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The Impact of Brazil's Fiscal Adjustment on External Financing of Public Projects

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ABSTRACT

The main objective of this paper is to analyze the external financing of Brazilian public projects given the fiscal adjustment program and the requirements and restraints of the Fiscal Responsibility Law[1]. The study takes into account the financial performance of loan agreements from the International Bank for Reconstruction and Development (IBRD) and the Inter-American Development Bank (IDB).

The central idea of the text is that the Brazilian commitment to fiscal discipline has slowed the country's execution of public investments and disbursement of external loan agreements. The considerable budget rigidity aggravates that scenario and circumscribes the government's ability to allocate budget resources to its priorities.

The immediate consequence of these facts has been the low performance of public projects financed by foreign funds in all areas: health, education, water, roads, etc. Moreover, the impossibility of new credit operations has been responsible for a reversal in the capital flow between Brazil and multilateral organizations.

The newly-elected government has committed itself to resume solid and sustainable economic growth and to meet social needs while maintaining fiscal discipline. Bearing that in mind, the paper concludes by presenting alternative proposals to minimize the impact of fiscal measures on public projects implementation and on disbursement of external resources.

[1] The views expressed in this work are those of the author and do not necessarily reflect institutional positions of the Secretariat of National Treasury.

INTRODUCTION

Over the last decade, Brazil has undertaken structural economic initiatives, including trade liberalization, elimination of chronic inflation, privatizations, and financial sector reforms. Despite these actions, the public debt increased sharply. Since the 1994 *Real* Plan, the net public debt increased from the equivalent of 30.4 percent of GDP at the end of 1994 to 58.1 percent of GDP at the end of 2003[2]. This increase was due to several factors, such as high real interest rates, currency devaluation, recognition of past liabilities, and successive fiscal deficits[3].

In October 1998, seeking to balance the public accounts, the government launched a fiscal stability program that combined rigorous targets for the primary fiscal surplus with tight subnational fiscal discipline enforced by state debt refinancing agreements[4]. One month later, to defend the *real* against speculative attacks caused by the Russian crisis and to support the country's fiscal program, Brazil and the International Monetary Fund (IMF) entered into a three-year stand-by arrangement, which made available funds equivalent to US$18.1 billion.

In addition, the Fiscal Responsibility Law (FRL) was passed in May 2000. This Law established principles, rules and regulations with a view of consolidating a responsible fiscal management regime at the federal and subnational levels of government (states, Federal District and municipalities). The legislation defined limits for fiscal variables and created mechanisms that allow the achievement of targets, as well as stipulated procedures to correct any possible deviations. Furthermore, the FRL determined institutional penalties for fiscal administrations and assigned personal responsibility wherever previously established rules and regulations were contravened.

Regardless of the aforementioned measures, debt costs have recently been driven up by other factors: the market reverberations of September 11, 2001; the Argentine debt crisis of late 2001; and the market uncertainty in 2002 about Brazil's fiscal performance after the general

[2] This concept of net public debt includes: the Federal Government debt, the Central Bank debt, the States and Municipalities debt, and the public enterprises debt. During the same period, the net debt of Federal Government and Central Bank raised from 13.1 percent of GDP in 1994 to 36.8 percent of GDP in 2003. These data are from Central Bank and from Ilan Goldfajn and Eduardo Guardia in *Fiscal Rules and Debt Sustainability in Brazil,* Banco Central do Brasil Technical Notes, n?39, July 2003, p. 16.

[3] World Bank, Country Assistance Strategy 2003-2004 for The Federative Republic of Brazil, Washington-DC. November 10, 2003, p.3.

[4] *Ibid.*

election. These factors contributed to increased spreads on Brazilian sovereign bonds and to depreciated currency in 2002.

As a result, the government redoubled fiscal discipline to control the public debt-to-GDP. ratio and to strengthen international creditability in Brazilian economy. On September 6, 2002, Brazil and IMF settled a US$30 billion stand-by arrangement[5]. The agreement required that primary surplus should be 3.75 percent of GDP in 2003 and that the inflation-targeting regime should continue.

In February 2003, newly-elected President Luiz Inácio Lula da Silva announced the elevation of primary surplus target to 4.25 percent of GDP, showing his commitment to carrying on the started fiscal reforms. In December 2003, a new one-year preventive IMF Program was concluded, augmenting Brazil's stand-by credit by SDR 4.5 billion (about US$6.6 billion) and extending it for 15 months[6].

The new government has committed itself to both macroeconomic stability and more equitable growth. Brazil's 2004-2007 Multi-Year Plan sent to the Congress in August 2003, gives high priority to efforts to eradicate hunger (Zero Hunger Program - *Fome Zero*), to create youth employment (First Employment Program - *Primeiro Emprego*), and to unify transfer programs for reducing poverty (Family Program - *Bolsa Familia*). Notwithstanding, the fiscal discipline and the considerable budget rigidity – resulting from the earmarked revenues and mandatory expenditures – have constrained the government's possibilities to allocate budget resources to its social program priorities[7].

Brazil's fiscal adjustment program has markedly reduced public investments. Budget cuts to meet primary surplus targets associated with earmarked revenues and constitutionally mandated expenditures have left little room for discretionary investment spending. Besides, since 1999, expenditures funded by loans from international financial institutions are considered as

[5] Letter of Intent for Financial Support from IMF written by President Fernando Henrique Cardoso. August 29, 2002.

[6] Letter of Intent for Financial Support from IMF written by President Luiz Inácio Lula da Silva. August 20, 2003.

[7] This subject is widely discussed in the document *Vinculação de Receitas dos Orçamentos Fiscal e da Seguridade Social e o Poder Discricionário de Alocação dos Recursos do Governo Federal* from Ministry of Planning, Budget and Management, Secretariat of Federal Budget, Brasília, February 2003.

regular budget expenditures, and thus are constrained by fiscal targets[8]. As a consequence, the pace of disbursements against external loans has slowed since 2000.

These measures have reduced budgets for investment projects supported by international financial institutions. Currently, multilateral organizations, such as the World Bank and the Inter-American Development Bank (IDB), hold about 14 percent of Brazilian federal external debt, the equivalent of US$10.7 billion[9]. While that percentage is small relative to the size of Brazil's external financial flows, partnerships with multilateral organizations have been fruitful. The low-cost of their financing has been relevant for meeting a part of Brazil's gross external liabilities of about US$70 billion[10] annually and for financing medium and long-term public projects. At the same time, these institutions have contributed technical assistance and knowledge based on their global experience.

The decrease in the disbursement of external resources has led Brazil to spend higher amounts on commitment fees, which are the charge usually due on the non-disbursed balance of loans. Also, the impossibility of new credit operations, stemming from the lack of fiscal space to include them in the annual budget law, has been responsible for a reversal in the capital flow between Brazil and the aforementioned multilateral organizations. Since 2000, the amount of resources entering into the country has fallen annually. In 2003, the World Bank and the IDB sent to Brazil US$2.38 billion. Over the same period, the country paid them US$4.79 billion, with US$3.67 billion as amortization and US$1.13 billion as fees[11]. In other words, the net negative resource transfer was about US$2.4 billion. To maintain the bilateral accounts in balance, the Brazilian government must create the conditions for public investment to recover.

This paper proposes alternative actions that aim to minimize, in the short-term, the impact of fiscal adjustment on the implementation of public projects. The subject is presented in five

[8] World Bank, *Country Assistance Strategy 2003-2004 for The Federative Republic of Brazil,* Washington-DC. November 10, 2003, p.25.

[9] Secretariat of National Treasury – STN/CODIV/GEEST

[10] *Ibid.*

[11] BRAZIL. Ministry of Planning, Budget and Management. Secretariat of International Affairs. *Fluxo Financeiro entre Brasil e Banco Mundial/BID*. Brasília. December 2003.

sections. First, in order to introduce the fundamentals of Brazil's fiscal program, the work begins with a brief overview of macroeconomic policy from 1994 through President Lula's administration.

The second section provides information on budgetary planning in Brazil in light of the Fiscal Responsibility Law. The Multi-Year Plan, the Budgetary Guidelines Law, and the Annual Budgetary Law are presented. In that way, one will understand the entire current legal structure that requires the Brazilian government to seek fiscal discipline.

Next, the performance of public projects funded by IBRD and IDB is examined, as well as the negative consequences of slower execution of those projects on the capital inflow.

The fourth section exposes the investment priorities of President Lula's administration and the overall resource allocation planning for the next four years according to Brazil's 2004-2007 Multi-Year Plan sent to the National Congress.

The challenge of meeting the primary surplus targets, considering the rigidity of the Brazilian budget, is analyzed in the fifth section. Moreover, the impact of fiscal targets on the performance of public projects financed by external loans is examined.

Finally, based on the current fiscal scenario and on the performance of public projects, some findings and proposals are reported as alternatives to ensure the fulfillment of the Multi-Year Plan objectives.

1. BRAZILIAN FISCAL ADJUSTMENTS OVER THE LAST TEN YEARS

Throughout the last decade significant economic reforms were implemented in Brazil aiming at stabilizing inflation, balancing the country's external accounts, and adjusting the public sector budget. During this period, the fiscal policy varied in accordance with the relevance policy-makers gave to diverse fiscal tools and with the ongoing government priorities. These years can be separated into three different phases.

1.1 First years of the *Real* Plan – 1994-1998

In July 1994, the Brazilian government initiated a new stabilization program which had been announced some months before. The *Real* Plan was conceived based on the assumption that Brazil's inflation rate was related to the public deficit and general indexation of the economy's nominal contracts. Consistent with this diagnosis, the strategy adopted was promoting a short-term fiscal adjustment and applying a price index to stabilize relative prices before the monetary reform introduced a new currency – the *real*.

The fiscal adjustment pillars just before the *Real* Plan and during subsequent years were: (i) revenue de-earmarking, by creating the Social Fund for Emergency (*Fundo Social de Emergência* – FSE), later called the Fund for Fiscal Stabilization (*Fundo para a Estabilidade Fiscal* – FEF); and (ii) tax revenue expansion.

The rigidity of government spending has broadened significantly over the last two decades. Some kinds of expenses - payroll, social security and earmarked expenditure – generated high pressures on the federal budget and public fiscal accounts. Authorities were aware that price stability would demonstrate the imbalance between flows of primary revenues and expenditures, since taxes were protected against inflation by indexing, whereas government expenditures were established in nominal terms. As a consequence, inflation caused a reduction in public spending in real terms. Thus, the prices stability would expose this "hidden" public deficit. This fact called for measures aiming to manage government accounts. Therefore, in 1994, the de-earmarking of 20 percent of all federal taxes and contributions was legally enforced for the constitution of the Social Fund for Emergency / Fund for Fiscal Stabilization. This fund was supposed to be temporary, until 1996. However, the term was extended to 1999. In 2000, the De-earmarking of Budget Revenues (*Desvinculação de Receitas Orçamentárias* – DRU) was created to maintain the percentage of revenues de-earmarked.

With regards to the revenues, administrative measures were adopted to combat the fiscal evasion. At the same time, changes were introduced in tributary structure via the elevation of some aliquots and the establishment of a new tax on financial transactions (*Imposto Provisório sobre Movimentação Financeira* – IPMF, later called *Contribuição Provisória sobre Movimentação Financeira* - CPMF). Throughout the period 1994-1998, about seven percent of overall treasury revenues came from IPMF/CPMF. Moreover, through the same period, increasing amounts of extraordinary revenues were collected as a consequence of public service concessions to the private sector[12]. In 1998, the Treasury received about R$13.5 billion categorized as extraordinary revenues, R$9.2 billion of which corresponded to telecommunication service concessions[13].

Associated to the objective of price stabilization, the Plan instituted two nominal anchors: a monetary anchor and an exchange rate anchor. Regarding the monetary anchor, some expansion targets in the money supply were established. And the exchange rate anchor defined that one *real* could not be superior to one US dollar.

