



PRESIDÊNCIA DA REPÚBLICA
Governo Fernando Henrique Cardoso

TWO YEARS OF CHANGE

BRASÍLIA
1997

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Brasil, Presidente, 1995- : (F.H. Cardoso)

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INTRODUCTION

Brazil has changed greatly during the past two years, and basically for the better. But we have not been the only ones to change. The world has also undergone a rapid and profound transformation.

Brazil feels quite at home in the contemporary world. Democracy and economic freedom are two ideals dear to all Brazilians. Rather than seeing the world as a threat, we view it increasingly as a series of opportunities that will help us achieve our long-desired objectives of economic development and social justice. External sources must provide ingredients that are essential for our sustained economic growth, such as capital to create jobs and sophisticated technology to make us competitive.

Globalization is an objective fact and not an ideological option. Realistically, we must accept it and struggle to extract from it the maximum benefit for Brazil. Contrary to what many believe, globalization is not a straight-jacket shaped merely by market forces, often undermining the State's independence and ability to act. The rules that discipline the activity of economic agents continue to be set politically by the State. The interplay of political interests is an integral part of the creation of the juridical and institutional framework of globalization. Thus, countries that do not play an active international role are condemned to be marginalized.

The State must be well prepared in order to ensure that its interests are protected while the rules of globalization are being established. It must also define its activities with greater precision because the range of issues with which it deals has become much more complex. Those who

announced the death of the State spoke too precipitously. The role of the State has, in a certain way, become even more essential. In addition to such classical functions as security, health and education, the State must now respond, in a democratic manner, to the growing demands for respect of human rights. A cohesive, well-organized and, therefore, strong State will be better positioned to resolve the needs that stem from globalization.

This rationale guides the actions of my government, a government inspired by social-democratic principles. We are successfully promoting changes that improve the country and strengthen our credibility overseas, beginning with the economic stability and growth brought by the *Real Plan*. These changes produced a perceptible improvement in the distribution of income for the poorest economic sectors.

In my international travels, I have conveyed this message of a rejuvenated Brazil that has entered a new phase of economic growth and of greater social justice. I tell government officials, businessmen, journalists and academicians of this new Brazil that we are building with each passing day. They have listened attentively and have responded positively, as proven by the numerous announcements of new productive investments in Brazil. Foreign interest in Brazil has grown significantly because our credibility has increased.

The following report of my administration's accomplishments demonstrates more than the fact that the country has progressed during the past two years. It shows that the nation is traveling along a well-defined path, a path that already enables us to build a better future for all Brazilians.

Fernando Henrique Cardoso

TWO YEARS OF CHANGE*

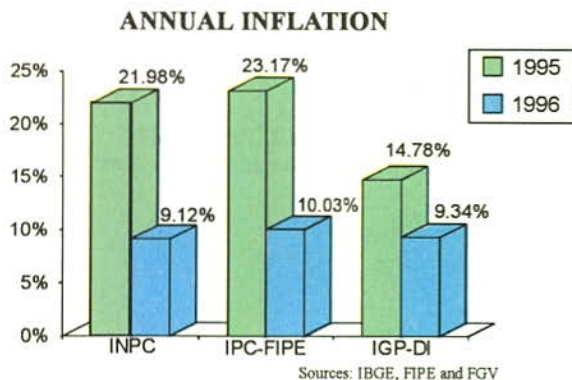
PART I — THE ECONOMY

Our report on the two years of this government begins by considering the most crucial issue in Brazil's economic transformation: the fight against inflation.

1. Inflation

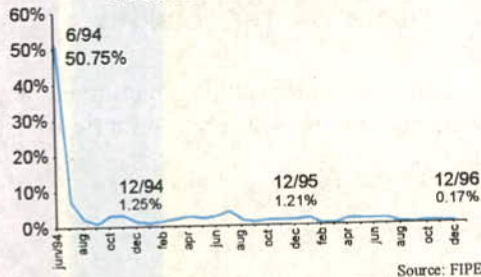
■ Stabilization

Brazil is enjoying its lowest level of inflation since the 1950s. Inflation is in the range of 10%; in 1995, it was about 20%. More than thirty months after the implementation of the *Real Plan*, the inflation rate is still declining. The annual rate in 1996 was, just a little more than two years ago, the rate for only one week. These data reflect the consolidation of the *Real Plan*. After thirty months, memory of the past inflation is beginning to crumble. Behind this anti-inflation effort, a change of mentality has taken place: indexation, a mechanism that automatically extended inflation, is disappearing.



