises in order to allow a more balanced approach to fiscal adjustment and to generate the resources necessary to support spending that addresses social and productive needs.

In designing fiscal adjustments strategies, policymakers often face short-term costs and constraints. Such concerns include the output and employment losses that may be incurred in rationalizing expenditure, the
possible short-term negative effect on growth of raising taxes, and the difficulties in modifying implicit social contracts by altering the role of government.

CHAPTER III - FISCAL ADJUSTMENT IN THE STATE OF BAHIA

1. The beginning of the current administration - goals

Although, as seen before, Bahia has undergone a process of adaptation to a new reality arising out of the economic stability favored both by the "Real Plan" and the globalization phenomenon. The Bahian economy has been attaining positive returns, even with the new Federal Government package.

In order to face the new challenges, the adjustments already accomplished in the State Public Administration, as well as the remedial actions in the public finances now strictly kept, have proved to be of the utmost importance.

The current administration began in 1994, but it continued the same guidelines and policies from the former administration that had begun in 1991. Since March/1991, the guidelines were:

- immediate sanitation of the public finance and adoption of specific policies in order to increase the revenues and reduce the expenditures including solving the state’s debts;
- implementation of administrative modernization program based on 2 important aspects: technology and investment in human resources; and
- adoption of a careful policy of tax breaks.

- Situation in 1991

When the government took office in March / 1991, the state was experiencing the following situation:

- Cash : negative balance = US$ 27 million;
- Bahian public debt : delayed and uncontrolled. The consequence was that the information from the Financial Secretariat and the related financial institutions was different. The total amount due and not paid was US$ 311.1 million (external = US$115.3 million and internal = US$ 195.8 million);
- The unfavorable financial situation of the state controlled bank (BANEBA- Banco do Estado da Bahia): 198,872,000 state bonds (LFTBA- Letras do Tesouro estadual) at Baneb and Central bank, that could have provoked an intervention in the state’s bank;
- Obsolete collection system;
- Deficits, as showed in Table 1: Main deficits in March 15, 1991

<table>
<thead>
<tr>
<th>SUBJECT</th>
<th>US$ MILLIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personnel</td>
<td>13</td>
</tr>
<tr>
<td>Transfer to the municipalities</td>
<td>11</td>
</tr>
<tr>
<td>Public debt</td>
<td>311</td>
</tr>
<tr>
<td>Social Security</td>
<td>198</td>
</tr>
<tr>
<td>Judicial decisions</td>
<td>2</td>
</tr>
<tr>
<td>Debts from previous fiscal years</td>
<td>10</td>
</tr>
</tbody>
</table>
Due to that naughty situation, the State government had to immediately implement many actions in order to restore the financial balance and keep the compatibility between revenues and expenditures:

- institution of new criteria of salary to the fiscal inspectors. This is based on the efficiency of their work;
- settlement of the State’s cash;
- payment of the salaries due and not paid;
- agreements with the Federal Government to exchange the State bonds for federal bonds;
- independence and decentralization of financial management. It underwent the following main changes: payments began to be made by each Secretariat and other offices instead of being all concentrated in the Financial Secretariat. Also, the transferences were anticipated, allowing the payments on time.
- improvement of the surveillance to ensure compliance by the taxpayer to tax laws. To this end, different measures were taken:
  - increased use of computers and software’s by the tax inspectors and treasury bureaucracy;
  - strengthening of the fiscal inspections at the state borders fiscal outputs as well as increased surveillance over internal transportation of goods;
  - training of human resources;
  - specific fiscal operations targeting certain business sectors that historically evaded paying taxes.
  - renegotiation of the public debt and regularity with the financial institutions such as IDB and KFW.

These above mentioned measures were implemented in 1991 and used until the end of the administration in 1993. Many of them still continue now. It’s possible to say that since 1991 the government has invested in modernizing the state machine. Such actions have profoundly changed the profile of the Bahian economy. Nevertheless, this paper will focus on the main measures taken since 1994 (the beginning of the current administration).

## 2. MEASURES ADOPTED BY STATE GOVERNMENT IN ORDER TO CUT DOWN THE PUBLIC SECTOR’S FISCAL IMBALANCE

These measures will be analyzed in terms of: revenue, expenditure and public debt. Before the description of the measures, there will be presented an overview of each one.

### 2.1. REVENUE

#### 2.1.1. OVERVIEW

The total revenue of the state is classified in Current (taxes, assets, and transfers) and Capital (credit operations, sale of assets, and others). In 1997, 69.5% consists of Current Revenue and 30.5% is Capital Revenue, as shown in Table 2.

<table>
<thead>
<tr>
<th>Source: Finance Secretariat / DEPAT-State Treasury Department</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negative cash balance</td>
</tr>
<tr>
<td>TOTAL</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CATEGORY</th>
<th>1994</th>
<th>1995</th>
<th>1996</th>
<th>1997</th>
<th>%</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.CURRENT REVENUE</td>
<td>2,986</td>
<td>3,634</td>
<td>3,948</td>
<td>4,030</td>
<td>69.5</td>
<td></td>
</tr>
<tr>
<td>1.1.TAX</td>
<td>1,874</td>
<td>2,374</td>
<td>2,628</td>
<td>2,444</td>
<td>42.1</td>
<td></td>
</tr>
<tr>
<td>1.2.ASSETS</td>
<td>155</td>
<td>39</td>
<td>22</td>
<td>160</td>
<td>2.8</td>
<td></td>
</tr>
<tr>
<td>1.3.CURRENT TRANSFERS</td>
<td>891</td>
<td>1,152</td>
<td>1,233</td>
<td>1,358</td>
<td>23.4</td>
<td></td>
</tr>
<tr>
<td>1.4.OTHER CURRENT REVENUE</td>
<td>66</td>
<td>70</td>
<td>65</td>
<td>68</td>
<td>1.2</td>
<td></td>
</tr>
<tr>
<td>2.CAPITAL REVENUE</td>
<td>69</td>
<td>453</td>
<td>487</td>
<td>1,770</td>
<td>30.5</td>
<td></td>
</tr>
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<td>2.1.CREDIT OPERATIONS</td>
<td>61</td>
<td>440</td>
<td>467</td>
<td>235</td>
<td>4.0</td>
<td></td>
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<td>2.1.1. CONTRACTS</td>
<td>61</td>
<td>44</td>
<td>253</td>
<td>235</td>
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<td></td>
</tr>
<tr>
<td>2.1.2. BONDS</td>
<td>0</td>
<td>0</td>
<td>214</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>2.2.SALE OF ASSETS</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1520</td>
<td>26.2</td>
<td></td>
</tr>
<tr>
<td>2.3.OTHER CAPITAL REVENUE</td>
<td>8</td>
<td>13</td>
<td>16</td>
<td>15</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>TOTAL REVENUE</td>
<td>3,055</td>
<td>4,087</td>
<td>4,435</td>
<td>5,800</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bahia’s General Financial Balances

Data corrected by the IGP-DI, converted to the US$ exchange rate for 12/31/97 (R$ 1.116)

With respect to Capital revenue, most noteworthy are credit operations aimed at financing new investments in accordance with the goals and objectives defined by the State Government, thus fostering the conditions necessary for the sustainable growth seen in the State of Bahia.

It should be emphasized that credit operations, while an alternative to attracting financial resources, have been utilized at levels far below legal limits (see Resolution nº 69/95, of the Federal Senate).

On the other hand, the Sale of Assets show a surprising increase in 1997, a fact which is explained by the privatization program initiated by the Government, which has resulted in the privatization of COELBA-Companhia de electricidade da Bahia (state’s electrical company), under conditions extremely favorable to the State.