The immediate success of stabilizing prices brought inflation down fast[14] and expanded the aggregate demand. This change, combined with a more open trade policy, resulted in increased imports and significant trade balance deficits. As a consequence, the country became more dependent on foreign financing in order to sustain the equilibrium in the current account. To handle such a situation, the government was forced to increase interest rates. Brazil thus experienced a

[12] Part of receipts from privatization program was considered as "concession". Thus, as extraordinary revenues they could be used to finance current expenses. Whether categorized as privatization revenues, these resources should be utilized to amortize public debt.

[13] RAMOS, Ana Paula (2001) *in* "A Política Fiscal do Plano Real e o Ajuste Fiscal para 1999-2001", *Revista de Economia Política*, 21(4):46-62, October-December, p. 47.

[14] From January to June, the 6-month accumulated inflation rate was 763.2 percent, whereas in the second half of 1994, the inflation rate dropped to 38.1 percent.

short-term capital inflow and the exchange rate was quickly overvalued, putting pressures on the trade balance and revealing the Brazilian external vulnerability (Table 1).

Table 1: Balance of Payments – 1994 to 1998

USD Billion

PERIOD	TRADE BALANCE	CURRENT ACCOUNT	CAPITAL INFLOWS	NET INVESTIMENT	OVERALL BP
1994	10.4	(1.7)	14.3	7.3	12.9
1995	(3.3)	(18.0)	29.3	4.7	13.5
1996	(5.5)	(23.1)	33.9	15.5	9.0
1997	(6.8)	(30.9)	25.9	20.7	(7.8)
1998	(6.9)	(33.6)	16.3	20.5	(17.3)

Source: Fernando Ferrari Filho and Luiz Fernando de Paula [15].

The international crises that emerged during the first years of *Real* Plan (Mexico – 1995, Asian countries – 1997, Russia – 1998) disclosed the external fragility of Brazilian economic policy and raised suspicions about its sustainability, based on overvalued exchange rates and high interest rates. Examples include the speculative attacks against the *real* that followed the East Asian and the Russian crises. The first crisis provoked significant capital outflows, thereby reducing Brazil's foreign reserves by almost 10 percent[16]. The second one led Brazil to enter into agreement with the IMF in November 1998.

The operation of the exchange rate anchor in a context of trade and current account liberalization resulted in serious economic imbalances, such as high interest rates, elevation of foreign debt and fast growth of internal public debt. Indeed, the strong demand for hedges against exchange rate devaluation and interest rate changes during these turbulent periods modified the profile of public debt. To rollover federal debt, the government was compelled to offer securities indexed to overnight and foreign exchange rates. At the end of 1998, more than 50 percent of federal domestic securities had been indexed to the overnight rate and another 20 percent to the foreign

[15] FERRARI and DE PAULA (2003) *in* "The Legacy of the Real Plan and an Alternative Agenda for Brazilian Economy", *Investigacion Economica* 62(244):57-92, April-June, p. 65.

[16] *Ibid*., p.68.

exchange rate[17]. This fact aggravated the fiscal accounts even more. During the period 1994-1999, the net debt-to-GDP ratio rose from 30.4 percent to 41.7 percent (Table 2).

Table 2: Public Sector Net Debt - Percent of GDP

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003*
Federal Government	13.1	13.4	15.9	18.7	25.0	30.1	31.0	32.8	35.3	36.8
State and Local Governments	10.1	10.7	11.6	12.9	14.1	16.3	16.2	18.3	18.4	20.2
Public Enterprises	7.2	6.7	5.9	2.8	2.6	2.8	2.2	1.6	1.7	1.1
TOTAL	30.4	30.8	33.4	34.4	41.7	49.2	49.4	52.6	55.5	58.1

* The net debt of federal government includes the Central Bank debt.

Source: Ilan Goldfajn and Eduardo Refinetti Guardia *in Fiscal Rules and Debt Sustainability in Brazil,* and Central Bank.

Despite the adverse effects caused by the implementation of the *Real* Plan, some structural reforms were introduced during this period aimed at sustaining fiscal adjustments: a) enlargement of privatization process, started in the 1980s; b) restructuring of states and local governments accounts, as a way to ensure their capability of payment and to diminish their risk of insolvency; c) administrative reforms, to reduce the payroll spending; and d) social security reforms, to eliminate an important cause of primary deficits in all government levels. These measures were strengthened after the announcement of a fiscal package in late 1998.

To face the pressures motivated by the Russian Crisis in the second half of 1998, which dramatically reduced the foreign reserves (Figure 1), the ongoing government launched in October the Fiscal Stabilization Program which then received the IMF support. As a consequence, a three-year stand-by arrangement made US$18.1 billion available over the duration of the program which was scheduled to finish in 2001, with US$15.9 billion accessible by the end of 1999[18]. According to Goldfajn and Guardia[19], the fiscal package comprised the following major initiatives: "

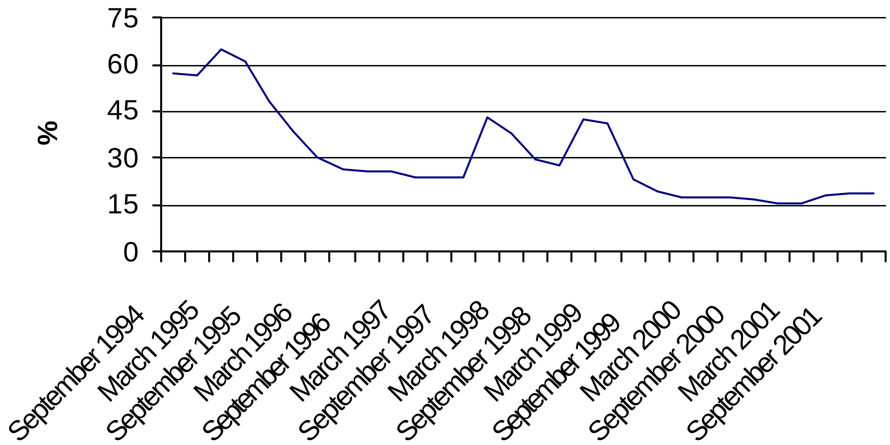
[17] *Ibid.*, p. 74.

[18] Letter of Intent for Financial Support from IMF written by President Fernando Henrique Cardoso, November 13, 1998.

[19] GOLDFAJN, Ilan; GUARDIA, Eduardo R (2003) *in Fiscal Rules and Debt Sustainability in Brazil*, Banco Central do Brasil Technical Notes, No. 39, July, p.17.

a) a front-loaded fiscal adjustment aiming to increase the primary surplus of the consolidated public sector; b) institutional reforms, notably the social security system and administrative reform; c) redesign of the fiscal federalism based on a comprehensive debt refinancing agreement with states and local governments; and d) reform of the budgetary process and the introduction of fiscal rules."

Figure 1: Net Foreign Reserves*



*Operational concept, including disposable assets.
Source: Fernando Ferrari Filho and Luiz Fernando de Paula

Goldfajn and Guardia argue that recent achievements in consolidating public sector primary surplus confirm the effectiveness of the reforms: "Starting from a primary deficit in 1997 and virtually zero primary surplus in 1998, the consolidated public sector has shown primary surpluses superior to 3.5 percent of GDP since 2000" [20].

The monetary policy during the first years of the *Real* Plan restrained the possibilities of Brazilian fiscal adjustment in that period. Moreover, the Brazilian economic policy strongly required a change to face international crises, successive attacks against the *real*, current account deficits and high interest rates.

[20] *Ibid.*, p.18.

1.2 Dealing with Crises – 1999-2002

Notwithstanding the IMF rescue package, Brazil did not succeed in recovering the confidence of the financial markets. Therefore, the government was unable to defend the *real* against pressures stemming from the Russian crisis and from speculative activity triggered by market operators. As a result, in January 1999, the exchange rate regime was altered: the floating exchange rate replaced the fixed exchange rate. Thus, the exchange rate of around R$1.2 per dollar at the beginning of January jumped to R$2.1 in March.

The currency devaluation immediately provoked an increase in inflation, which soared from 1.7 percent in 1998 to 19.9 percent in 1999. At the same time, the public debt indexed to the foreign exchange rate increased, causing the elevation of net public debt-to-GDP ratio from 41.7 percent to 49.2 percent. Despite these immediately harmful consequences, the Brazilian economy shortly showed signs of recovery. In the second half of 1999, GDP increased from 0.8 percent to 4.2 percent in December of 2000[21].

The second term of President Fernando Henrique Cardoso was characterized by the implementation of the Fiscal Stabilization Program and by the fulfillment of the fiscal targets agreed to with IMF, under a inflation-targeting and floating exchange rate regime.

In accordance with the IMF arrangement, the Brazilian public sector would need to produce successive primary surpluses in the next three years: 3.1 percent of GDP in 1999, 3.25 percent of GDP in 2000, and 3.25 percent of GDP in 2001. The major effort should be undertaken by the federal government which should generate 2.4 percent of GDP in 1999, 2.65 percent of GDP in 2000, and 2.6 percent of GDP in 2001.

To reach these results, a set of measures was defined that was connected to revenue elevation and expenditure reduction, in addition to the regulation of administrative and social security reforms and the submission to the Congress of the Fiscal Responsibility Law. The actions agreed to with the IMF focused mainly on short-run initiatives and tax hikes to meet fiscal targets[22].

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[21] FERRARI and DE PAULA, *op.cit*., p.70.

[22] RAMOS (2001), *op. cit.*, argues that the actions agreed with to the IMF followed the same fiscal orientation adopted by the government since *Real* Plan was introduced: substantial increase in revenues and cuts concentrated in investments

Regarding the revenues, the measures were: a) a term extension of tax on financial transactions (CPMF); b) a categorization of part of the extraordinary revenues as current revenues; and c) an increase of taxes and contributions. On the expenditure side, there were two initiatives: a) cuts of 20 percent in "Capital and Current" spending (mostly investments and wages) during 1999; and b) annual reduction of federal enterprise investments by 0.29 percent of GDP[23].

Despite these measures, the most important and long lasting initiatives of this period with the purpose of consolidating the Brazilian fiscal adjustment were related to the refinancing of states' and municipalities' debts and the passage of Fiscal Responsibility Law[24].

Throughout the period 1997-2000, 25 states and 183 municipalities refinanced their liabilities and restructured their banks. By December 2001, the total amount restructured by National Treasury summed more than US$100 billion[25].

The federal government refinanced the states' debts for 30 years, charging a real fixed interest rate of six percent. On the other hand, the agreements required the compliance of local governments with a fiscal adjustment program, which included targets and commitments connected to: a) financial debt to net revenues ratio; b) primary surplus; c) public personnel spending; d) tax revenues; e) state reform and/or privatization; and f) investment level.

With regards to the municipalities' agreements, municipalities were not obliged to accomplish a specific fiscal program, but those municipalities which refinanced their liabilities became forbidden from borrowing money until their financial debt-to-revenues ratio was less than one.

The criteria, conditions and requirements set by federal government for restructuring the states' and municipalities' debts provoked a sound change in the fiscal performance of

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because of public spending rigidity (payroll, social security, mandatory spending). ROCHA and PICCHETTI (2003) propose the adoption of an analytical tool to assess Brazilian fiscal adjustment which categorizes fiscal adjustments in two types: Type 1, more lasting, when adjustments rely primarily on spending cuts (wages, social security, transfers), and Type 2, soon reversed, when adjustments rely primarily on tax increases and cuts in public investments.

[23] RAMOS (2001), *op.cit*., p. 60.

[24] GOLDFAJN and GUARDIA (2003), *op.cit*, p. 18

[25] GOLDFAJN and GUARDIA (2003), *op.cit*., p. 19.

subnational governments. This new standard of behavior was intensified after the approval of the Fiscal Responsibility Law (FRL).