(*) Edited version of the President's presentation in the Planalto Palace on December 12, 1996.

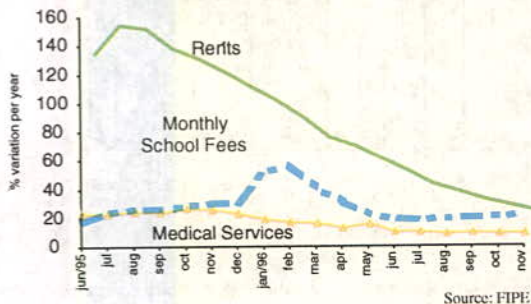
INFLATION - IPC - FIPE (June 1994 — December 1996) MONTHLY CHANGE



Inflationary data indicate that the Brazilian economy is passing through a period of relative price accommodation in which price fluctuations are converging toward a lower plane. Thanks to the opening of the economy, the cost of tradable goods has fallen because the international prices became the reference prices.

During 1996, the prices of non-tradables also stopped moving upward, notably for services and rents. The cost of rents, medical services and school tuitions are not only falling, but are also converging toward a lower level. The following graph shows that the cost of services, which in 1995 contributed the most to the inflation rate, is now steadily declining.

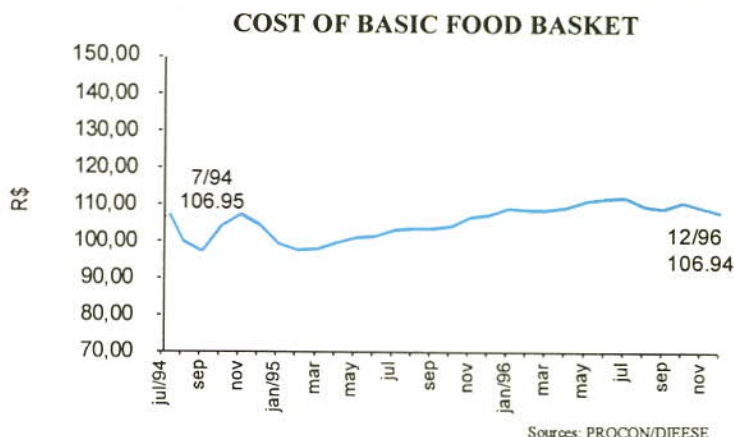
PRICE FLUCTUATIONS Change relative to year earlier



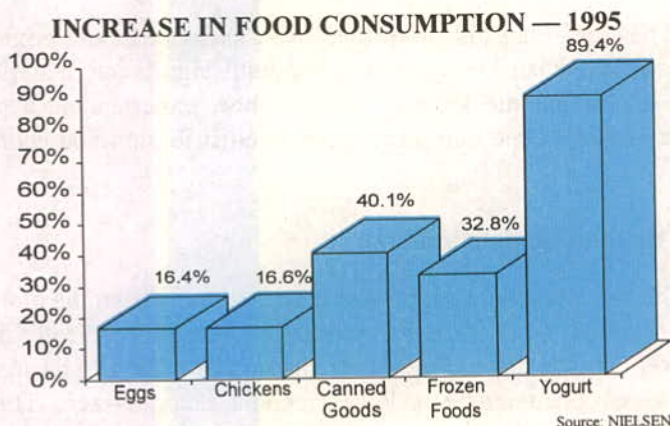
The *Real Plan* did more than bring inflation under control. It caused also a redistribution of income with significant benefits for Brazil's lowest income sectors. Brazil is now experiencing a period characterized by stable currency, income redistribution and economic growth.