In terms of Current revenue, tax revenues are the most important, corresponding to more than 60% of the Current Revenue and more than 40% of the total revenue.

Revenue from Federal Government Transfers is important in the revenue for the State of Bahia corresponding to approximately 34% of the Current Revenue and 23% of the Total Revenue in 1997. However, it still does not comprise a determining factor in the upward curve of Revenues Belonging to the Treasury of the State of Bahia, due to the outstanding performance of the already-mentioned Tax Revenues.

The participation of Capital Revenue with respect to Total Revenue in 1997, was 30.5% with the most outstanding being the income stemming from the Sale of Assets in the State Privatization Program.

2.1.2. F.P.E(Fundo de participacao dos estados)-State Participation Fund
The FPE allotment of the State of Bahia is determined by methodological criteria adopted by the Federal Government through the National Treasury Department (Secretaria do Tesouro Nacional), which calculates the participation of each State holding reserves in the trinomial Revenue, Population and Area of the Federated States.

In spite of the fact that Bahia’s FPE share is among the largest in the country, it represents a mere 14.2% of the Total Revenue, being surpassed by the Tax Revenues (42.1%) and by the Capital Revenue (30.5%).

Revenue from the FPE share of the State of Bahia over the last four years (1994-1997) has shown real growth. In 1996, the State received the share of the Participation Fund, the equivalent to US$ 803 million, representing a growth on the order of 2.0%, in comparison to the previous year. And in 1997, US$ 889 million, indicating an increase of 8.81 %, compared to 1996, as it’s shown in table 3.

### Table 3: EVOLUTION OF ICMS AND FPE REVENUE (In US$ Million)

<table>
<thead>
<tr>
<th>REVENUE</th>
<th>1994</th>
<th>1995</th>
<th>95/94%</th>
<th>1996</th>
<th>96/95%</th>
<th>1997</th>
<th>97/96%</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICMS</td>
<td>1,858</td>
<td>2,291</td>
<td>23.3</td>
<td>2,488</td>
<td>8.6</td>
<td>2,432</td>
<td>(2.25)</td>
</tr>
<tr>
<td>FPE</td>
<td>580</td>
<td>787</td>
<td>35.7</td>
<td>803</td>
<td>2.0</td>
<td>825</td>
<td>2.7</td>
</tr>
</tbody>
</table>

Source: Bahia’s General Financial Balance

Data corrected by IGP-DI and converted by the US$ exchange rate for 12/31/97 - R$ 1.116)

#### 2.1.3. ICMS-Tax on circulation of goods and services

The state’s primary source of revenues is the ICMS tax((Imposto sobre circulacao de mercadorias e servicos), which is a tax on the value of goods and services similar to a value-added tax. It is the most important revenue of the State, corresponding to 93.14% of the Tax Revenues, and to 41.15% of the Total Revenue.

As noted before, the ICMS, theoretically, holds strong correlation with the GDP. Historically, the ICMS has shown growth higher than that of the Bahian GDP. In the past three years, for example, (94-96), the ICMS showed average real growth of 19.4%, for an average growth of the Bahian GDP of 4.1%.

### Table 4: REAL GROWTH % - ICMS x GDP/BA

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>ICMS</td>
<td>26.2</td>
<td>23.3</td>
<td>8.6</td>
<td>(2.25)</td>
<td>14.0</td>
</tr>
<tr>
<td>GDP/BA</td>
<td>6.7</td>
<td>1.8</td>
<td>3.9</td>
<td>4.0 *</td>
<td>4.1</td>
</tr>
</tbody>
</table>

*This figure is actual Jan-Sept; estimated Oct-Dec.

Source: Financial Secretariat and Planning Secretariat(SEPLANTEC / SEI)

Given the effects of the new economic measures and, primarily, the repercussions of the Kandir Law, which provokes the reduction of the ICMS revenue in 1997, the average growth projected for the ICMS (1997-2000) is a mere 3.7%, as opposed to an average increase projected for the Bahian GDP of 4.3%.

### Table 5: STATE OF BAHIA - ICMS x GDP

<table>
<thead>
<tr>
<th>YEAR</th>
<th>% REAL GROWTH</th>
</tr>
</thead>
</table>
Yet, it should be noted that the State of Bahia can benefit by the measures adopted by the Federal Government, as long as there is an increase in the volume of resources via the FPE calculation and of the IPI on Exports, given a potential increase of revenues through Income Tax and the Tax for Industrialized Products. Consequently, the expectations hold that the State of Bahia will not be affected by the adoption of the recent economic measures since it is already financially balanced and adjusted and, on the contrary, even able to come out ahead.

In absolute terms, the revenue from ICMS in the State of Bahia is among the largest tax collections in the country (São Paulo, Minas Gerais, Rio de Janeiro, Rio Grande do Sul, and Paraná).

This is also reflected at the fact that Bahia had the largest percentage increase of the collection of ICMS among other large State collectors over the period 1993-96. Over the cumulative period 1994-96, the rate of growth was 33.94%, also higher than that of the other States examined.

Table 6: ICMS COLLECTION OF MAJOR BRAZILIAN STATES (In US$ Million)

<table>
<thead>
<tr>
<th>STATES</th>
<th>1994</th>
<th>1995</th>
<th>1996</th>
<th>95/94%</th>
<th>96/95%</th>
<th>96/94%</th>
</tr>
</thead>
<tbody>
<tr>
<td>SÃO PAULO (SP)</td>
<td>16,377</td>
<td>20,022</td>
<td>21,289</td>
<td>22.2</td>
<td>6.3</td>
<td>30.0</td>
</tr>
<tr>
<td>MINAS GERAIS (MG)</td>
<td>4,419</td>
<td>5,099</td>
<td>5,388</td>
<td>15.4</td>
<td>5.7</td>
<td>21.9</td>
</tr>
<tr>
<td>RIO DE JANEIRO (RJ)</td>
<td>4,161</td>
<td>4,980</td>
<td>5,186</td>
<td>19.7</td>
<td>4.1</td>
<td>24.6</td>
</tr>
<tr>
<td>RIO GRANDE DO SUL (RS)</td>
<td>3,623</td>
<td>3,868</td>
<td>3,984</td>
<td>6.8</td>
<td>3.0</td>
<td>10.0</td>
</tr>
<tr>
<td></td>
<td>94</td>
<td>95</td>
<td>96</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>------------------</td>
<td>-----</td>
<td>-----</td>
<td>-----</td>
<td>----</td>
<td>----</td>
<td>----</td>
</tr>
<tr>
<td>PARANA (PR)</td>
<td>2,409</td>
<td>2,733</td>
<td>2,795</td>
<td>13.5</td>
<td>2.2</td>
<td>16.0</td>
</tr>
<tr>
<td>BAHIA (BA)</td>
<td>1,858</td>
<td>2,291</td>
<td>2,488</td>
<td>23.3</td>
<td>8.6</td>
<td>33.9</td>
</tr>
<tr>
<td>SANTA CATARINA (SC)</td>
<td>1,594</td>
<td>1,849</td>
<td>1,903</td>
<td>16.0</td>
<td>2.9</td>
<td>19.4</td>
</tr>
<tr>
<td>TOTAL</td>
<td>34,441</td>
<td>40,842</td>
<td>43,033</td>
<td>18.6</td>
<td>5.4</td>
<td>24.9</td>
</tr>
</tbody>
</table>

Source: Bahia’s Balance data and COTEPE-Comissao Tecnica Permanente

Graphs 3,4,5: COMPARISON OF ICMS GROWTH IN THE MAJOR STATES

2.1.4. MEASURES ADOPTED TO INCREASE REVENUES
This revenue growth can be explained by different measures undertaken to this achievement in the fiscal and financial areas:

2.1.4.1. FISCAL AREA

A) PGM _Planejamento e Gerenciamento de Mercado

Fiscally, a vigorous modernization program stands out, with an immediate positive effect on fiscal efficiency, whose consequences have manifested themselves as an increase in revenues and optimization of costs... The ICMS collection in the State of Bahia over the past six years (1992-96 and expected for 1997) has shown consistent real growth.