The Fiscal Responsibility Law was approved on May 4, 2000. It is a federal law applicable to all levels of government which stipulates a general framework for budgetary planning, execution and reporting, aiming at sustainable fiscal adjustment and limiting public indebtedness[26]. The FRL establishes institutional sanctions and penalties for noncompliance, and the public officials are liable to sanctions and penalties detailed in the Fiscal Crimes Law. The two most relevant FRL provisions are: a) prohibition of the federal government from financing state and local governments; and b) definition of debt ceilings for each level of government. The importance of the first restriction is that it preserves the existing contracts, avoiding the risk of intergovernmental bailouts. Regarding the second requirement, the debt ceilings must be approved by senate resolution, based on an executive branch proposal, and have to be defined as a percentage of the net current revenue. Whether these top limits are overtaken, the excess has to be eliminated within one year. While the excess persists, new financing and discretionary transfers from the federal government are prohibited[27].

The LRF also introduced limits for payroll spending and the following important rules: a) new, recurrent expenditure (for a period exceeding two years) must be matched by full funding, i.e., stemmed from revenue increase or expenditure reduction; b) tax benefits can only be included in annual budget together with instruments to offset their impact on the budget for two consecutive years; c) public financial institutions are not allowed to lend to their main shareholders.

The institutional reforms undertaken since late 1998, mainly after the Fiscal Responsibility Law, brought about a significant improvement in Brazilian fiscal performance. According to Goldfajn and Guardia, "fiscal rules do not compensate for bad fiscal management or eliminate structural imbalances, but they do contribute to restoring creditability, increasing

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[26] INTERNATIONAL Monetary Fund – IMF (2001). *Brazil: Report on Observance of Standards and Codes (ROSC) – Fiscal Transparency*. IMF Country Report 10/217. Washington: IMF, p. 9.

[27] GOLDFAJN and GUARDIA (2003), *op. cit*., p. 19-20.

transparency, and improving fiscal management practices"[28]. The fiscal rules have allowed the country to face some unfavorable circumstances within a relative stability.

In 2001, external and internal events affected some Brazilian macroeconomic indicators associated with growth, inflation and public debt. These factors were: a) Brazil's energy crisis in 2001; b) recession in the U.S. economy, particularly after the terrorist attacks on September 11; c) stagnation in Japan's economy; and d) Turkish and Argentine crises.

As a consequence of these factors, economic growth fell from 4.4 percent in 2000 to 1.4 percent in 2001, inflation was running at 10.4 percent in 2001, and the net public debt ratio increased from 52.6 percent in 2001 to 55.5 percent in 2002, although the primary surplus had increased during same period from 1.8 percent of GDP in 2001 to 2.4 percent of GDP in 2002[29]. Furthermore, the spreads on Brazilian sovereign bonds were raised from levels in the 600 basis points in late 1999 to a peak of 2,443 basis points in September 2002[30].

The 2001 adverse scenario was aggravated in 2002 by market uncertainty about Brazilian fiscal performance after the general election. To strengthen the country's creditability, in September 2002, the government and IMF settled a US$30 billion stand-by arrangement. The agreement required that primary surplus for consolidated public sector be 3.75 percent of GDP in 2003 (or higher if necessary to stabilize the public debt ratio) and the inflation-targeting regime be continued.

1.3 President Lula's Administration – 2003

In February 2003, one month after the beginning of President Lula's mandate, the new government announced the elevation of the primary surplus target for the consolidated public sector from 3.75 percent of GDP to 4.25 percent of GDP, with the purpose of showing to the financial market the continuity of Brazil's austere fiscal discipline.

[28] *Ibid.*, p. 25.

[29] BRAZIL, Central Bank, *Annual Report 2001, p. 48, and 2002,* p.94.

[30] BRAZIL, Ministry of Finance, Secretariat of National Treasury, *Annual Borrowing Plan 2003,* January 2003, p.13.

This primary surplus target was inserted in the Budget Guidelines Law and in the proposal of Multi-Year Plan for 2004-2007, fixing 2.45 percent of GDP as the federal primary surplus target during next four years.

The new administration objectives have been to maintain macro stability and achieve economic growth, by promoting the sustainable reduction of interest rates. To realize these goals, the Brazilian government has committed itself to long-term fiscal equilibrium, inflation-targeting and floating exchange rate regimes[31].

During the first year of President Lula's term, the economic policy requirements were incompatible with his economic growth objective. By September of 2003, the interest rates were kept above 20 percent per annum in order to stabilize inflation, dropping to 16.91 percent not until December. As a consequence, the resumption in economic activity started in the second half of 2003. During the year, the economic growth rate was negative (-0.2 percent)[32]. However, other economic indicators experienced an encouraging performance in 2003.

The inflation rate fell from 26.41 percent in 2002 to 7.67 percent in 2003. The trade balance increased from US$13.12 billion in 2002 to US$24.83 billion in 2003. At the same time, the current account deficit of US$7.72 billion in 2002 became a surplus of US$4.05 billion at the end of 2003, provoking the elevation of foreign reserves and the reduction of Brazilian external vulnerability[33].

The new government has declared an interest in starting an innovative fiscal adjustment. During 1995-2002, the equilibrium in public accounts was mainly reached by augmenting the tax burden and by increasing public net debt. The current policy orientation intends to promote the fiscal adjustment by cutting public expenditures[34].

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[31] BRAZIL. Ministry of Finance. *Political Letter for IBRD Programmatic Lending.* Brasília. December 23, 2003.

[32] BRAZIL. Instituto Brasileiro de Geografia e Estatística – IBGE. *Indicadores IBGE. Contas Nacionais Trimestrais*. October/December 2003.

[33] BRAZIL. Banco Central do Brasil. *Boletim - Quadros Estatísticos*. March 2004.

[34] BRAZIL. Ministry of Finance. Secretariat of Economic Policy. *Boletim de Acompanhamento Fiscal*. Brasília. September 2003, p. 1.

In 2003, the federal primary surplus was raised from 2.35 percent in 2002 to 2.59 percent. The federal net debt increased by 1.5 percent compared to December 2002, but the prudent management of public debt had extended maturities and improved its structure. In 2002, just 2.5 percent of total debt corresponded to fixed-rate-linked securities. In 2003, this percentage increased to 13.1 percent, reducing the debt exposure to foreign-exchange-linked securities[35].

In December 2003, a new one-year preventive IMF Program was concluded, which extended for 15 months and augmented Brazil's stand-by credit by SDR 4.5 billion (about US$6.6 billion). The agreement was part of the government strategy to exit from Fund support. The arrangement aimed at providing insurance against the impact of any deterioration in the international environment, insulating the country from potential external shocks, and smoothing the path of repayments to the IMF.

Since taking office, the government has borne out its commitment to pursue macroeconomic stability, by concluding important structural reforms, such as pension and tax reforms, and by ensuring sustainable fiscal adjustment. This attitude has created a stable domestic climate to face external adverse circumstances, allowing the country to resume economic activity.

[35] BRAZIL. Ministry of Finance. Secretariat of National Treasury. *Resultado do Tesouro Nacional*. Brasília. January 2004, p.16.

2. BUDGETARY PLANNING IN BRAZIL AFTER PASSAGE OF THE FISCAL RESPONSIBILITY LAW

The system of budgetary planning in Brazil is defined in the 1988 Federal Constitution and is regulated by Law No. 4,320/1964. The main characteristic of the Brazilian budget is that it is an authorizing, not imposing tool. In other words, the national Congress approves ceiling amounts and the Executive branch is not obliged to spend all resources allocated in the annual budget.

In Brazil, the budgetary and financial management responsibilities are shared by the Ministry of Planning, Budget and Management (MP) and Ministry of Finance (MF). The Secretariat of Federal Budget in MP is in charge of preparing the proposition of the General Budget of the Union (*Orçamento Geral da União* - OGU) and, along with the Secretariat of National Treasury in MF, defines the financial programming after the approval of Congress.

The three main instruments to guide fiscal and public expenditure management are: a) the Multi-Year Plan (*Plano Plurianual* - PPA); b) the Budget Guidelines Law (*Lei de Diretrizes Orçamentárias* - LDO); and c) annual budget laws (*Lei Orçamentária Anual* - LOA). The annual budget is prepared according to the Budget Guidelines Law and the investments included in the budget must be taken from the Multi-Year Plan.

The Ministry of Finance, through the Secretariat of National Treasury, is responsible for controlling and registering the budget execution, for financial programming and for elaborating the financial balance sheet.

The Fiscal Responsibility Law (FRL)[36] gave more transparency to the budget process and fiscal management. Transparent procedures must be used in the preparation, approval, and implementation of Budget Guidelines Law and Annual Budget Law, as well as in the preparation of the annual accounts, public debt reports, summarized budget execution reports and fiscal

[36] *Complementary Law No.101*, of Mai 4, 2000.

management reports. The procedures include the publication and broad dissemination (via electronic media) of those documents.

The FRL introduced the requirement of settling up fiscal targets for a three-year period, pointing out the estimated revenues and expenditures, and indicating the premises related to those targets. Moreover, it defined limits for personnel spending and required the institution of limits for public indebtedness as a percentage of the net current revenue. The FRL also determined that to create recurrent expenditure (for a period exceeding two years), the authorities must designate a source of revenue or point out a reduction in another expenditure.

The LRF provided a number of institutional and individual penalties for noncompliance. Institutional penalties for the federal government include suspending the arrangement of new credit operations and declaring null and void, *ips jure*, the acts that: a) provide no compensation mechanism to a permanent increase in expenditure, b) provide no limit for commitments applied to inactive personnel expenditure, and c) increase personnel expenditure 180 days before the end of the mandated term.

In addition to these penalties, government authorities are subject to individual liability and punished by loss of position, barring from public office, imprisonment, and payment of fines.

2.1 Multi-Year Plan

The Multi-Year Plan (*Plano Plurianual* - PPA) is a four-year plan to be produced by each government at the beginning of its four-year mandate[37]. The PPA has to be approved by the National Congress. It is an instrument both of strategic orientation for economic development and of medium-term resource allocation. All federal government spending is presented in PPA by programs. A rolling three-year budget plan and individual annual budgets are integral parts of the PPA framework.

The Constitution requires that the Budget Guidelines Law and all plans for regions or sectors are developed consistently with the PPA. Therefore, the PPA seeks to integrate planning and

[37] The PPA must be presented to the congress until August 31 of first year of president mandate.

budgeting. In accordance to the Constitution, the PPA shall include all public spending. On the other hand, there is no model or content legally defining the PPA's specific structure.

2.2 Budget Guidelines Law

The Budget Guidelines Law (*Lei de Diretrizes Orçamentárias* – LDO) is drawn up on an annual basis[38]. It establishes the general rules for preparing the budget for the subsequent year. The LDO contains the annex of fiscal targets, which must include the following, *inter allia*:

a) annual targets, expressed in current and constant terms, for revenue, expenditure, nominal and primary results (deficit/surplus), and the public debt level, for the following fiscal year and two fiscal years thereafter;

b) assessment of compliance with the targets established for the preceding year;

c) priorities for allocating resources;

d) listing and analysis of fiscal risks, including the contingent liabilities;

e) investment policy for official credit agencies;

f) changes in initial net wealth, including the revenue stemming from privatizations (if any); and

g) proposals relating to changes in tax legislation, estimates and offsetting mechanisms for tax expenditures, and the margin for increases in mandatory recurrent expenditures.

[38] The Law No. 10.707 of July 30, 2003, established the Budgetary Guidelines Law for elaborating the General Budget of Union for 2004.

2.3 Annual Budget Law

The draft of the annual budget law must be prepared in compliance with the guidelines and priorities enacted by the Budget Guidelines Law, and subject to the parameters and limits established in the Fiscal Responsibility Law.