■ Income Redistribution

The lowest income population benefited most from the monetary stabilization that the *Real Plan* produced. An excellent indicator during this period was the price increase for the mix or basket of basic foods (*cesta básica*) consumed by the lowest income sectors — zero. This mix of foods currently costs the same as it did in July 1994 (R\$106.95). The poor obviously have benefited tremendously from this price stability.

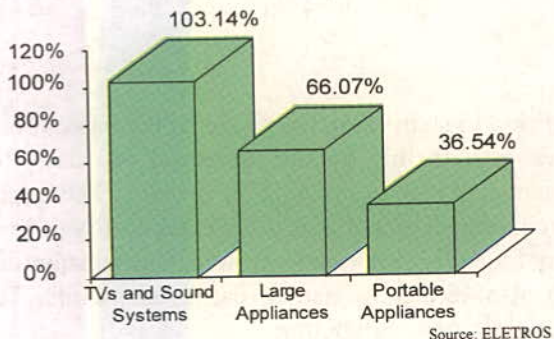


In addition to stabilizing the prices of the basic food items, the *Real Plan* was responsible for the increased consumption of foodstuffs, and especially of items high in protein. The expanded consumption of chicken demonstrates the greater ability of lower income sectors to buy foods that are rich in protein. The substantial growth in yogurt sales also reflects a rise in eating standards. The average Brazilian is eating more and better.

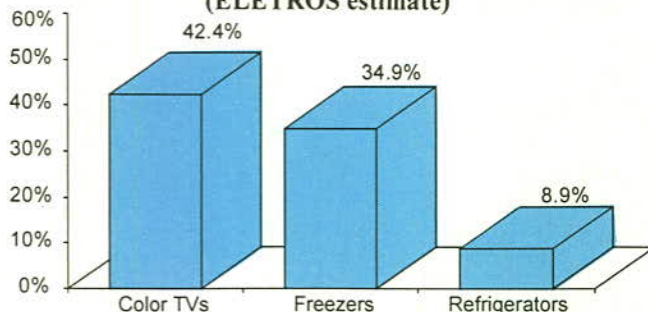


The sales of durable goods rose as well during the two years of this government. The sales of refrigerators, freezers, televisions, sound systems and small appliances grew substantially. The data from the National Survey of Sample Households (*Pesquisa Nacional por Amostragem de Domicílio — PNAD*) for 1995 indicate that, since the implementation of the *Real Plan*, Brazilian households are increasingly better equipped with appliances. These data show that the economic improvement has been not only in the consumption of basic foodstuffs, but also in durable goods. These facts show the profound change taking place in the population's lives.

**INCREASE IN ELETRONICS SALES
(1996/1994)**



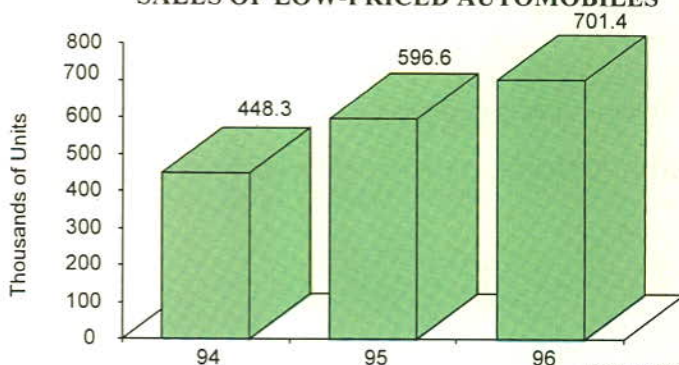
**INCREASE IN HOUSEHOLD OWNERSHIP
OF ELECTRIC APPLIANCES (1996/93)
(ELETROS estimate)**



Sources: IBGE/PNAD/ELETROS

The sales of low-priced automobiles also demonstrated the effective redistribution of income during the past two years. Purchases of such vehicles grew 33% in 1995 and 57% in 1996. These numbers mean that the sales of cars to the lower income sectors rose faster than did the total production of autos.