The growth of the ICMS collection can be attributed, among other reasons, to the development of a market management and planning system called PGM..

This program has the objective of the management of tax collection and planning fiscal actions’ with a focus on the economic activity exercised by the taxpayers, resulting in the creation of managers specialized by market sector and implementation of a philosophy of partnership in the treasury-taxpayer relationship.

The needs for the development of this system were: a large territorial system, a large number of taxpayers and the consequent difficulty in coordinating various bureaus.

The achievement can be described as the efficiency of the process of collection and auditing, through a market analysis system, identifying priority segments with their respective taxpayers, selecting opportunities for increasing collection and defining action strategies differentiated by sector. Thus, each "manager" is specialized in each different segment and can compare the collection’s performance with the economic performance of his sector.

The results already obtained are: monitoring of the sectors, fighting tax evasion and growing tendencies of collection.

B) PROMOSEFAZ-(Programa de Modernizacao da Secretaria da Fazenda

The Finance Secretariat developed an important administration modernization program called PROMOSEFAZ, which is being implemented with resources financed by IDB- Interamerican Development Bank and the State Treasury as described below in Table 7:

<table>
<thead>
<tr>
<th>FINANCING SOURCE</th>
<th>AMOUNT US$ Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>IDB</td>
<td>21,000</td>
</tr>
<tr>
<td>STATE TREASURY</td>
<td>20,800</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>41,800</strong></td>
</tr>
</tbody>
</table>

This program has the objectives of modernization, optimization and improvement of public management and its guidelines are:

- institutional strengthening, with heavy investments in the development of human resources;
- management efficiency through the following mechanisms:
  a) result-guided planning and evaluation system;
  b) technical and managerial development and
c) decentralization of operational responsibilities;

- focus on information by:
  a) data base range;
  b) managerial information;
  c) data permanent evaluation; and
  d) integration with external data base;
- modern information technology, including:
  a) data electronic incoming;
  b) package networks;
  c) Internet/Intranet;
  d) client/server architecture; and
  e) distributed data base.

Many results can be already seen, such as the development of the systems below:

- control of in-transit commodities;
- economic-fiscal information;
- information of taxpayers;
- writing infraction reports / fiscal auditing;
- fiscal and tax legislation system;
- management and control of tax credit;
- planning and management of supervision;
- automated management and control of materials.

In order to implement all these systems, there were acquired equipment as described: notebooks, processors PCs, servers, software, printers, scanners and nobreaks.

Also there were acquired 400 vehicles to the fiscal inspectors activities and were altered the installations of the diverse departments of the Secretariat.

Such a fact stems from the success of the previous and current Administration in searching for and localizing new investments for the State, as well as the modernization and systematization of collection and fiscal controls.

2.1.4.2. FINANCIAL AREA:

A) SICOF (Sistema de Informações contabeis e financeiras)
The Secretariat of Finances also developed a finance and accounting information system SICOF which seeks to rationalize functions, routines, programs, files, data structures (on-line and batch), in order to ensure the accomplishment of the following objectives:

- Provide the Secretariat of Finance with an effective instrument for the State’s budget, finance and accountancy control and follow up;
- Automatize the process of public revenue and expense budgetary execution, increasing the degree of consistency and reliability for the recording of the administrative acts and facts subject to registration;
- Systematize the access and to activate the operational and managerial information for use in the several decision-making levels.

The system was designed to meet the demand of about 400 administrative and management units within the Three State Powers, involving the following bodies and entities: Legislative Assembly, Court of Justice, Court of Accounts of the State, Court of Accounts of the Municipal districts, Public Ministry, State Secretariats and Bodies Directly Subordinate to the Governor, Autarchies, Foundations, Special Fund, and the Public Companies and Societies of Mixed Economy in the execution of their Investment Budgets.

To increase the efficiency with regards to one of its basic premises, that is to say, to facilitate a good performance as instrument of managerial information, the administrative and management units were given total operational autonomy, which allows the generation of independent reports, consolidated in several degrees of interaction.

In spite of the Secretariat of Finance being responsible for the management of the system, its operation complies with the principle of Independence of Powers, facilitating, however, the consolidation of the data from all Three Powers as it regards the annual accountability process.

SICOF’s basic functions are to control (1) the annual budgetary execution, (2) the financial administration of the State Treasury resources and (3) the accounting entries.

The execution of the budget occurs only and exclusively through SICOF which, by means of the appropriate technical resources, validates the operations allowed and blocks actions that are not-allowed or do not meet the requirements, including the verification for the existence of enough balances for the intended operation.

Some of its operations are:

- Control expenses through the Table of Quarterly Allotments;
- Itemize the controlled expenses by means of the Plan of Quarterly Application;
- Decentralize credits, by the budgetary units, for execution in the management units;
- Pawning, liquidation and payment of the budgetary expense.

The financial control, under the responsibility of the Treasury Department, has several functions administered by SICOF, among them:

- The financial resources collected by the Treasury, destined to the Secretariats and other Bodies Directly Subordinate to the Governor, are defined in the Plan of Quarterly Applications;
- The expenses are unfolded into sub-sets, in compliance with the Plan of Quarterly Application;
- The amounts to be spent in this period (quarterly) is then made available to the budgetary units according to set schedules and set by the entry of financial resources;
• The budgetary units, on their turn, make the amounts available to the management units or transfer them to the Indirect Administration Entities;

• For the payment to be carried out by the management units, the system checks the consistency of the nature of the expense to be paid and the QCT(Quadro de cotas trimestrais - Table of Quarterly Allotments) resource made available, extending the payment only if compatibility is shown.

• The sources of financial resources are controlled from the entrance of the revenue to the payment of the corresponding expense;

• The amounts extended by the Treasury to the units are recorded and controlled, with the financial resources being kept in the State’s Only Account or Single Account;

• The payments are carried out through the "Electronic Bank Order," by means of data transmission directly to the drawee’s bank.

During the development of the accounting routines, the goal was to simplify the operations, so that they could be executed with a minimum of interference by the user. The accounting entries are automatically selected by the system as the budgetary and financial operations are accomplished.

As foreseen in the system’s project draft, the next step will be its implementation in local networks, using a client-server platform in order to meet the peculiarities of each executing body, with batch processing in the mainframe for updating the data that affects the more than one unit.

2.2. EXPENDITURES

2.2.1. OVERVIEW

The total expenditures of the central administration was U$ 4,798 million in 1997, including the current and the capital expenditures. The Current Expenditures represent approximately 77% of the total expenditures, being US$3,705 million in 1997 and for the period 1994-97, it maintained an average annual growth rate of 16.4%.