The annual budget law must contain an annex statement that budget is compatible with the goals and objectives defined in the fiscal target annex of the Budget Guidelines Law.

Moreover, the annual budget law will include a definition of the contingency reserve, as percentage of net current revenue, to cover expenditures (such as public disaster outlays) for which the law does not provide.

2.3.1. Decree of Budget and Financial Execution

The decrees of budget and financial execution[39] institute limits for utilization of budgetary resources, taking into account up-to-date estimates for revenue, expenditure, nominal and primary results (deficit/surplus), and public debt.

The decrees aim to ensure that the disbursement of resources will be done in a timely manner, as well as the equilibrium between revenues and expenditures will be maintained during the year. They include revenue forecasts by tax category on a bi-monthly basis; sub-targets for the cumulative primary surplus (April, August); payment limits on a monthly basis; and annual limits for budget execution (budget spending in Brazil is not mandatory).

As already mentioned, since 1999, expenditures funded by loans from international financial institutions (IFIs) have been treated as regular budget spending, subject to overall fiscal targets and constraints. Previously, IFI funding had been considered additional to the budget resources. As a result, both the loans of multilateral organizations and the counterpart funds were inserted and limited by decrees of budget and financial execution. This fact aggravated a problem

[39] The decree of budget and financial execution which deals with the budgetary and financial programming for 2004 is the Decree No. 4.492, of February 18, 2004. It establishes the monthly chronogram of disbursement for Executive branch.

that traditionally impaired the financial performance of external agreements - the "lack of counterpart funds".

2.3.2. Budget Rigidity

The rigidity of the budget in Brazil has a dual origin. First, it stems from the presence of revenue earmarked for financing some categories of expenditures. Secondly, it results from the existence of legal minimum limits for some social spending (mandatory expenditures).

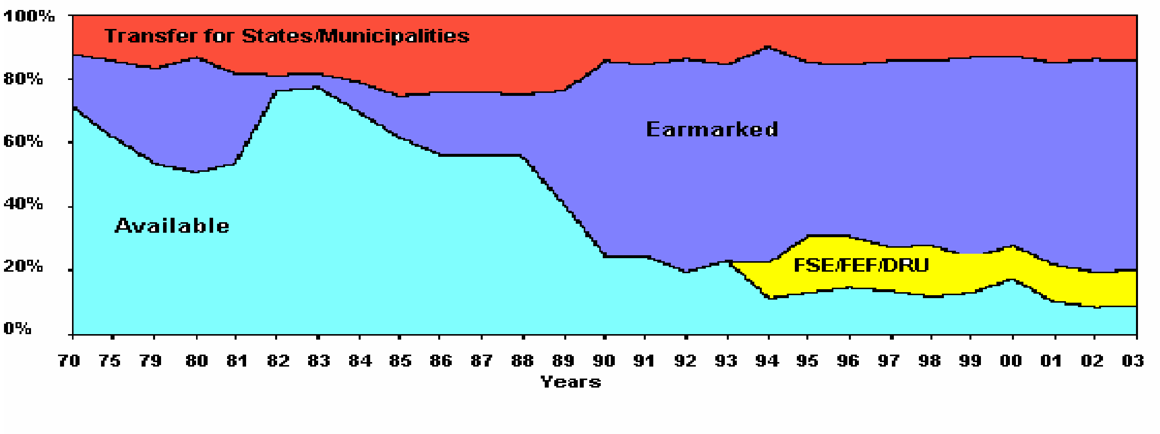
The purpose of both tools has been to ensure that some social expenses will not be reduced, and that certain expenditures and programs will be protected from the uncertainty of funding availability in the annual budget processes.

Nevertheless, recently, the rigidity of the budget has caused considerable strain in the execution of discretionary spending. Since the late 1980s, extensive use of revenue earmarking has increased dramatically; many factors have contributed to this trend. The most important was the 1988 Constitution which, along with other previous laws, created specific destination for federal revenues. Moreover, obligatory spending in the federal budget increased from 4.6 percent of GDP in 1999 to 7.9 percent in 2002[40]. About 55 percent of non-earmarked revenue is allocated to finance mandatory expenditures (Figures 2 and 3).

The government's efforts to maintain large primary surplus in order to protect the credibility of its macroeconomic management and debt sustainability have narrowed the possibilities of federal spending even more. Several priority programs have suffered budgetary cuts, and their implementation has been impaired by the lack of funding predictability.

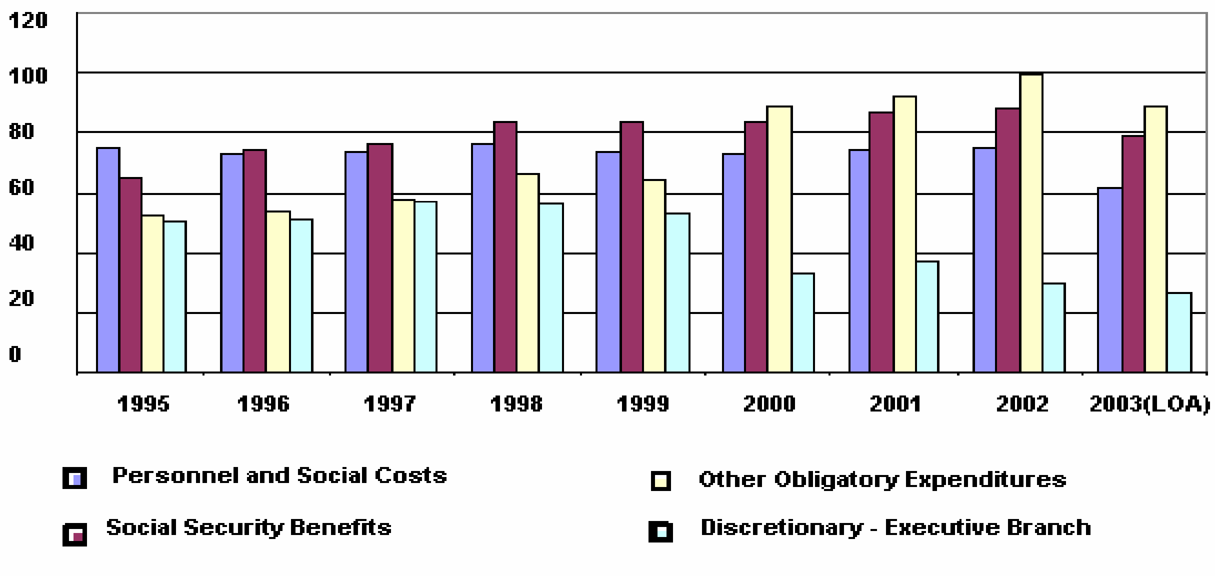
[40] Obligatory expenditures include those associated with constitutional transfers, subsidies, unemployment insurance, payments for judicial sentences, FUNDEF, Organic Law of Social Assistance, Fund for Poverty Combat, among others.

Figure 2: *Composition of the Budgetary Revenue – 1970 to 2003*[41]



Source: Ministry of Planning, Budget, and Management. Secretariat of Federal Budget.

Figure 3: Evolution of Primary Expenditures (R$ million) [42]



Source: Ministry of Planning, Budget and Management. Secretariat of Federal Budget.

[41] Only treasury revenues, not considered securities or privatizations. As already said, since 1994, it has been legally enforced the de-earmarking of 20 percent of all federal taxes and contributions for the constitution of the following funds: FSE – Social Fund for Emergency, later called FEF – Fund for Fiscal Stabilization (1994- 1999); and DRU – De-earmarking of Budget Revenues (2000-2007).

[42] Ministry of Planning, Budget and Management. Secretariat of Federal Budget. *Vinculação de Receitas dos Orçamentos Fiscal e da Seguridade Social e o Poder Discricionário de Alocação dos Recursos do Governo Federal* . Brasília. February 2003, p.12.

3. IBRD AND IDB PORTFOLIOS

There is much literature dealing with the role international financial institutions play in emergent countries like Brazil. Many works have been written about the efficiency of these institutions in meeting their main social objective - fighting poverty and improving the living standards of the local population - by promoting sustainable economic growth[43]. The purpose of this paper is not to discuss that point of view, but to recognize the fact that maintaining partnerships with financial multilateral organizations, like IBRD and IDB, has been important for Brazil.

It is unquestioned that the execution pace of projects funded by IBRD and IDB is usually relatively slow because countries have to comply with their rules[44]. Nevertheless, these institutions have given significant contributions based on their global and regional experience. They have long cooperated with the country, by providing technical assistance, supporting research and knowledge management, training people, and creating and strengthening institutional capacity.

Furthermore, along with Brazilian public banks, these institutions have constituted a valuable source of medium and long-term financing for the private sector[45]. They have also contributed to disseminating best practices in environmental, social and corporate governances, and corporate and financial restructuring.

The share of IBRD and IDB resources in Brazilian federal foreign debt is not so relevant. Actually, it represents 14 percent of total external debt, corresponding approximately to US$10.71 billion (Table 3). Nevertheless, they play a remarkable role as a low-cost source for meeting part of Brazil's gross external financing requirements, about US$70 billion annually[46].

[43] Examples are the works of STIGLITZ, Joseph and KANBUR, Ravi, inter allia.

[44] SOARES, R.P. in *Dívida Pública Externa – Empréstimos do BIRD ao Brasil* argues that, in part because of rules, delays in execution of IBRD loans have brought about higher payments for Brazil and sluggish inflow of resources. He analyzed the effective cost of 33 contracts that entered into effectiveness between 1980 to 1997 and concluded that the cost of loans increased about 3.7 percent per annum.

[45] IDB and IFI – International Finance Institution from World Bank Group provide credit lines for private sector.

[46] The average cost of IBRD and IBD loans authorized in last two years was 3.28 percent per annum. In the same period the cost of sovereign issues were of about 11.92 percent per annum (see Annex 4).

Table 3: Composition of Federal Foreign Debt

(US$ thousands)

	Dec 2003	(%)
FEDERAL FOREIGN PUBLIC DEBT	**78,240,751**	**100%**
1) Securities Debt	**59,398,440**	**76%**
1.1) *Bradies*	16,377,857	21%
1.2) Sovereign Issues	43,020,583	55%
2) Loan Agreements Debt	**18,842,311**	**24%**
2.1) Multilateral organizations - IBRD/IDB	10,711,373	14%
2.2) Government Banks and Agencies	3,218,340	4%
2.3) Paris Club	4,912,598	6%

Source: Secretariat of National Treasury - STN/CODIV/GEEST

3.1 Portfolios' Features

The ongoing Brazilian federal portfolio, comprising IDB and IBRD loans, totals about US$6.33 billion, which includes recently signed, but not yet disbursed contracts (Table 4). IDB holds 61 percent of the whole portfolio, at US$3.88 billion. Given that the IDB has been lending more money to Brazil than to any other country, the IDB exposure to Brazil is, currently, the highest one.

Considering the private sector, the IDB program in Brazil is about US$10 billion. Annually, IDB commitments are about US$1.5 billion. Since most of these commitments are in investment loans, they are disbursed slowly because of the fiscal factors discussed above. Notwithstanding, the bank has positively assessed the execution of projects.[47]

[47] The "Country Document – Brazil", paper prepared by IDB presenting its finance strategy for next years and an assessment of ongoing projects, is not concluded yet. It is expected to be finished up to April 2004.

Table 4: IDB and IBRD Loans for Federal Government.

US$ Thousands

LOANS	AMOUNT	PERCENTAGE
IDB-OC/SF	3,882,000	61%
IBRD	2,445,440	39%
TOTAL	6,327,440	100%

Based on data from Secretariat of International Affairs – SEAIN/MP.