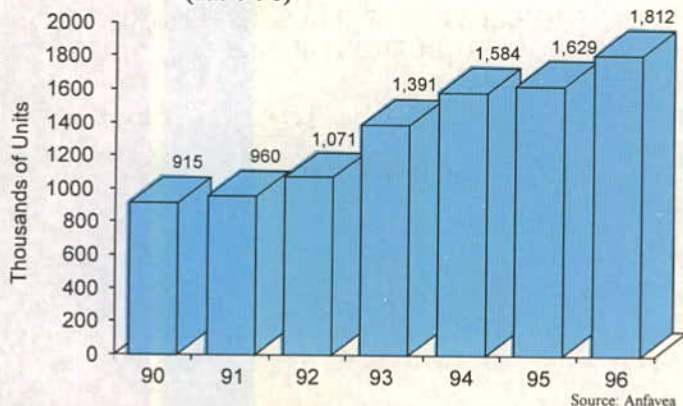
SALES OF LOW-PRICED AUTOMOBILES



Source: Anfavea

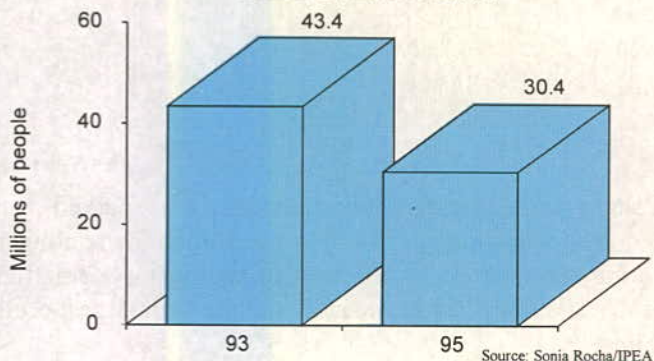
The sharp jump in automobile purchases has sparked a major expansion of production since 1994. Thanks to the new contingent of buyers entering the market, by the turn of the century Brazil could become the world's fourth largest market and the fifth largest producer of automobiles.

AUTOMOBILE PRODUCTION (1990-96)



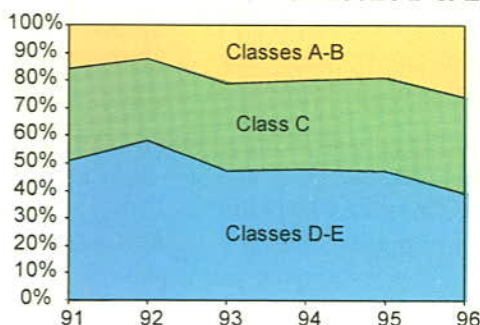
The redistribution of income was, therefore, the most eloquent social effect of monetary stabilization. The number of poor people fell noticeably. Research by IBGE and IPEA reveals that thirteen million Brazilians rose out of poverty between 1993 and 1995 (in 1993 there were 43.3 million people below the poverty line; in 1995 there were 30.4 million). Moreover, after the introduction of the *Real* Plan, a significant increase occurred in the average income of people living below the poverty line. Thus, the *Real* Plan not only brought inflation under control, it also avoided having the poorest sectors of society pay the economic cost of this anti-inflation program.

REDUCTION IN THE NUMBER OF PEOPLE BELOW THE POVERTY LINE



Another way to measure the positive affect of the Real Plan is to look at the movement of people among Brazil's social classes. The number of people in the poorest classes (known as "D" and "E") declined 17% while the number in the richer classes ("A" and "B") rose 21%. These numbers show that the country is undergoing a shift in its social structure. Millions of Brazilians are moving up to join the middle class. This movement is terribly significant because it means that stratified social structures are being modified, something that is difficult to do in any society.

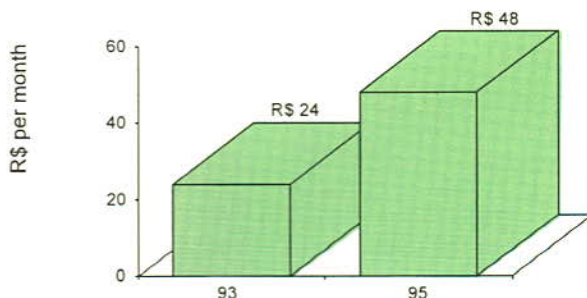
REDUCTION OF CLASSES D & E



Source: Datafolha

The average monthly income of the poorest 10% of the population doubled between 1993 and 1995. This increase signifies that not only did the number of poor people decline, but also that those who continued below the poverty line were not as poor as they had been.