The Capital Expenditures of the State represent about 23% (approximately US$1,093 million), of the Total Expenditure in 1997, as shown below:

| Table 8 : GENERAL EXPENDITURES OVERVIEW 1994 / 1997 (In US$ Million) |
|------------------|-----|-----|-----|-----|-----|-----|
| CATEGORY         | 1994| %   | 1995| %   | 1996| %   |
| 1.CURRENT EXPENSES | 2,392| 76.3| 3,185| 73.0| 3,583| 78.1|
| 1.1.PERSONNEL    | 1,287| 41.0| 1,694| 38.9| 1,809| 39.4|
| 1.2.INTEREST EXPENSES(SERVICE) | 174| 5.5| 228| 5.2| 232| 5.1|
| 1.3.TRANSFERS TO MUNICIPALITIES | 488| 15.6| 620| 14.1| 698| 15.2|
| 1.4.OTHERS      | 443| 14.1| 643| 14.8| 843| 18.4|

| CATEGORY         | 1997| %   | 1997| %   | 1997| %   |
| 2.CAPITAL EXPENSES | 744| 23.7| 1,176| 27.0| 1,008| 21.9|
| 2.1.INVESTMENTS  | 579| 18.4| 656| 15.1| 634| 13.8|

S	In US$ Million}
### 2.2. PERSONNEL EXPENDITURES:

#### Table 9: PERSONNEL EXPENDITURES - 1994 / 2000

<table>
<thead>
<tr>
<th>YEARS</th>
<th>US$ Million</th>
<th>VARIATION%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>1,287</td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td>1,662</td>
<td>29.13</td>
</tr>
<tr>
<td>1996</td>
<td>1,777</td>
<td>6.92</td>
</tr>
<tr>
<td>1997</td>
<td>1,839</td>
<td>3.49</td>
</tr>
<tr>
<td>1998</td>
<td>1,838</td>
<td>0.05</td>
</tr>
<tr>
<td>1999</td>
<td>1,837</td>
<td>0.05</td>
</tr>
<tr>
<td>2000</td>
<td>1,814</td>
<td>(1.25)</td>
</tr>
</tbody>
</table>

Source: Bahia’s General Financial Balances

Data corrected by IGP-DI and converted by the US$ exchange rate for 12/31/97 (R$ 1.116)

The personnel expenditures of the State grew at an average rate of 13% for the period 1994-97. In 1997, the personnel expenditures were US$1,839 million, representing an increase of 3.5% with respect to the previous year and approximately 38% of the Total Expenditures.

Personnel expenditures, while under control (including the number of employees) in fact have show real growth, basically explained by the legal increases in the minimum salary and cumulative remuneration (overtime, holiday pay and other benefits). In 1995 the increase in the minimum salary was 42.86%, in 1996 it was 12% and, in 1997 it was 7.14%.
The level of personnel expenditures of the State, in relation to the Current Net Revenue, has maintained itself below levels established by the Federal Constitution and legal norms (Camata Law).

The percentage level, in addition to showing regard for the law, represents control of public finances exercised by the current and previous administrations of the State of Bahia.

In the 1994-97 period, the levels of personnel expenditures, in relation to the Current Net Income, has always remained below 57%. In the fiscal year 1997, the level is approximately 50%.

Additionally, the newspaper A Folha de São Paulo, on 11/26/97, highlights that the Camata Law is observed by in only 7 Brazilian States. It is the case that among the 6 largest ICMS-collecting States, only the State of Bahia is within the legal limits.

Table 10: PERCENT PARTICIPATION OF THE PERSONNEL EXPENDITURES IN NET CURRENT INCOME IN MAJOR BRAZILIAN STATES

<table>
<thead>
<tr>
<th>STATE</th>
<th>1996 %</th>
<th>1997 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>SÃO PAULO</td>
<td>66</td>
<td>62</td>
</tr>
<tr>
<td>MINAS GERAIS</td>
<td>81</td>
<td>81</td>
</tr>
<tr>
<td>RIO DE JANEIRO</td>
<td>88</td>
<td>81</td>
</tr>
<tr>
<td>RIO GRANDE DO SUL</td>
<td>88</td>
<td>85</td>
</tr>
<tr>
<td>PARANA</td>
<td>77</td>
<td>71</td>
</tr>
<tr>
<td>BAHIA</td>
<td>56</td>
<td>51</td>
</tr>
</tbody>
</table>

Extracted from article published on Folha de São Paulo newspaper, on 11/26/97, pg 01, section 06 - Brazil

* The projection of 52% for Bahia was published in the newspaper.

2.2.3. INVESTMENT AND OUTLAYS:

2.2.3.1. OUTLAYS:
The outlay expenditures of the State of Bahia have shown decreased rates of growth from year to year, with a growth of 18% in 1997, 31% in 1996 and 45% in 1995. Compared to the respective previous years;

Such behavior in the rates of increase in outlays is explained by (1) the conservative position of the state government in relation to public expenses, and (2) in the control of expenditures not only without compromising quality but on the contrary with improvement and expansion of the services provided to the public by the State.

2.2.3.2. INVESTMENTS:

In the period 1995-1997, the investments of the state with own resources increased.

The State puts aside a significant part of its revenues for public investments. The investment programs are basically backed by its own resources and, in complementary fashion, with resources originating from credit operations backed by international organizations (IBRD, IDB, KFW, OECF, etc) and with national creditors (CEF-Caixa Economica Federal, BNDES-National bank of economic and social development, etc).

There are governmental priority investments in progress in areas such as environmental and urban sanitation (Bahia Azul), low-income housing (Viver Melhor), transportation (Corredores Rodoviários), tourism (Prodetur), urban development (Produr), and regional development (Sertão Forte).

The social areas have also been given priority by current and previous governments. The construction of new educational facilities, training and career development centers for teachers, hospitals, health centers, the re-equipment and modernization of the civil and military police are characteristic examples of this governmental action.

The significant increase in the amount of investments in the year 1997 compared to 1996 is explained by the success of the state privatization program confirming the purpose of the government in intensifying the public development projects throughout the State. In 1997, the growth in public investments surpassed the outlay expenditures. And the perspectives are to maintain this level, as shown below:

Table 11: CURRENT EXPENSES AND INVESTMENTS TRENDS

<table>
<thead>
<tr>
<th>YEAR</th>
<th>CURRENT EXPENSES *</th>
<th>ANNUAL VARIATION %</th>
<th>INVESTMENT</th>
<th>ANNUAL VARIATION %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>443</td>
<td>---</td>
<td>579</td>
<td>---</td>
</tr>
<tr>
<td>1995</td>
<td>643</td>
<td>45.10</td>
<td>656</td>
<td>13.30</td>
</tr>
<tr>
<td>1996</td>
<td>843</td>
<td>31.10</td>
<td>634</td>
<td>33.33</td>
</tr>
<tr>
<td>1997</td>
<td>996</td>
<td>18.15</td>
<td>854</td>
<td>34.70</td>
</tr>
</tbody>
</table>

*This don’t include personnel, interest and transfer to municipalities expenses.

Source: Bahia’s General Financial Balances

Data corrected by IGP-DI and converted by the US$ exchange rate for 12/31/97 (R$ 1.116)

2.2.4. MEASURES ADOPTED TO REDUCE EXPENDITURES

Another fundamental program developed by the administration was the reduction of the size of the state through the privatization of state owned companies or outsourcing of services. It was a necessary decision so that the state could concentrate on the execution of its basic functions and consequently reduce expenditures and be more efficient. Some measures have been taken since 1991 such as:

- Privatization of Companhia de Navegação Baiana (CNB), transferring to free enterprises the operation of the ferry-boat system, which has represented annual savings of about US$ 20 million to the State
Treasury;

- Privatization of Companhia de Eletricidade da Bahia (COELBA), bringing US$ 1,553 million to the state treasury. These financial resources will be applied to education, health and infrastructure investments;

- Privatization of BANEB: within the next few days, the state is publishing guidelines calling for two companies of consultants to evaluate and format the bid process for the privatization of this bank;

- Transformation of the DESENBANCO (Bahia State Development Bank) into a Development Agency;

- Outsourcing of Public Services, beginning with some hospitals and other providers of public service such as nurseries and schools;

- Concession for the exploitation of toll roads, notably in face of the duplication of the Linha Verde Highway and BR-324 Highway (Salvador-Feira de Santana);

- Studies are being developed for the privatization of the Empresa Baiana de Abastecimento de Água S/A (EMBASA or Bahia’s Water and Sanitation Company);

- Implementation of the Voluntary Dismissal Program (PDV);

2.3. PUBLIC DEBT

The objective of this section is to present regarding to the public debt of the state of Bahia what has been done by the State over the past four years, what it plans to do in the next three years. It will furnish an evaluation of the results obtained as well as other analyses on the subject -- its origin and evolution over the 1990s. The goal is to show an overview of the sources and the destiny of the originating resources that have been attracted from national and international financial organizations.