The IBRD also has a large ongoing program in Brazil (fourth largest in size, after China, India and Mexico), comprising 54 active projects and US$4.9 billion in commitments at the end of the bank's 2003 fiscal year (Jul/Jun) [48], along with more than 20 grants. About half of the portfolio supports federal programs (though many are implemented at the state or local-level) and about half supports programs at state-level[49].

According to the "Country Assistance Strategy for 2003-2004", a document developed by IBRD, just four projects are currently in "problem" status, 12 projects have slow disbursement, and 20 projects (nearly half the portfolio) suffer from chronically inadequate budgetary resources for timely implementation. Nonetheless, the IBRD assesses that percentage of problem projects has not exceeded ten percent of the portfolio, and proactivity has been at or near 100 percent, indicating that when problems do arise, bank clients and staff have been quick to take action.

The two programs, IDB and IBRD, are highly matched in terms of objectives, with a focus on social development, environment, growth and infrastructure, and good governance. However, there are different areas of strength and emphasis[50]. IDB focuses more on secondary and higher education, whereas IBRD emphasizes basic education. The IBD's portfolio is concentrated on urban actions compared with IBRD's stronger stress on rural areas. Finally, considering the

[48] WORLD Bank Group (2003). Country Assistance Strategy 2003-2004 for The Federative Republic of Brazil. Washington-DC. November 10, p. 95.

[49] Brazil is one of the few countries where sub-national governments can borrow directly from IBRD.

[50] WORLD Bank Group (2003). Country Assistance Strategy 2003-2004 for The Federative Republic of Brazil. Washington-DC. November 10, p. 30.

resources channeled to projects carried out by federal government, 33 percent of IDB's portfolio has been financing highway improvements, whereas 18 percent of IBRD's portfolio is concentrated in decentralization of urban transport (Table 5).

Table 5 : Portfolios' Features – Federal Projects

	LOAN AMOUNT (US$ Thousands)	PERCENTAGE
IBD	3,882,000	100%
SECONDARY AND HIGH EDUCATION	660,000	17%
URBAN IMPROVEMENTS	412,500	11%
HIGHWAYS	1,292,000	33%
OTHERS	1,517,500	39%
IBRD	2,445,440	100%
BASIC EDUCATION	362,030	15%
RURAL POVERTY	285,600	12%
URBAN TRANSPORTS	436,000	18%
OTHERS	1,361,810	55%

3.2 Performance

The pace of IDB and IBRD disbursements has slowed markedly since 2000 due to chronically unavailable budgetary resources for timely implementation at both the federal and state-level. Two factors have primarily caused Brazil's budget shortage: fiscal adjustment program and revenues earmarking practice.

Fiscal measures since the late 1990s have resulted in substantially reduced fiscal space for public investments. As already mentioned, budget cuts to meet primary surplus targets combined with earmarked revenues, and mandatory expenditures left little room for discretionary investment spending. Moreover, over the last five years, expenditures funded by loans from international financial institutions, previously considered additional to the budget, have been treated as regular budget expenses, subject to fiscal targets and constraints.

These measures have led to reduced budgets for investment projects financed by international financial institutions. And, at the state-level, implementation of fiscal discipline through the rules consolidated in the Fiscal Responsibility Law has had a similar effect. The consequence of all this has been a slowing of the rate of investment lending disbursements, which fell by almost half from 1999 to 2003 (Table 6).

Table 6: Cash Flow Between Brazil and Multilateral Organizations (IBRD and IDB)[51]

USD Thousands

YEAR	DISBURSEMENT	AMORTIZATION	INTERESTS AND FEES	NET TRANSFER
1992	909	1,573	894	(1,558)
1993	807	1,584	835	(1,612)
1994	1,039	1,690	802	(1,453)
1995	1,327	1,732	776	(1,181)
1996	2,330	1,521	699	110
1997	2,793	1,376	677	740
1998	2,972	1,308	748	916
1999	4,471	1,246	934	2,291
2000	4,542	1,184	1,269	2,089
2001	2,662	1,112	1,198	352
2002	3,585	2,131	1,049	405
2003	2,383	3,665	1,127	(2,409)

Source: Secretariat of International Affairs – SEAIN/MP

In addition, devaluations over the last several years have translated into larger dollar-denominated loan undisbursed balances. That fact magnified the effect of slow disbursements (Table 7). Such a decrease in the disbursement of external resources has led Brazil to spend higher amounts on commitment fees, which are the charge usually due on the principal amount of the loan not withdrawn from time to time[52].

[51] The figures include the resources channeled to federal and state governments.

[52] Currently, that charge is usually equal to 0.75 percent per annum. Up to December 31, 2003, Brazil had paid about US$91 million as commitment fee, corresponding to 1.54 percent of the total federal portfolio amount which is about US$5.9 billion.

Table 7: Performance of Federal Projects Partially Financed by IBRD and IDB[53]

USD Thousands

Bank	Quantity of Contracts	Loan Amount	Undisbursed Balance	Disbursement Average (last two years)	Disbursement Percentage (last two years)
IBRD	24	2,124,820	951,672	144,340	6.8%
IBD	21	3,777,000	1,643,599	241,266	6.4%
TOTAL	45	5,901,820	2,595,271	385,606	-

Prepared based on data from Secretariat of International Affairs – SEAIN/MP, in December 2003

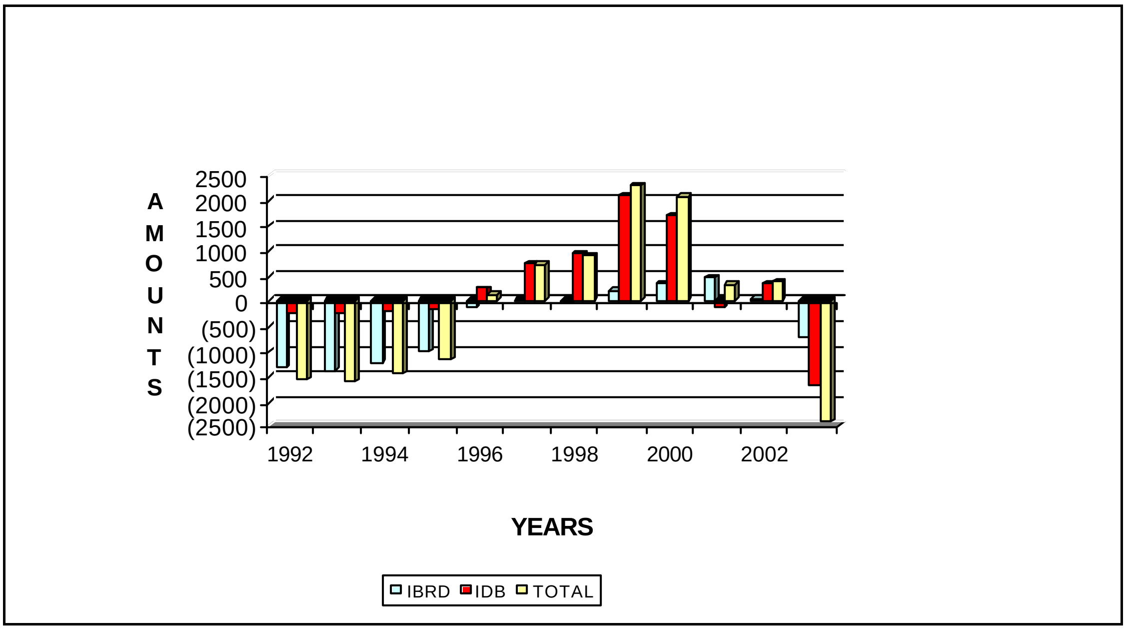
Also, the impossibility of new credit operations, stemming from the lack of fiscal space to include them in the annual budget law, has been responsible for a reverse in the capital flow between Brazil and multilateral organizations. Since 2000, the amount of resources entering into the country has fallen annually[54]. In 2003, the World Bank and the IDB sent US$2.38 billion to Brazil. Over the same period, the country paid to them US$4.79 billion, US$3.66 billion as amortization and US$1.13 billion as fees[55]. In other words, the net negative resource transfer was about US$2.40 billion. (Table 6 and Figure 4). To maintain the bilateral accounts in balance, the Brazilian government must create the conditions for public investment to recover.

[53] Only contracts whose disbursement has started.

[54] Considering resources channeled to both federal and state governments.

[55] BRAZIL. Ministry of Planning, Budget and Management. Secretariat of International Affairs. *Fluxo Financeiro entre Brasil e Banco Mundial/BID*. Brasília. December 2003.

Figure 4: Cash Flow Between Brazil and Multilateral organizations (IBRD and IDB)[56]



To address such a situation, the Brazilian government has started a plan, with banks support, for partial cancellations of loan balances and has sought to improve alignment of projects with budgetary priorities. Moreover, alternatives for relaxing federal budget rigidities have been studied.

[56] Resources channeled to both federal and states governments.

4. BRAZIL’S 2004-2007 MULTI-YEAR PLAN

The Brazilian development strategy for the next four-year period is defined in the Multi-Year Plan (*Plano Plurianual* – PPA, *“Plano Brasil de Todos”*), submitted to Congress in September 2003. The nature and scope of the PPA have changed since first initiated in the late 1980s. This PPA has a regional focus and great emphasis on equitable economic growth; however the current structure of government proposal is similar to the previous PPA.

The Plan was conceived after public consultations, through “civil society participation forums”, established in each of 26 states and the Federal District. The process of participative planning was coordinated by the Secretariat-General of the Presidency.

Principles, indicators and projections

The purpose of the Brazilian government is to set up a virtuous circle between investment and consumption through the PPA implementation. The idea is to bolster the economic growth founded on mass consumption expansion, since the rise in mass consumption stimulates private investment. However, resuming economic growth requires higher infrastructure spending. In this way, public-private partnerships will be fostered.

In accordance with the PPA, the state shall play a decisive role in carrying out social and economic development. The fundamentals of macroeconomic stability that permeate the PPA are: a) sound external accounts, b) fiscal consistency, characterized by sustainable public debt, and c) low inflation.

The PPA is framed in financial terms consistently with the country’s revenue projections, which are expected to equal annually about 23 percent of GDP. The budget rigidities (revenues earmarking / mandatory expenditures) are also taken into account. The primary expenditures shall remain steady at 17.11 percent of GDP in 2005, 2006 and 2007.

With regards to the fiscal strategy, the PPA proposes to reduce the public debt-to-GDP ratio and, gradually, to increase the governmental social spending. To meet these objectives, the government will prepare the annual budget following two directives. First, the primary surplus of public sector will be kept at a level compatible with the reduction of net debt to 50 percent of GDP by the end of 2007. Secondly, the budget will be adjusted, by decreasing the weight of payroll within the overall spending and increasing the participation of public investments.

The economic growth (from 3.5 percent in 2004 to five percent in 2007) and primary surplus targets, considering the inflation and exchange rate projections, shall result in a net public debt reduction of almost 11 percent of GDP. In line with these figures, Brazil's borrowing requirements are expected to decrease throughout the period covered by PPA.

During the PPA years, the primary surplus target for the federal government is 2.45 percent of GDP. The overall primary surplus of the public sector for the same period is 4.25 percent of GDP – 1.05 percent of GDP obtained by states and Federal District, and 0.75 percent by state enterprises.

The indicators used to estimate the public sector debt in 2004-2007 are presented below.

Table 8: Main Indicators and Forecasts

	2004	2005	2006	2007
Price Index – IGP-DI (% p.a.)	7.5	5.0	4.5	4.0
Price Index – IPCA (% p.a.)	5.5	4.5	4.0	4.0
Real Implicit Interest Rate on Public Debt (average % p.a.)	8.1	7.5	5.8	4.1
Nominal Implicit Interest Rate on Public Debt (average % p.a.)	14.5	12.4	10.1	8.3
Exchange Rate – R$/US$ (at end of year)	3.51	3.64	3.75	3.86
Recognised Contingent Liabilities (% of GDP)	0.66	0.64	0.63	0.62
Net Debt of Public Sector (% of GDP)	58.1	55.0	51.9	48.2
Growth Rate of GDP (%)	3.5	4.0	4.5	5.0
Growth Rate of Government Spending (%)	3.0	3.5	4.0	4.5

Source: BRAZIL. Law Draft No. 30/2003. Multi-Year Plan 2004-2007.

