

# LOAN COMMITTEE

LC-M-86-16

June 10, 1986

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Minutes of the Loan Committee Meeting to Consider  
BRAZIL - Credit and Marketing Reform Project Held  
on May 14, 1986 in Conference Room E-1208

## A. Present

### Committee

Messrs. E. Stern, Chairman  
S. S. Husain  
A. D. Knox  
J. D. Wood  
D. Goldberg  
Mrs. A. Krueger

### Others

Messrs. A. Choksi  
J. Collell  
S. El Serafy  
R. Gonzalez Cofino  
J. Joyce  
E. Kopp  
C. Lewis  
F. Lysy  
N. Roger  
R. Ruivivar  
E. Schuh  
J. Wijnand  
Mmes. P. Donovan  
L. Fox  
M. Molaes  
L. Yap

## DISTRIBUTION

### COMMITTEE

Senior Vice President, Operations (Chairman)  
Senior Vice President, Finance  
Vice President & General Counsel  
Vice President, Operations Policy  
Regional Vice President concerned\*  
Vice President, Energy & Industry (for lending  
in these sectors and SALs)  
Vice President, Economics and Research (for non-  
project lending)

### OTHERS

Standard (see OMS 9.25 page 7)

\*Copy to all other Regional Vice Presidents

B. Issues

1. The Loan Committee met to discuss the operation and took up the issues raised in the Country Policy Department's memorandum of May 14, 1986. The discussion covered (a) the soundness of the macroeconomic framework for the loan and other macroeconomic issues; (b) the policy conditions for second tranche release; (c) the Government's new rural credit policy; and (d) tranching of the loan.

C. Discussion

2. Macroeconomic Issues. The question was raised as to whether the Bank should at this time be considering a substantial volume of program-type assistance to Brazil (totalling US\$1.0 billion for the proposed Power and Credit and Marketing Reform Loans) when questions still remained about the Government's macroeconomic policies. The Chairman responded that Brazil's overall economic performance, especially in the external sector, had been good. Major improvements in policies had been made, particularly in recent months. The Region stated that the Government was aiming to reduce the public sector deficit from about 3.5% of GDP in 1985 to 2% in 1986, though it was likely that the final outcome would be somewhat higher, in the 2%-3% range. A reduction in the Government's outstanding debt was also being planned. The achievement of these targets might be made possible by the "seigniorage gains" emerging from monetary expansion in an environment of declining inflation and a corresponding willingness by the public to hold more money balances. This monetary expansion would increase the monetary base to GDP ratio from 2% in 1985 to slightly more than 5% in 1986. Responding to a question from the Chairman about the views of the Fund on the Government's fiscal program, the Region replied that the Fund would prefer to see a surplus and a sharper reduction in Government debt. The Region, however, believed that the level of the public sector deficit now being envisaged, which implied sharp cutbacks in the investment program for parastatals, and the likely means of financing the deficit, were consistent with the objectives of the stabilization program. The Region said that the Brazilian Government did not intend at this time to seek a Fund agreement nor to allow Fund monitoring of economic performance other than the usual Article IV consultations, and that a Fund mission for this purpose was scheduled to visit Brazil in the Summer.

3. Concerning the monitoring of fiscal performance, the Region stressed that a commitment was made by the Government during the recent negotiations on the Public Sector Management Technical Assistance Project to regularly provide to the Bank information on the public sector investment program as well as on the overall Government budget. The Committee agreed that monitoring the Government's performance in these respects would be carried out through that project, and not the proposed loan.

4. Regarding the prospects of debt repayments to Paris Club creditors, the Chairman inquired whether progress was being made towards the resumption of at least interest payments on debt owed by the Government. He was concerned that unless this issue was resolved soon, it would be difficult to defend continued Bank lending to Brazil at the



Board. The Region said that discussions with the Paris Club were continuing and that an informal Paris Club Meeting was scheduled to start on May 15, 1986. The Bank's concern about this matter had been conveyed to the Brazilian authorities, and the Region intended to keep reminding the Brazilians of the Bank's concern.

5. Second Tranche Conditions. The Committee discussed the trade and pricing policy reforms which would form part of the conditionality of the second tranche. According to the Region, the lifting of price controls was essential to the full implementation of these reforms, and the second tranche would not be released therefore until such lifting of price controls had started. The Region expected this process to be gradual. However, a number of important steps, comprising a substantial part of second tranche conditionality, could be taken in the interim. These would include specific actions to expand the access of producers and traders to the futures market; to improve the terms and increase the flow of financing for domestic storage; to improve stock information and crop forecasting systems, and to simplify trade regulations. Actions would also be taken, while the price freeze was in effect, to establish the system of minimum prices and market safeguards, which could be implemented in early 1987 once the price freeze had ended.

6. While recognizing that work was still ongoing on defining the details of the policy conditionality of the second tranche, the Committee directed that the President's Report should include in the body of the text an indication of the specific actions which the Bank expected the Government to take for second tranche release.

7. Rural Credit Policy. The Committee discussed the new system of variable interest rates on official rural credit, and the continuing system of mandatory credit allocations. The Region stated that under the Government's new rural credit policy, interest rates on official credit would be adjusted every six months, based on the current rate of discount on Treasury bills. The new policy was considered by the Region to be a major improvement as the Treasury bill rate would reflect inflationary expectations prevailing in the market at that time, helping to ensure positive real interest rates, albeit with some lag. The Treasury bill rate was determined in a relatively broad market, and was not likely to be easily manipulated. Although its use as a reference rate for long-term interest rates was not completely satisfactory, there were no market-determined long-term interest rates available. Whatever long-term rates existed (such as under certain industrial credit lines) were administratively determined. The Committee endorsed the use of this short-term market-determined rate as an objective basis for the structure of official interest rates. With regard to mandatory credit allocations, the Chairman believed that the gradual dismantling of the present system of directed credit should be the next step in the process of rural credit reform. The Region responded that they would seek to clarify the Government's position on this issue during negotiations, and that specific actions toward this objective would be pursued under the proposed Financial Sector Reform Loan, scheduled for FY87.

8. Tranching. The Chairman stated that a large first tranche could be supported based on the substantial macroeconomic and credit policy improvements that had already been made. Referring to other tranching arrangements advocated by some Committee members as an insurance against the risk of conflict between second tranche conditions and the price control program, the Chairman agreed to let the Region determine the exact tranching. The Region confirmed its proposal for two tranches of US\$300 million and US\$200 million, respectively.

D. Conclusion

9. The Committee approved the recommendation to invite negotiations on the terms and conditions proposed by the Region.

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