The resources originating through state tax collection on their own are not sufficient to attend to the diverse sectors of governmental action. Due to this fact, it becomes necessary to obtain credit where resources are earmarked for specific investments. Such investments follow public welfare guidelines.

2.3.1. main contracts since 1994)

In the 1994-97 period, the State of Bahia added on debt totaling US$ 1,406 million, of which, US$ 1,266 are related to the main programs.

Of the debt incurred over this period, the volume of external operations reached a level of US$ 911 million of which the Inter-American Development Bank contributed US$ 487 million of 53.4%, US$ 329 million the World Bank or 36.1% and the remaining 0.5% came from KFW, FIDA and OECF (a total of US$ 95 million).

The BAHIA AZUL program deserves special attention, combining sanitation measures, environmental preservation, preventive health, elevation of the quality of life standards, and enhanced possibilities for the development of tourism. The programming of investments includes the following credit operations: IDB, in the amount of US$ 264 million, OECF, in the amount of US$ 68 million, IBRD, in the amount of US$ 124 million, in additional to the internal loans signed with CEF (sanitation) at approximately US$ 65 million and BNDES, US$ 19 million.

The project VIVER MELHOR, which focuses on the area of housing, occupies a great allocation of loan resources from 1994-97, at about US$ 98 million, with the Caixa Econômica Federal as the creditor.

The debt contracted with the international financial agencies FIDA and KFW also stands out – it is earmarked for the financing of the program SERTÃO FORTE, which seeks to promote sustainable development in the Semi-Arid region via two routes (1) support for agricultural production and (2) expansion of water supplies.
<table>
<thead>
<tr>
<th>BANK</th>
<th>PROGRAM</th>
<th>OBJECTIVE</th>
<th>CONTRACT AMOUNT</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>IDB</td>
<td></td>
<td></td>
<td>487</td>
<td>38.4</td>
</tr>
<tr>
<td></td>
<td>Bahia Azul</td>
<td>Environmental Sanitation</td>
<td>264</td>
<td>20.8</td>
</tr>
<tr>
<td></td>
<td>PCT</td>
<td>Roadways</td>
<td>147</td>
<td>11.6</td>
</tr>
<tr>
<td></td>
<td>Prodetur</td>
<td>Tourism Development</td>
<td>76</td>
<td>6.0</td>
</tr>
<tr>
<td>IBRD</td>
<td></td>
<td></td>
<td>329</td>
<td>26.0</td>
</tr>
<tr>
<td></td>
<td>Bahia Azul</td>
<td>Environmental Sanitation</td>
<td>124</td>
<td>9.8</td>
</tr>
<tr>
<td></td>
<td>Produzir</td>
<td>Reduction of Rural Poverty</td>
<td>105</td>
<td>8.3</td>
</tr>
<tr>
<td></td>
<td>Produr</td>
<td>Urban Development</td>
<td>100</td>
<td>7.9</td>
</tr>
<tr>
<td>KFW</td>
<td>Sertao Forte</td>
<td>Basic Sanitation-Western</td>
<td>7</td>
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</tr>
<tr>
<td>FIDA</td>
<td>Sertao Forte</td>
<td>Community Development</td>
<td>20</td>
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<tr>
<td>OECF</td>
<td>Bahia Azul</td>
<td>Environmental Sanitation</td>
<td>68</td>
<td>5.4</td>
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<tr>
<td>CEF</td>
<td></td>
<td></td>
<td>178</td>
<td>14.1</td>
</tr>
<tr>
<td></td>
<td>Viver Melhor</td>
<td>Housing and Sanitation</td>
<td>163</td>
<td>12.9</td>
</tr>
<tr>
<td></td>
<td>Pnafe</td>
<td>Modernization of Finance Secretariat</td>
<td>15</td>
<td>1.2</td>
</tr>
<tr>
<td>BNDES</td>
<td></td>
<td></td>
<td>177</td>
<td>14.0</td>
</tr>
<tr>
<td></td>
<td>PCT</td>
<td>Roadways</td>
<td>76</td>
<td>6.0</td>
</tr>
<tr>
<td></td>
<td>Bahia Azul</td>
<td>Environmental Sanitation</td>
<td>85</td>
<td>6.7</td>
</tr>
<tr>
<td></td>
<td>Prodetur</td>
<td>Tourism Development</td>
<td>16</td>
<td>1.3</td>
</tr>
</tbody>
</table>

TOTAL = 1,266 100.0

2.3.2. Composition of the Debt Balance 1994-/97

Table 14: COMPOSITION OF THE DEBT BALANCE (IN US$ MILLION)
The balance owed on the State’s Public Debt reached US$ 4.7 billion in December of 1997. The composition is 93.8% in internal credit operations and 6.2% in external credit. External operations make up only 6.2% (US$ 289 million) which is basically debt contracted with bilateral and multilateral organizations.

The debt increase over the period from 1994 to 1997 was, in absolute terms, US$ 844 million, where the primary cause was bonds debt, due to the policy of high interest rates imposed by the federal government for the fixed-income market. But, since December the bonds debt was assumed by the National Treasury.


Starting in 1994, a decrease in the external debt intaking of the State has been evident as part of the renegotiation, with the Federal Government, of debts together with private international banks -- the Brady Plan. The level renegotiated then enters the balance of internal debt, which, in part, explains the growth of it.

The projection of the total stock of the debt, including those operations of credit in progress, shows a stable profile being estimated through the year 2000.

Graph 7:

In January of 1994, the State of Bahia was part of the national program of consolidation and re-scaling by the Federal Government of internal debt of the States and municipalities. It signed the refinancing contract under the terms of Law 8.727/93 which reformulated its profile of debt intaking.

The refinancing involved contractual debts with CEF-Caixa Econômica Federal, BNDES, Banco Central (renegotiation of BANEB), Banco do Nordeste do Brasil and Banco do Brasil, including the assumption by the State of debts originating from some indirect administration organizations, such as EMBASA, CERB, DESENVALE, BAHIATURSA and CNB.
In 1995, the State of Bahia, authorized by Resolution nº 98/92 of the Federal Senate, signed the refinancing contract for the external debt (Brady Plan), related to principal overdue (since 1988) and subdue, as well as non-remissible interests starting in 1991 owed to foreign private banks. One step forward, therefore, was taken.

In February of 1996, after the elimination of DESENALE-Companhia de Desenvolvimento do Vale do São Francisco, the State Treasury, together with the National Treasury, took over its debt. During the same period it also sized the URBIS-Habitacao e Urbanismo da Bahia- debt related to bonds credit under support of Law 8.727/93.

Finally, in the second half of 1997, the State signed, together with the Federal Government, the refinancing contract of its bonds debt in terms of Law 9.496/97.