Organization

The 2004–2007 PPA actions will be undertaken along five **dimensions**: economic, social, regional, environmental, and democratic. These interconnected strategic dimensions are reproduced in the PPA's three **mega-objectives**:

a) social inclusion and reduction of inequality;

b) sustainable economic growth and reduced regional inequalities; and

c) promotion of citizenship and participation.

Each of the three mega-objectives is separated into ten **challenges**. These challenges have a group of target indicators – achievable by 2007. Every one of the PPA **programs** is developed consistently with one of the 30 challenges. The program managers are responsible for ensuring that the performance indicators are reached.

Resources

The resources of PPA come mainly from the fiscal and social security budget (73.6 percent of overall revenue sources). The participation of official credit agencies (10.5 percent) and the investment of federal enterprises (7.7 percent) are also important.

Table 9: Resources of PPA (R$)

Fiscal and Social Security Budget	1,367,343,742,274	73.6%
Investments of federal enterprises	143,113,985,914	7.7%
Expenditure plan of federal enterprises	15,231,625,275	0.8%
Funds-availabilities	78,481,324,423	4.2%
Official credit agencies	194,896,785,100	10.5%
Tax expenditures[57]	14,884,380,494	0.8%
Partnership[58]	39,910,319,735	2.1%

[57] In accordance with the Fiscal Responsibility Law (art. 14), tax expenditures have to be considered within revenues estimative. Tax expenditures (tax incentives, tax benefits or tax breaks): are defined as all amnesty, relief, assumed credit, ad hoc exemptions, or changes in a given tax rate or calculation base, lending to reduced public revenue levels.

[58] Include states, municipalities and private sector

Others	3,219,678,088	0.2%
Total	1,857,081,841,303	100%

Source: BRAZIL. Law Draft No. 30/2003. Multi-Year Plan 2004-2007.
The figures do not add 100.0% due to rounding.

The programs of PPA are grouped together according to their purpose: a) ending-oriented programs, related directly to mega-objectives; b) programs for managing public policy, connected to policy-making, coordination, surveillance, and assessment; c) programs for providing state services, including goods and services necessary for state operation; and d) programs for administrative support, fitting administrative support to other programs (ending-oriented programs/ programs for managing public policy)

The ending-oriented programs represent 90.3 percent of overall resources allocated in PPA, corresponding to R$ 1,60 billion (equivalent approximately to US$ 550 million)[59]. The strong priority given to the social inclusion agenda is reflected in the funding plans - social programs dominate planned PPA spending. Mega-objective one (social inclusion and reduction of inequality) absorbs 63 percent of all expenditures for ending-oriented programs. Mega-objective two (sustainable economic growth) benefits from 35 percent while the mega-objective three (citizenship and participation) gets two percent.

The resource destination according to the different sectors are presented in tables below.

Table 10: Mega-objective one - Programs for enhancing social inclusion and reduction of inequality, by sector (R$)

Social Security	697,566,609,103	68.8%
Health	133,518,685,592	13.2%
Education	56,506,195,595	5.6%
Social Assistance	49,312,870,507	4.9%
Housing	21,070,650,815	2.1%
Urbanism	12,718,325,229	1.2%
Sanitation	12,617,012,110	1.2%
Transport	8,792150,000	0.9%
Agrarian Organization	5,796,344,711	0.6%

[59] BRAZIL. Law Draft No. 30/2003. Multi-Year Plan 2004-2007

Others	16,733,910,718	1.6%
Total	1,014,632,754,376	100%

Source: BRAZIL. Law Draft No. 30/2003. Multi-Year Plan 2004-2007.
The figures do not add 100.0% due to rounding.

Table 11: Mega-objective two - Programs for bolstering sustainable economic growth, by sector (R$)

Infrastructure	189,085,674,629	32.0%
Productive Sector	154,436,421,919	26.1%
Exportation Support	58,590,854,804	9.9%
Information and Knowledge	5,421,944,805	0.9%
Environment	4,001,116,696	0.7%
Others	180,067,534,583	30.4%
Total	591,603,547,436	100%

Source: BRAZIL. Law Draft No. 30/2003. Multi-Year Plan 2004-2007.

Table 12: Mega-objective three – Programs for promoting citizenship and participation, by sector (R$)

National Defense	12,131,845,607	16.6%
Public Security	8,476,720,998	11.6%
Justice	2,635,199,482	3.6%
Foreign Relations	2,286,384,043	3.1%
Citizen Rights	1,418,788,827	1.9%
Culture	923,535,587	1.3%
Sport and Leisure	403,250,379	0.6%
Others	44,641,561,750	61.2%
Total	72,917,286,674	100%

Source: BRAZIL. Law Draft No. 30/2003. Multi-Year Plan 2004-2007.
The figures do not add 100.0% due to rounding.

5. PUBLIC INVESTMENT – CHALLENGES AND PROPOSALS

Promoting sustainable growth and social equity while maintaining balanced public accounts have been the main challenges for President Lula's administration. Consistent with PPA, the government intends to succeed in those tasks, by adopting microeconomic policies that aim to enhance the investment climate and productivity. The idea is to carry out actions to improve the infrastructure, regulatory environment, and financial sector as a path to higher growth. However, the lack of funds for critical investments – a consequence of fiscal adjustment and budget rigidity – is a constraint.

Actions incorporated in PPA can be financed through four mechanisms: public sources, private sources, payments by users and beneficiaries, and public-private partnerships. Public sources include mainly tax revenues and loans contracted by governments. Private sources are the contributions by foundations, NGOs, individuals, and non-profit corporations. Payments by users and beneficiaries take the form of market mechanisms where people pay tariffs for using public services. Finally, public-private partnerships are combinations of sources[60].

To improve the quality and flexibility of public spending allocation and to execute the programs covered by PPA, two measures have to be applied: a) sustaining the development of tools which aim to reduce budget rigidity, and b) seeking financial support that does not affect fiscal balances, such as private sector investments.

The first measure has been a concern since 1994, when it was initially legally enforced the de-earmarking of 20 percent of all federal taxes and contributions for the constitution of the Social Fund for Emergency – FSE, later called the Fund for Fiscal Stabilization – FEF, which lasted until 1999. In 2000, the De-earmarking of Budget Revenues – DRU was created. It is supposed to be in force until 2007.

[60] In accord with *Law Draft No. 2.546/2003* sent by government to the Congress, Public-Private Partnership contracts are "deemed to be agreements entered into between government or public sector entities and private sector entities that set up a legally binding obligation to establish or manage, in whole or in part, services, undertakings and activities in the public interest, in which the private sector partner is responsible for the financing, investment and management".

The second measure is expected to start as soon as the Public-Private Partnership Law (PPP Law) is approved. Its draft was sent by the Executive branch to Congress in November 2003. The law will provide the regulatory framework for public-private partnerships, broadening the existent possibilities. Currently, according to the Law No. 8,987/95, which establishes rules and requirements for concession and permission of public services, the private sector is responsible for entrepreneur risk and the public sector cannot transfer resources or provide guarantees for investment return. Therefore, the private investments made under the current legislation have only been channeled for undertakings in which tariffs are sufficient to pay for delivered services. On the other hand, after the PPP Law is passed, the public sector will be authorized to supplement tariffs and provide guarantees for private sector loans.

In addition to the aforementioned measures, and in connection with the implementation of external loan agreements, two steps have to be taken: a) concluding studies aimed at determining loan balances that can be cancelled without any impairment to project execution, and b) choosing the best lending instruments for making multilateral funding available.

Related to the first course of action, cancellations have to be done where funds are not needed or cannot be used in the remaining project period. As quoted above, successive devaluations made the project costs in dollars cheaper than they were when the project started. Discussions about this subject have been carried out by the Ministry of Planning, Budget, and Management, the Ministry of Finance and the sector ministries responsible for public projects partially financed by external resources. The discussions have the purpose of evaluating the adequate balance amount to be canceled.

Regarding the lending instruments multilateral organizations offer, it is important to admit that the traditional investment instruments are no longer effective. They require counterpart funds, the use of banks' rules for procurement and the development of new projects jointly with financial institutions. As a result of these features, and considering the limited room the Brazilian government has for discretionary spending, conventional investment loans have become difficult to arrange, since they must match the government's fiscal priorities.

Over the last five years, Brazil has increasingly contracted policy-based loans which constitute lending instruments to support policy reforms. Under this kind of contract, lending is made in response to reforms already enacted, rather than conditioning loan disbursements on predefined government actions. Brazil's external vulnerability has made the flexibility of such a lending instrument especially advantageous.

Recently, a new product has been offered by IBRD which led the Brazilian government to start discussions with IDB that aim to seek the development of a similar lending instrument. That product, called Sector Wide Approach (SWAp), permits the financing of existing government programs, as well as the use of existing institutions and systems [61]. Therefore, SWAp constitutes a lending product capable of addressing fiscal constraints both by tying external funds to the highest priority programs and by minimizing the risks of budget cuts. These features have made this option very attractive.

Traditional investment loans disburse against specific spending categories and impose banks' procurement and reporting requirements. An important characteristic of SWAp is that IBRD resources are pooled with counterpart funds and disbursed from the same account, giving more flexibility than other instruments. As a consequence, the resources are disbursed in a relatively quick manner. Besides, pooling opens the possibility of linking financing to results and rewarding efficiency.

Given the fiscal constraints Brazil faces nowadays, new instruments have to be explored. In this sense, dialogue with multilateral organizations plays an important role. Approaches that tie financing to outputs and benchmarked performance, and allow channel resources for ongoing priority programs seem to be the best short-run solution for resuming the pace of loan disbursements.

[61] The bank's permission for use of existing institutions and systems depends on its previous assessment. Last year, IBRD discussed and agreed with the federal government on a Country Procurement Assessment (CPAR), which rates federal procurement systems and institutions economic, efficient and transparent, and of (the low end of) average risk.

CONCLUSION

This paper has sought to discuss the effects of tight Brazilian fiscal policy on the execution of public projects partially financed by multilateral organizations. The analysis took into account the financial performance of IBRD and IDB loan agreements.

The central idea of the text is that the Brazilian commitment to fiscal discipline has led the country to reduce the pace of execution of public investments and the disbursement of external loan agreements. Considerable budget rigidity, stemming from earmarked revenues and mandatory expenditures, aggravates this scenario and circumscribes the government's ability to allocate budget resources to its priorities.

The immediate consequence of these facts has been the low performance of public projects financed by foreign funds. Moreover, the impossibility of new credit operations has been responsible for a reversal in the capital flow between Brazil and multilateral organizations.

The newly-elected government has committed itself to create the necessary conditions to resume economic activity and to meet social demands while maintaining fiscal discipline. Bearing that in mind, this paper proposes to address the impact of fiscal measures on implementation of public projects and on disbursement of external resources by: a) sustaining the development of tools which aim to reduce budget rigidity; b) seeking financial support that does not affect fiscal balances, such as private sector investments; c) concluding studies aimed at partial cancellations of loan balances; and d) choosing the best lending instruments for making multilateral funding available.