INCREASE IN MONTHLY INCOME OF THE POOREST 10% OF THE POPULATION



Source: Sonia Rocha / IPEA

2. Growth

Many criticized the *Real* Plan because they believed a tight monetary policy would not allow the economy to grow. Just the opposite has occurred.

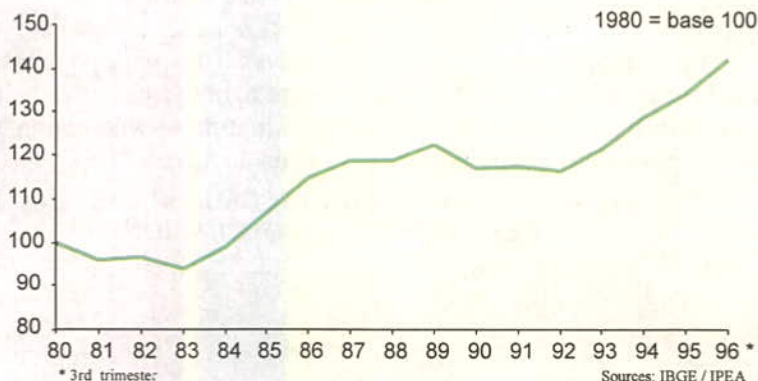
■ Gross Domestic Product (GDP)

The Gross Domestic Product (GDP) expanded 4.2% in 1995. It is estimated that it grew 3.1% in 1996.

Given the rates of growth projected for the next few years, Brazil could grow some 30% during the period 1993-98, achieving an annual GDP of US\$1 trillion by the turn of the century. If the current rate of population growth continues, Brazil's per capita income would reach US\$6,000.

That level of income would represent a substantial improvement for the population, but the government's objectives are even more ambitious. It wishes to reach a level of income that is much closer to that of countries which, at present, are relatively developed.

CHANGE IN GDP

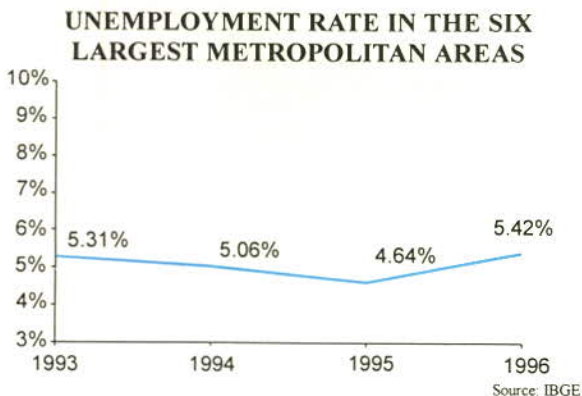


■ Employment

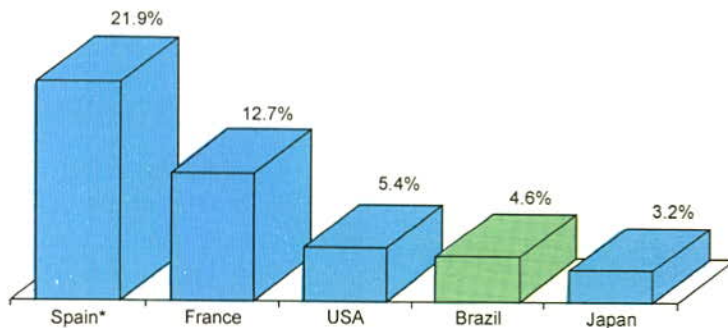
Unemployment is one of the most discussed current issues. Following a small rise in the unemployment index during early 1996, the unemployment rate returned to a level of 5% later in the year. This rate is comparable to that of the United States (5.4%) and significantly less

than that of such countries as Spain (21.9%), Argentina (17%) and France (12.7%).