It is important to clarify that such negotiations are not the result of specific gratuity of the Federal Government towards the State of Bahia. In the first place, the total debt of the State, compared with all the other States, has always been small or modest. The Central Bank’s August ‘97 report, for example, indicates a share of just 4.4% of which bonds debt is only 1.6%. The Government of the State, therefore, adopted a nation-wide program, much more oriented toward the improvement of other large States and, along these lines, it would be counterproductive for Bahia not to comply, when beneficial, advantageous conditions were offered.

2.3.4. Debt Balance as Guarantee

The debt balance of the Public Debt of Bahia is supported by guarantees that amount to US$3.572 million, counter-guarantees amounting US$ 249 million. Additionally, US$779 million of LFTBA’s debt is guaranteed by the State Treasury itself, through the Public Debt Fund.

The FPE stands out as the principal source of income used as guarantee and counter-guarantee for credit operations.

A small part of the reserve -10.1 %- is guaranteed by mutual real estate mortgages, corresponding to the URBIS debt (Law 8.727/93), taken over by the State in 1996.

2.3.5. Expenses of debt (service)

The service of debt of the State of Bahia, in 1997 was US$492 million, representing a variation relative to 1994 of 42.3 %.

In 1995 and 1996, increases occur in expenses due to bonds debt turnover, which led to accounting entries of amortization through redemption and revenue from bonds placement. However, excluding these entries, a discrete growth in expenses is observed along with a tendency toward stabilization through 1997, shown by a decline in relative terms.

With regard to the role of expenses in the Real Net Income, a steady behavior is seen within the legal limits (in accordance with Resolution 69/95 of the Federal Senate).

The portion of the State income earmarked as guarantees for the payment of expenses is approximately 50% of the States Participation Fund. This means that Bahia is capable of paying almost twice its annual debt service.

2.3.6. Debt Intaking Capacity

According to Resolution 69/95 of the Federal Senate, the State of Bahia has kept itself within the legal limits of debt intaking, maintaining, still, an available margin for new contracts. Until September/1997 (the last updated information), the State has committed only 16.7% of the Real Net Income, in contrast to the 27% established by the law, as shown in Table 14:

CAPACITY OF THE STATE TO INCURR DEBT (In US$ Million)
I- AMOUNT THAT THE STATE CAN INCURR

<table>
<thead>
<tr>
<th>27% RNR *</th>
<th>AMOUNT CONTRACTED</th>
<th>MARGIN AVAILABLE</th>
</tr>
</thead>
<tbody>
<tr>
<td>US$ 982</td>
<td>607</td>
<td>375</td>
</tr>
</tbody>
</table>

II- MAXIMUM ANNUAL EXPENSES ALLOWED UNDER LAW

<table>
<thead>
<tr>
<th>YEAR</th>
<th>16% RNR</th>
<th>ANNUAL EXPENSES **</th>
<th>MARGIN AVAILABLE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>US$ 582</td>
<td>422</td>
<td>160</td>
</tr>
<tr>
<td>1998</td>
<td>US$ 608</td>
<td>485</td>
<td>123</td>
</tr>
<tr>
<td>1999</td>
<td>US$ 625</td>
<td>524</td>
<td>101</td>
</tr>
<tr>
<td>2000</td>
<td>US$ 652</td>
<td>556</td>
<td>96</td>
</tr>
</tbody>
</table>

* Under Federal laws, the state is not allowed to incur new debt above 27% of its REAL NET REVENUES (RNR)= Total Revenue - Credit operations Revenue - Sale of assets - Transfers to municipalities. In this case, the state has US$ 607 million of debt which is not above the federal regulations. US$ 627 million from August 1996 to July 1997.

** Exclusive to law 7976/82.

Source: Finance Secretariat/DEPAT- Treasury Department.
Converted by the dollar of 09/30/97 (R$ 1.0964)

With regard to the capacity for payment, as the expense overview shows, the situation is also comfortable: annually, the State spends on debt-related services an average of 14% of its Real Net Income, as opposed to the 16% authorized by law.

2.3.7. Swap of the Bonds Debt

The process of swapping debt (bonds) of the State of Bahia was recently concluded, having been signed, with the Federal Government, a consolidation and debt refinancing contract as it regards the Program of Support and Re-structuring and of the Fiscal Adjustment of the States (Federal Law 9.496/97).

The previous conditions imposed on bonds, such as state bills, imposed high fees due to national financial market policies.

The refinancing delineates a new profile marked by longer payment periods as well as fee reduction. The new debt profile will allow the State annual saving of more than US$200 million, anticipating the obligations that must be undertaken with high internal interest fees, as recently determined by the Federal Government.

2.3.8. PRESENT SITUATION OF THE DEBT

2.3.8.1. Retaking Access to Multilateral Organizations Since 1993

The State of Bahia has had access to bilateral and multilateral financial institutions since 1981, notably the IDB, KFW, the World Bank, and, more recently, FIDA and OECF.

During the 1980s, however, due to failures in the completion of projects and declarations of defaults, relations of the State with Multilateral Agencies deteriorated. Starting in 1993, with the improvement and financial re-ordering of the State, relations resumed, with open recognition of a situation of regularity, principally attested by the IDB and by the World Bank, making viable requests for new development loans.
The resources acquired through these organizations have been directed toward a variety of public works projects, including housing, basic sanitation, environmental cleanup, roadways, electricity, community development, agricultural stimulation, and tourism development.

### 2.3.8.2. Debt in Adjusted Profile

Starting in 1991, the State of Bahia has developed actions oriented toward promoting the adjustment of its debt taking profile.

Thus, contracts have been signed with the federal government, lengthening the existing plan of old credit operations and obtaining better financing conditions. These negotiations are being properly timed by adjustment programs delineated for the states. Currently, 60% of the internal debt stock comes from contracts made before 1991, renegotiated under this program.

With regard to the external debt, all the financing obtained since 1991 has originated from multilateral and bilateral organizations, whose rates meet the policy for a better financial resources attraction for the investments in the State.

### 2.3.8.3. Inexistence of "Aros" (Anticipated Budgetary Income)

Under the current composition of state public debt, there are no records of credit operation for the anticipation of budgetary income (ARO).

### 2.3.8.4. Inexistence of Default

Punctuality in debt payments has been characteristic of the State of Bahia (or Administration) since 1991.

### CHAPTER IV - PRESENT SITUATION OF THE STATE

#### 1. RESULTS

The total revenue of the State of Bahia shows a tendency for growth that even the most conservative projections indicate will persist. During the period 1994-97, this revenue almost doubles in real terms (table 2) surpassing the level of US$ 3.055 billion for a total of US$ 5.8 billion in 1997. The Current Revenue continue showing a tendency for growth. During the past four years there has been a persistent growth in tax revenues, reflecting the implementation of fiscal and economic policies by the State Government.

One of the best results of the fiscal adjustment in Bahia is the foreign currency issuer credit rating "BB-" assigned by Standard & Poors to the state and the fact that it was constrained by the "BB-" foreign currency rating of the Federative Republic of Brazil.

Below there is the transcription of the article "Bahia(State of) NEW RATING" pages 62/65 from the magazine "Standard & Poors Credit Week" -March 25,1998 - Rating News:

"Bahia exhibits the following credit characteristics:

- A highly professional and progressive administration that is focused on critical infrastructure investment, economic development and management reforms;
- Adequate financial performance that has remained balanced over time as capital investment has increased;
- A debt burden that is currently considered manageable on a per capita basis ($367), but higher when debt service as a percent of budget is considered; and
- Recent increases in private economic investments (totaling $2.6 billion in 1995 and 1996), which in addition to state investments, have contributed to average annual increases in real gross state product of
"Under the current administration (in its second four-year term), the state has embarked on several reforms designed to promote economic development and improve services through efficiencies in government. The administration has consolidated departments and considerably reduced its number of agencies. Through a voluntary dismissal program, the state reduced its staff by 8,000 or 4% of the total.