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ANNEXES

A – 1 Cash Flow between Brazil and Multilateral organizations

FINANCIAL FLOW

IBRD - International Bank for Reconstruction and Development

CASH FLOW
Calendar Year (Jan/Dec)

USD MILLION

YEAR	DISBURSEMENT	AMORTIZATION	INTERESTS AND FEES	NET TRANSFER
1992	581	1266	647	(1332)
1993	471	1279	579	(1387)
1994	640	1346	537	(1243)
1995	837	1376	491	(1030)
1996	1500	1222	416	(138)
1997	1416	1048	380	(12)
1998	1332	995	378	(41)
1999	1534	909	436	189
2000	1693	865	462	366
2001	1639	785	359	495
2002	1400	1028	338	34
2003	1291	1633	377	(719)

APPROVED AND CONTRACTED AMOUNT
Calendar Year (Jan/Dec)

USD MILLION

YEAR	APPROVED AMOUNT	CONTRACTED AMOUNT
1992	1131	1344
1993	1002	636
1994	760	1024
1995	462	404
1996	918	858
1997	1701	1104
1998	1097	1291
1999	1465	1738
2000	1594	1290
2001	1556	1654
2002	1419	1602
2003	1157	1150

Source: Ministy of Planning, Budget and Management. Secretariat of International Affairs.

FINANCIAL FLOW

IDB - Inter-American Development Bank

CASH FLOW
Calendar Year (Jan/Dec)

USD MILLION

YEAR	DISBURSEMENT	AMORTIZATION	INTERESTS AND FEES	NET TRANSFER
1992	328	307	247	(226)
1993	336	305	256	(225)
1994	399	344	265	(210)
1995	490	356	285	(151)
1996	830	299	283	248
1997	1377	328	297	752
1998	1640	313	370	957
1999	2937	337	498	2102
2000	2849	319	807	1723
2001	1023	327	839	(143)
2002	2185	1103	711	371
2003	1092	2032	750	(1690)

APPROVED AND CONTRACTED AMOUNT
Calendar Year (Jan/Dec)

USD MILLION

YEAR	APPROVED AMOUNT	CONTRACTED AMOUNT
1992	941	1117
1993	896	412
1994	1132	897
1995	1582	774
1996	1686	1573
1997	1624	2325
1998	1476	981
1999	4555	5188
2000	444	877
2001	1951	570
2002	690	2299
2003	242	155

Source: Ministry of Planning, Budget and Management. Secretariat of International Affairs.

FINANCIAL FLOW

IBRD - International Bank for Reconstruction and Development and IDB - Inter-American Development Bank

CASH FLOW
Calendar Year (Jan/Dec)

USD MILLION

YEAR	DISBURSEMENT	AMORTIZATION	INTERESTS AND FEES	NET TRANSFER
1992	909	1573	894	(1558)
1993	807	1584	835	(1612)
1994	1039	1690	802	(1453)
1995	1327	1732	776	(1181)
1996	2330	1521	699	110
1997	2793	1376	677	740
1998	2972	1308	748	916
1999	4471	1246	934	2291
2000	4542	1184	1269	2089
2001	2662	1112	1198	352
2002	3585	2131	1049	405
2003	2383	3665	1127	(2409)

APPROVED AND CONTRACTED AMOUNT
Calendar Year (Jan/Dec)

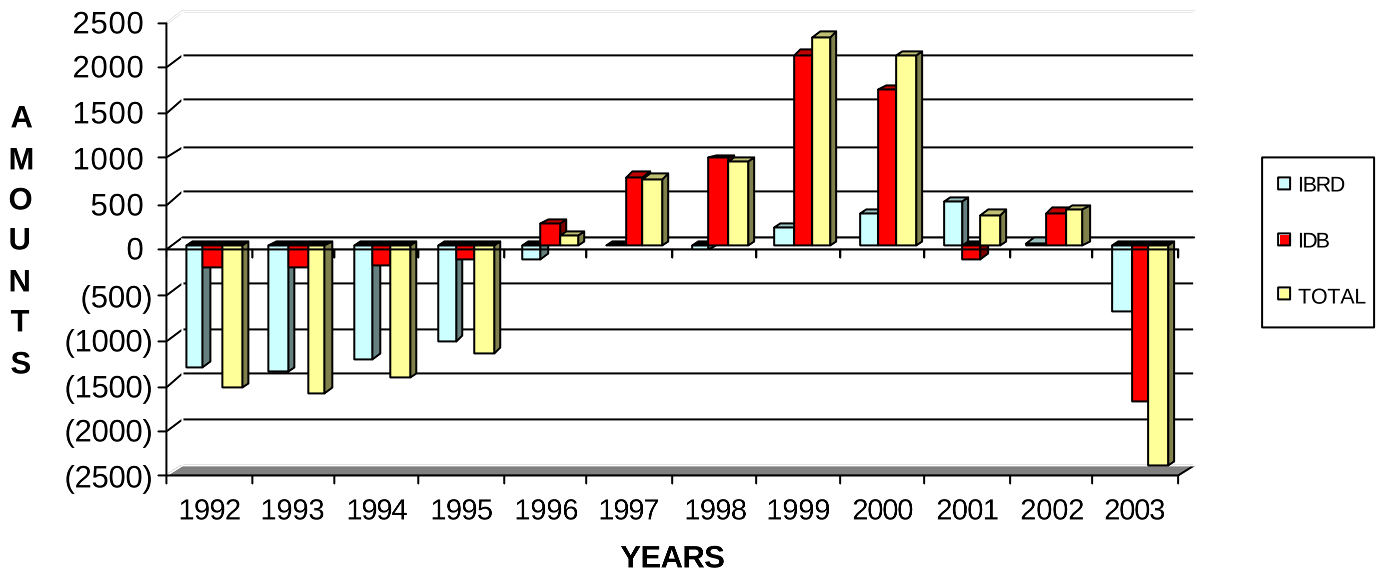
USD MILLION

YEAR	APPROVED AMOUNT	CONTRACTED AMOUNT
1992	2072	2461
1993	1898	1048
1994	1892	1921
1995	2044	1178
1996	2604	2431
1997	3325	3429
1998	2573	2272
1999	6020	6926
2000	2038	2167
2001	3507	2224
2002	2109	3901
2003	1399	1305

Source: Ministry of Planning, Budget and Management. Secretariat of International Affairs.

FINANCIAL FLOW

IBRD - International Bank for Reconstruction and Development and IDB - Inter-American Development Bank



ANNEX

A – 2 Federal Projects Partially Financed by IBRD and IDB Loans

FEDERAL PROGRAMS PARTIALLY FINANCED BY IBRD AND IDB LOANS [1]

(USD thousands)

BORROWER	PROJECT	FUND	CONTRACTUAL AMOUNT
Ministry of Agriculture	PRODETAB - Support for Technologic Development in Agriculture	IBRD	60,000
Total			60,000
Ministry of Science and Technology	PADCT III - Reform of Science and Technology	IBRD	155,000
Total			155,000
Ministry of Culture	MONUMENTA - Preservation of Urban Historic Patrimony	IDB-OC	62,500
Total			62,500
Ministry of Education	PROEP - Reform of Professional Education	IDB-OC	250,000
	Enhancing School Fund - Phase II	IBRD	202,030
	Enhancing School Fund - Phase III	IBRD	160,000
	PROMED - Expansion and Improvement of High Schools Teaching	IDB-OC	250,000
	University Access	IDB-OC	5,000
Total			867,030
Ministry of Finance	PNAFM - Support for Fiscal Administration in Municipalities - Phase I	IDB-OC	300,000
	PNAFE - Strengthening and Modernizing Fiscal Administration in States	IDB-OC	500,000
	PROAT I - Improvement of Central Bank Tools	IBRD	20,000
	PROGER - Strengthening Fiscal and Financial Management	IBRD	8,880
	PROAT II - Improvement of Central Bank and CVM Tools	IBRD	14,460
Total			843,340
Ministry of Social Security	PARSEP - Reform of Social Security System in States and Municipalities	IBRD	5,000
	PROAST - Technical Assistance for Social Security Reform	IBRD	5,050
	PROPREV - Support for Modernization of Social Security Administration	IDB-OC	57,000
	PREV-MUNICIPIOS - Support for Modernization of Social Security Systems in Municipalities	IBRD	5,000
Total			72,050

BORROWER	PROJECT	FUND	CONTRACTUAL AMOUNT
Ministry of Health	REFORSUS - Reform of Healthy Sector	IDB-OC	350,000
		IBRD	300,000
	VIGISUS - Vigilance of Healthy Sector - Phase I	IBRD	100,000
	Training Nursing Workers	IDB-OC	185,000
	Family Healthy - Phase I	IBRD	68,000
	AIDS III - AIDS Project- Phase III	IBRD	100,000
Total			1,103,000
Ministry of Cities	Decentralization of Urban Transport in Belo Horizonte	IBRD	99,000
	Decentralization of Urban Transport in Recife	IBRD	102,000
	PROSANEAR - Technical Assistance for Prosanear Program	IBRD	30,300
	PMSS II - Modernization of Sanitation Enterprises	IBRD	25,000
	PAS - Social Actions in Sanitation	IDB-OC	100,000
	HABITAR BRASIL - Improvement of Urban Areas	IDB-OC	250,000
	Decentralization of Urban Transport in Salvador	IBRD	150,000
	METROFOR - Metro in Fortaleza - Fase II	IBRD	85,000
Total			841,300
Ministry of Development	Communities Settlements in Rural Areas	IDB-OC	51,000
	Rural Credit and Poverty Combat	IBRD	202,100
Total			253,100
Ministry of Environment	PROECOTUR - Technical Cooperation for Ecotourism Development in Legal Amazon	IDB-OC	11,000
	PANTANAL - Sustainable Development in Pantanal - Phase 1	IDB-OC	82,500
	PROAGUA - Water in "Semi-Arido" Area	IBRD	198,000
	National Environment Fund – Phase I	IDB-SF	24,000
	National Environment Program - Phase II	IBRD	15,000
	Controlling and Preventing Fire in Amazon	IBRD	15,000
	Management of Hydric Resources in "São Francisco" River Basin	IBRD	8,500
Total			354,000

BORROWER	PROJECT	FUND	CONTRACTUAL AMOUNT
Ministry of Energy	Technical Assistance for Energy Sector	IBRD	12,120
Total			12,120
Ministry of Planning, Budge, and Management	REDE IPEA - Public Policy Studies	IDB-OC	25,000
	Modernization of Executive Branch in Brazil	IDB-OC	57,000
Total			82,000
Ministry of Transports	Descentralization of Federal Highways	IDB-OC	300,000
		IBRD	300,000
	"Fernão Dias" Highway -Phase I	IDB-OC	267,000
	"Regis Bittencourt" Highway	IDB-OC	450,000
	"Fernão Dias" Highway -Phase II	IDB-OC	275,000
Total			1,292,000
Senate	INTERLEGIS - Legislative Branch Integration	IDB-OC	25,000
Total			25,000
Union Account Office	Modernization of TCU (Tribunal de Contas da União)	IDB-OC	5,000
Total			5,000
IDB-OC/SF Loans - TOTAL		61%	3,882,000
IBRD Loans - TOTAL		39%	2,445,440
IDB-OC and IBRD Loans - TOTAL		100%	6,327,440

1 - Include programs in execution and recently signed.

Prepared based on data from Secretariat of International Affairs/ Ministry of Planning, Budget, and Management - January 2004.

ANNEX

A – 3 Performance of Federal Projects Partially Financed by IBRD and IDB Loans

Performance of Federal Projects Partially Financed by IBRD and IDB [1]

Date: 12/31/2003

USD Thousands

Bank	Quantity of Contracts	Loan Amount 1	Disbursed 2	Cancelled 3	Balance 4=1-(2+3)	Disbursement Average (last two years)	Disbursement Percentage (year)	Commitment Fee [2] (paid) 5	Percentage 6 = 5/1
IBRD	24	2,124,820	959,028	214,120	951,672	144,340	6.8%	23,907	1.13 %
IBD	21	3,777,000	1,986,866	146,535	1,643,599	241,266	6.4%	67,371	1.78 %
TOTAL	45	5,901,820	2,945,894	360,655	2,595,271	385,606		91,278	

1- Only contracts whose disbursement has started

2 – Banks charge a commitment fee corresponding to the rate of 0,75% per annum on the principal amount of the loan not withdrawn from time to time.

Prepared based on data from Secretariat of International Affairs – December 2003

ANNEX

A – 4 Financial Conditions of Multilateral Organizations’ Loans and Sovereign Issues Costs

MULTILATERAL ORGANIZATIONS - Authorized Operations by Ministry of Finance

BORROWER	BANK	Currency	Amount	Equivalent Amount (US$)	Project	Financing Option	RATE	Annual Average rate (%) 1	Spread (%) 2	TOTAL (%) 3=1+2	Commitment Fee (%)	Flat Fee (%)	Effective Cost - IRR (%)	Final Maturity (Year)	Period of Grace (Years)
2002															
RFB/MME	BIRD	US$	454,550,000	454,550,000	Electric Sector	Fixed-Spread Loan	Libor 6m US$	1.90	0.55	**2.44**	0.85	1.00	**2.63**	**10.00**	9.5
RFB/MP/MF	BIRD	US$	404,040,000	404,040,000	Programatic Loan for Public Sector	Fixed-Spread Loan	Libor 6mUS$	1.90	0.55	**2.44**	0.85	1.00	**2.57**	**10.50**	10.0
RFB/MS	BIRD	US$	68,000,000	68,000,000	Family Healthy	Fixed-Spread Loan	Libor 6m US$	1.90	0.55	**2.44**	0.85	1.00	**3.06**	**16.00**	6.0
RFB/BACEN E CVM	BIRD	US$	14,460,000	14,460,000	BACEN and CVM	Variable-Spread Loan	Libor 6m US$	1.88	0.45	**2.33**	0.75	1.00	**2.47**	**15.00**	5.0
RFB/MPAS	BIRD	US$	5,000,000	5,000,000	PREV - Municipalities	Variable-Spread Loan	Libor 6m US$	1.88	0.45	**2.33**	0.75	1.00	**2.70**	**15.00**	5.0
RF/MEC	BIRD	EUR	182,800,000	196,557,528	Fundescola III	Fixed-Spread Loan	Euribor 6m US$	3.36	0.55	**3.91**	0.85	1.00	**4.81**	**12.00**	5.0
RFB/ME	BID	US$	5,000,000	5,000,000	Diversity in University	Single Currency	Funding cost	5.69	0.10	**5.79**	0.75	1.00	**6.29**	**20.50**	3.5
RFB/MF/MP	BID	US$	500,000,000	500,000,000	Promoting Human Capital	Single Currency	Funding cost	5.69	0.10	**5.79**	0.75	1.00	**6.09**	**21.50**	1.5
2003															
RFB/MF	BIRD	US$	505,050,000	505,050,000	Programatic Loan for Urban Reform	Fixed-Spread Loan	Libor 6m US$	1.24	0.50	**1.74**	0.85	1.00	**1.86**	**10.50**	8.0
RFB/MP/MF	BIRD	US$	404,040,000	404,040,000	Programatic Loan for Fiscal Reform	Fixed-Spread Loan	Libor 6m US$	1.24	0.50	**1.74**	0.85	1.00	**1.86**	**11.00**	6.0
RFB/MS	BIRD	US$	100,000,000	100,000,000	AIDS III	Variable-Spread Loan	Libor 6m US$	1.22	0.45	**1.67**	0.75	1.00	**2.05**	**15.00**	5.0
RFB/MME	BIRD	US$	12,120,000	12,120,000	Technical Assistence for Electric Sector	Variable-Spread Loan	Libor 6m US$	1.22	0.45	**1.67**	0.75	1.00	**2.07**	**15.00**	5.0
RFB/TCU	BID	US$	5,000,000	5,000,000	Modernization of TCU	Single Currency	Funding cost	4.98	0.40	**5.38**	0.75	1.00	**5.73**	**20.00**	3.0
Total		**US$**		**1,026,210,000**											

Prepared based on data from Secretariat of National Treasury - STN/COREF/GERFI

STATISTICS MEASURES

	Operations in US$	
SAMPLE	**13**	
MEAN	**3.28**	**%**
MEDIAN	**2.60**	**%**
STANDARD DEVIATION	**1.63**	
MAXIMUM	**6.29**	**%**
MINIMUM	**1.86**	**%**

SOVEREIGN ISSUES

BORROWER	ISSUE	CURRENCY	AMOUNT	EQUIVALENT AMOUNT (US$)	Spread (%)	INTEREST RATE (%)	FLAT FEE (%)	FINAL MATURITY (YEARS)	EFFECTIVE COST - IRR (%)
2002									
RFB	Global 2010	US$	1,000,000,000	1,000,000,000	7.19	**12.00**	-	**8.00**	**12.99**
RFB	Global 2012	US$	1,250,000,000	1,250,000,000	7.54	**11.00**	**0.60**	**10.00**	**13.23**
RFB	Global 03/2008	US$	1,250,000,000	1,250,000,000	7.38	**11.50**	**0.55**	**6.00**	**12.06**
RFB	EURO 2009	EURO	500,000,000	543,630,000	6.46	**11.55**	**0.40**	**5.00**	**11.68**
2003									
RFB	Global 01/07	US$	1,000,000,000	1,000,000,000	7.83	**10.00**	**0.30**	**4.00**	**10.93**
RFB	Global 2013(CAC)	US$	1,250,000,000	1,250,000,000	7.38	**10.25**	**0.35**	**10.00**	**10.85**
RFB	Global 2011 (CAC)	US$	500,000,000	500,000,000	7.57	**10.00**	**0.25**	**8.00**	**12.21**
RFB	Global 2024 (CAC)	US$	833,000,000	833,000,000	7.64	**8.88**	**0.31**	**21.00**	**12.20**
RFB	Global 2010 (CAC)	US$	750,000,000	750,000,000	6.33	**12.00**	**0.25**	**8.00**	**13.13**
RFB	Global 2011 (CAC)	US$	1,500,000,000	1,500,000,000	5.61	**9.45**	**0.28**	**7.50**	**9.,68**
TOTAL				**9,876,630,0000**					

Nota: Prepared based on data from Secretariat of National Treasury – STN/COREF/GERFI

STATISTICS MEASURES

	Issues in US$	
S AMPLE:	**9**	
MEAN	**11.92**	**%**
MEDIAN	**12.20**	**%**
STANDARD DEVIATION	**1.14**	
MAXIMUM	**13.23**	**%**
MINIMUM	**9.68**	**%**

ANNEX

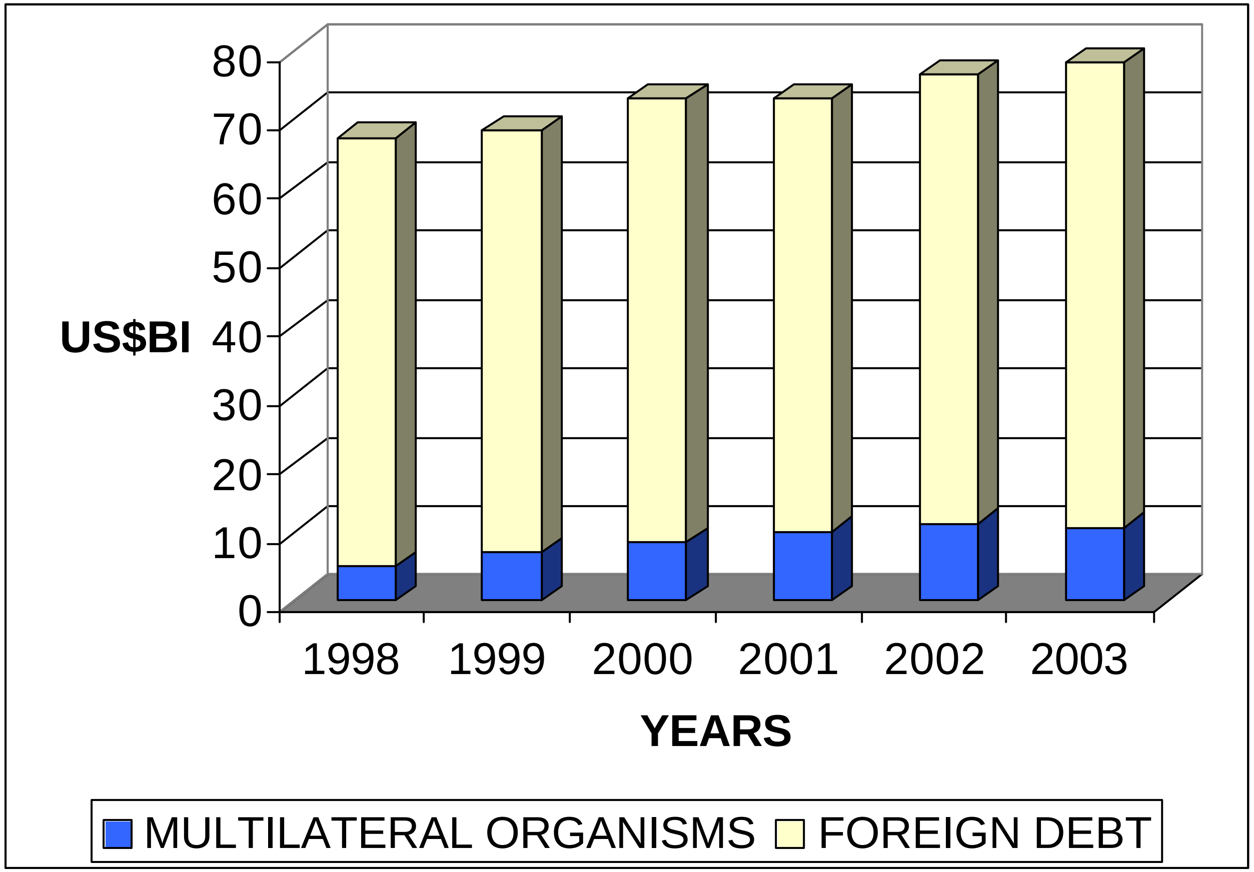
A – 5 Balance of Federal Foreign Debt

BALANCE OF FEDERAL FOREIGN DEBT

(USD thousands)

	Dec 1998	Dec 1999	Dec 2000	Dec 2001	Dec 2002	Dec 2003	(%) Dec 2003
FEDERAL FOREIGN PUBLIC DEBT	**67,370,775**	**68,243,817**	**73,024,391**	**72,969,017**	**76,478,635**	**78,240,751**	**100%**
1) Securities Debt	**48,799,472**	**49851,661**	**53,962,209**	**53,647,158**	**56,793,280**	**59,398,440**	**76%**
1.1) *Bradies*	39,900,620	33,910,347	26,478,066	19,603,207	18,514,826	16,377,857	21%
1.2) Soverein Issues	8,898,852	15,941,314	27,484,143	34,043,951	38,278,454	43,020,583	55%
2) Loan Agreements Debt	**18,571,303**	**18,392,156**	**19,062,182**	**19,321,858**	**19,685,355**	**18,842,311**	**24%**
2.1) Multilateral organizations - IBRD/IDB	49,51,694	7,015,283	8,524,707	10,043,262	11,136,044	10,711,373	14%
2.2) Government Banks and Agencies	3,583,072	2,997,023	3,425,462	3,402,394	3,393,152	3,218,340	4%
2.3) Paris Club	10,036,537	8,379,850	7,112,013	5,876,202	5,156,158	4,912,598	6%

Prepared based on data from Secretariat of National Treasury - STN/CODIV/GEEST



80
70
60
50
40
30
20
10
0
US$BI
1998
1999
2000
2001
2002
2003
YEARS
MULTILATERAL ORGANISMS
FOREIGN DEBT