In addition, the administration has implemented a privatization plan. In 1997, the state auctioned COELBA—the state-owned power distribution company—to private investors for approximately $1.5 billion. Roughly $400 million of the proceeds will be used to create a retirement fund for state employees. This innovative use of funds is part of the administration’s program to continue to reduce the state’s personnel costs that now constitutes approximately 50% of the state’s current expenses (Below the legal limit of 60%).

The state is currently developing plans to privatize one of the state’s two banks, BANEB. The state has committed to borrow $330 million to "recapitalize" the bank to make it more attractive to potential buyers. While the additional $330 million in debt is considered manageable, it is not certain at this time if that amount will prove sufficient."

2. PROJECTIONS: 1997-2000

2.1. REVENUES

The State estimates that Total Revenue for the 1997-2000 period will increase moderately given the historical evolution of the numbers for the period 1994-1997.

Table 15

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1998</td>
<td>1999</td>
</tr>
<tr>
<td>1 - CURRENT INCOME</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.1 - Tax Income</td>
<td>4,534</td>
<td>4,664</td>
</tr>
<tr>
<td>1.1.1 - ICMS</td>
<td>2,870</td>
<td>2,956</td>
</tr>
<tr>
<td>- Other</td>
<td>2,756</td>
<td>2,839</td>
</tr>
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<td>1.1.2 - Fees</td>
<td>77</td>
<td>82</td>
</tr>
<tr>
<td></td>
<td>5</td>
<td>5</td>
</tr>
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<td>1.2 - Accrued Income</td>
<td>113</td>
<td>118</td>
</tr>
<tr>
<td>1.2.1 - Financial Operations</td>
<td>183</td>
<td>166</td>
</tr>
<tr>
<td>1.2.2 - Others</td>
<td>176</td>
<td>158</td>
</tr>
<tr>
<td></td>
<td>8</td>
<td>8</td>
</tr>
<tr>
<td>1.3 - Current Transfers</td>
<td>1,416</td>
<td>1,474</td>
</tr>
<tr>
<td>1.3.1 - FPE</td>
<td>969</td>
<td>1,010</td>
</tr>
<tr>
<td>1.3.2 - INH</td>
<td>108</td>
<td>113</td>
</tr>
<tr>
<td>1.3.4 - Others</td>
<td>339</td>
<td>351</td>
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<tr>
<td>1.4 - Other Income</td>
<td>65</td>
<td>67</td>
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<tr>
<td>2 - FINANCIAL INCOME</td>
<td>459</td>
<td>309</td>
</tr>
<tr>
<td>2.1 - Credit Operations</td>
<td>445</td>
<td>302</td>
</tr>
<tr>
<td>2.2 - Sale of Assets(*)</td>
<td>14</td>
<td>6</td>
</tr>
<tr>
<td>2.3 - Other Financial Income</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>3 - TOTAL INCOME</td>
<td>4,993</td>
<td>4,972</td>
</tr>
</tbody>
</table>

Source: Bahia’s General Financial Balances

Adjusted by the average IG/P-D inflation index.
Current Revenues and Tax Revenues are expected to increase given the demonstrated historical performance. However, the government’s projections are correlated to the GDP growth of Bahia and Brazil both of which are conservative.

Furthermore, the trend of revenue from Sale of Assets shows a decline and Current Transfers maintain their tendency toward growth as correlated with the growth of the Brazilian GDP which are conservative and consistent.

Capital revenue, given prospective credit operations, will decline over time starting in 1998. This shows the comfortable situation of the State in undertaking new debt.

Revenues from the sales of assets are projected under the privatization program. In 1998, the privatization of BAHIAGAS is in the works. Once this privatization is done, revenue from the sales of assets ceases to be significant.

2.2. EXPENDITURES

Total Expenditures projected for the 1997-2000 period shows a declining tendency.

The Current Expenditures are determined with regard to the rationalization of Current Expenses within the legal parameters, making possible, for example, an annual increase, starting in 1998, of 2.0% for Staff.

Table 16:

<table>
<thead>
<tr>
<th>PROSPECTIVE EXPENSES</th>
<th>BUDGETARY BALANCE PROJECTION - 1997/2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>DESCRIPTION</td>
<td>1997</td>
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<tr>
<td>1 - CURRENT EXPENSES</td>
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<tr>
<td>1.1 - Personnel</td>
<td>3,748</td>
</tr>
<tr>
<td>1.1.1 - Active Employees</td>
<td>1,871</td>
</tr>
<tr>
<td>1.1.2 - Retired Employees</td>
<td>1,540</td>
</tr>
<tr>
<td>1.2 - Debt Burdens</td>
<td>322</td>
</tr>
<tr>
<td>1.3 - Other Current Expenses</td>
<td>338</td>
</tr>
<tr>
<td>1.3.1 - Transfers to Municipalities</td>
<td>1,539</td>
</tr>
<tr>
<td>1.3.2 - Transfers to Autarchies and Foundations</td>
<td>734</td>
</tr>
<tr>
<td>1.3.3 - Transfers to Funds</td>
<td>176</td>
</tr>
<tr>
<td>1.3.4 - Direct Applications</td>
<td>170</td>
</tr>
<tr>
<td>1.3.5 - Other Current Expenses</td>
<td>411</td>
</tr>
<tr>
<td>1.3.6 - Other Current Expenses</td>
<td>47</td>
</tr>
<tr>
<td>2 - FINANCIAL EXPENSES</td>
<td>1,116</td>
</tr>
<tr>
<td>2.1 - Amortizations</td>
<td>204</td>
</tr>
<tr>
<td>2.2 - Total Investment</td>
<td>1,272</td>
</tr>
<tr>
<td>2.2.1 - Financial Investments</td>
<td>137</td>
</tr>
<tr>
<td>2.2.2 - Investments</td>
<td>1,034</td>
</tr>
<tr>
<td>2.3.3 - Other Financial Expenses</td>
<td>21</td>
</tr>
<tr>
<td>3 - TOTAL EXPENSES</td>
<td>5,164</td>
</tr>
</tbody>
</table>

The debt burden is declining due to the lack of new contractions (this can be seen in the Revenue from Credit Operations). On the other hand, the transfers to funds, autarchies, and foundations show stable levels through 2000. The stability of the Transfers to Municipalities is correlated to the Total Revenue, as it is constitutionally protected.

Finally, given the current levels of debt and prospective debt, the Administration is committed to invest via "the Pluriannual Plan of Government Investments" that includes the legal and financial elements guiding Investments.

2.3. INVESTMENT PROGRAMS

The planned investments for the period 1997-2000 are significantly superior to the previous three-year period 1994/96, which averaged about US$ 626 million. In 1997 just with the State’s resources, US$ 479 million were
invested, in addition to US$392 million from other sources, making total investment US$871 million.

In the three-year period 1998-2000, investments from its own resources are estimated to be US$ 686 million, US$558 million, and US$590 million. Related sources of investment (including credit operations) are estimated at US$526 million, US$386 million and US$285 million. Thus, Total Investments for 1998-2000 will total US$1,212 million, US$944 million and US$875 million, respectively.

For the prospective period, programs in the area of Water Resources, Power Generation, Culture, and Planning stand out. In the area of Water Resources, the Bahia Azul program will make a series of interventions in Environmental Sanitation, totaling US$390 million in the 1997-2000 period. It should be emphasized that in Sanitation and Housing alone another US$ 421 million will be spent in the projected period.

The Highway Program (Corredores Rodoviários), vital to the production in the Western region of the state, will be concluded in the coming year. Tourism was given priority, with resources for the three-year period 1997/99 estimated to total US$199 million, while support to rural communities through Project Produzir, will have resources allocated up to the year 2000 of US$137 million.

Table 17: PROJECTED INVESTMENTS

<table>
<thead>
<tr>
<th>YEAR</th>
<th>INVESTMENTS IN US$ MILLION</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>TREASURY</td>
</tr>
<tr>
<td>1998</td>
<td>686</td>
</tr>
<tr>
<td>1999</td>
<td>558</td>
</tr>
<tr>
<td>2000</td>
<td>590</td>
</tr>
</tbody>
</table>

Table 18: TREASURY INVESTMENTS

<table>
<thead>
<tr>
<th>YEAR</th>
<th>FREE</th>
<th>COUNTERPART</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>AMOUNT</td>
<td>%</td>
<td>AMOUNT</td>
</tr>
<tr>
<td>1998</td>
<td>517,928</td>
<td>75.5</td>
<td>167,766</td>
</tr>
<tr>
<td>1999</td>
<td>428,729</td>
<td>76.8</td>
<td>129,266</td>
</tr>
<tr>
<td>2000</td>
<td>515,371</td>
<td>87.2</td>
<td>74,983</td>
</tr>
</tbody>
</table>

2.4. SOCIAL SECURITY AND PENSION LIABILITY FUND

It is a pioneer initiative, in terms of Brazilian States, aiming to make possible the implementation of a new pension model. The facts are as follows:

- In the year 2011, the retirements and pensions will make up 50% of personnel's payroll, a gradual reduction of the State’s current duties is intended.
- The current expenditure (US$ 1.8 billion per year) of the Treasury with Personnel will be above US$ 2.4 billion given conservative projection for next 30 years.
- The ratio of personnel expenses and Net Current revenue current stands at 50.90%. The aim is to reduce this ratio to about 39.86% at the end of this 30-year period (considering an annual 2% INCREASE in the NET INCOME). With the FUND, those figures will be reduced to 30.29% at the end of that same period.
- For the capitalization of the FUND, the following funds are being made available:
  US$ 360 million from the State Treasury.
  EMBASA (to be privatized) share sale revenue amounting to US$ 36 million.
State real estates, amounting to US$ 36 million.


Keeping the contributions by the public workers, with an initial reduction in the amounts for posterior growth along the years.

Increasing the contribution by the State, with increment of more than 60% of current amounts, along the years.

- Outsourcing the administration of the FUND would allow other State expenses to be immediately reduced, such as the administrative expenses of IAPSEB(Instituto de Assistencia e Previdencia Social do Estado da Bahia).

- Considering a totally conservative administration, and taking into consideration only the application of those US$ 360 million, the FUND would have a "useful life" of 21 years.

2.5. PROGRAM OF FISCAL INCENTIVES

As a consequence of the stage of budgetary balance and sanitation of the public finances achieved, the state of Bahia feels at ease to sign, by means of adequate negotiation, serious and realistic commitments with segments and entrepreneurial groups that, by the activity developed or by these germinative effects in the attraction of other investments, represent potential originators of the process of economic growth and social development.

The government of the state of Bahia is aware that the partnership between the public power and the private investor is a factor essential to swiftness of development of the state. From the investor’s point, the guarantee of return required by the magnitude of the disbursements undertaken must present itself, overall, concrete and foreseeable. To the state, by its turn, it falls to ensure conditions of stimulus to the serious and well administered enterprise, be it by means of adequate infra-structure, be it by the concession of fiscal incentives and of lines of credit capable of contribute to the efficiency and longevity of the new businesses.

The State of Bahia’s foreign trade challenges will be very large until the end of this decade. According to our previews, the state’s GDP should reach US$43.0 billion by the year 2000, representing an average annual expansion of 5.0%. Therefore, it can be estimated a foreign trade flow of US$6.0 billion for that year representing an average annual growth of 10.0%. Reaching this target the State of Bahia will have gotten the proportion of 14.0% of the its GDP that is the same proportion registered by the brazilian foreign trade in 1995.

This should be a target to be attained by the private sector of the economy and secondly by the government. The state and federal governments should stimulate the private sector providing good conditions for doing business and for new investments. The private sector should look for new business and work together with the government presenting to it the new business opportunities. And both, government and the private sector should work for the expansion of the international trade flow and stimulate the new investments that are the propulsive force for development.

Thus, allying itself with the Federal Government inasmuch as respects the recent measures -consubstantiated in Law n 9444/97- specifically directed at the automotive segment taken with the objective of promoting the development of the Northern and Northeastern and Central-Southern Regions and, viewing at, by the use of competence to it bestowed in the terms of the Federal and State Constitutions, the state of Bahia has been working ceaselessly on the edition of new norms, as well on the adequacy of those ones existing, with the objective of offering to the enterprises of the automotive sector significant incentives and proper to the implantation and expansion of enterprises of the branch.

FINAL REMARKS
The Directors of IMF commended the progress made in setting the finances of the states of Brazil on a more sustainable path, in particular through the restructuring of their debt at substantially reduced interest rates. To ensure long-term sustainability, it was essential that debt restructuring be accompanied by the negotiation and firm implementation of strong fiscal adjustment programs by the states, and by the use of a large share of their privatization proceeds to reduce debt.

They also stressed the importance of speedily concluding the negotiations of such programs, and emphasized that expenditure restraint will be key to the states’ fiscal adjustment in 1998. Moreover, the federal government will need to monitor closely and enforce firmly the implementation of those programs, and to ensure that the states fully service their rescheduled debt.

The directors still welcomed the authorities’ recent progress in obtaining Congressional approval of the proposed constitutional reforms concerning the social security and public administration system, and the prospect of final approval of that legislation in the near future. Some Directors noted, however, that it would be desirable to move forward as soon as possible with a further, more comprehensive reform of the social security system.

Directors welcomed the steps taken in the context of the fiscal package to eliminate some important regional fiscal incentives and to streamline direct taxation, as well as the authorities’ intention to put forward soon proposals for a comprehensive fiscal reform and their efforts to improve efficiency in health and education spending. They also took note of the recent improvements in key social indicators, and encouraged the authorities to continue to strive for a reduction of poverty and income inequality.

This valuation from IMF is good. But it’s obvious that a democratic system such as the Brazilian one needs a great deal of patience and competency to overcome all these challenges. Up to this moment, the Brazilian federal government has gotten satisfactory success in this field.

Brazil is headed in the right direction. The same can be said about the state of Bahia, which finds itself in a privileged position of financial stability, with 1)its own resources available for investment, 2)public accounts in satisfactory condition as a result of the implementations of administrative reforms and 3)positive economic tendencies.

The positive tendencies are identifiable as 1)an emerging economy, 2) large areas to be exploited, 3) viable infrastructure conditions, 4) relatively unique advantages and 5) growing markets. Furthermore, the state has welcomed investments to diversify its economic base.

The positive effect of governmental policy-making, however, is neither established nor sustained without strong political determination. The entire country knows that the state of Bahia has earned its place in the national political scene.

According to the Governor Dr. Paulo Souto, "Bahia is now conscious of how important the decisions made since 1991 are. Compared to other states of the country, the conclusion is that Bahia anticipated many decisions, preparing itself to this difficult period of transition looking forward to having an economic stability. The task is hard, but together we will get it. We will continue the efforts to a new level of development for Bahia, resulting in better conditions of life for the Bahian population".

"Not knowing it was impossible to do, he went there and did it"

Jean Cocteau

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