The IBGE unemployment index, represented in the graph below, is the only Brazilian index comparable to that of other countries because it is the only one that applies the same methodology as that used in other nations. As the IBGE index shows, the rate of unemployment did rise between 1995 and early 1996. Subsequently, however, it stabilized and today is lower than it was in 1993. Between November and December 1996, the rate of open unemployment registered in the country's six principal metropolitan areas dropped from 4.56% to 3.82%, well below the 5.42% average for the year.



COMPARATIVE UNEMPLOYMENT RATES (November 1996)



*Sep. 1996

Sources: The Economist/IBGE

This fact does not signify that there is no unemployment. It means simply that we are measuring, in terms of averages, what is happening on a national level. Research that points to high levels of unemployment usually refers to local situations or to specific economic sectors that are being restructured. The fact that the highest unemployment rates are in São Paulo, for example, reflects movement in the country's economic standard, a change in industrial investment, or even a geographical shift of economic activity.

The automobile industry should be analyzed separately. At the beginning of this government, only two states had automobile production plants — São Paulo and Minas Gerais. These two states now have more auto factories than they had two years ago, and they have enlarged their output. During the same period, the auto industry has expanded to Rio de Janeiro, Paraná, Rio Grande do Sul and Santa Catarina. It will soon be going to the Northeast and to Goiás.

The auto industry produces vehicles with advanced technology, and the parts industries must achieve these same technological standards. Many component producers have already adjusted to this new situation, some are in the process of adjustment, and others have closed. The government has not ignored this situation. The BNDES has created a special credit line to assist the parts producers, just as it did for the textile industry and the shoe manufacturers to restructure their operations. In addition, the Ministry of Labor has been financing numerous support programs. The Professional Training Program, for example, trained close to a million workers in 1996.

■ Pro-Investment Measures

The government has implemented concrete and effective measures to stimulate development. On one hand, it is firmly controlling inflation. On the other, it reduced interest rates, expanded credit facilities, and continued the privatization of state companies. It also launched a program of priority objectives — Brazil in Action (*Brasil em Ação*). This program promotes public investment in ports, railways, waterways,

roads, education and health in order to provide adequate physical and human infrastructure for the country's development.

The increased consumption, the redistribution of income and the reduction of unemployment were made possible by the government's pro-growth policies. These policies included the reduction of taxes, of financial charges and of infrastructure costs.

• Reduction of Taxes

a) Sales Tax

One of the government's most important pro-investment actions was to reform the sales tax (ICMS). With the new ICMS, the producer, whether he is a big or small farmer, industrialist or merchant, is exempt from paying the ICMS on his inputs: raw materials, electrical energy, office supplies, etc. This measure represents a reduction in investment costs of about 15% and, in some cases, as much as 30%. It should cause investment to rise to nearly 20% of GDP and should account for additional annual GDP growth of 1.5%. The new law eliminates also the ICMS on exports of raw materials and semi-manufactures, such as soybeans, orange juice, minerals and steel products. These items, which account for a third of Brazil's exports, have been paying as much as 13% in sales taxes. With this change, we will be able to export more, to create more employment, and to improve salaries. The national producer has had to face the unfair competition of imported goods that do not pay taxes even while he has had to bear a heavy tax burden. With the new law, the national producer will be in a better position to compete and, therefore, to retain his Brazilian work force.

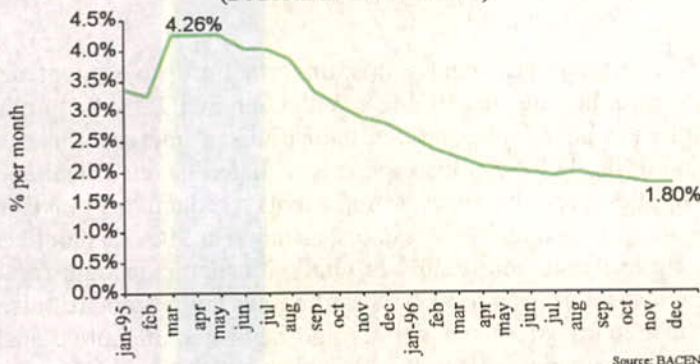
b) Other Tax Measures

Besides the sales tax reform, two other pro-investment measures are worth mentioning: 1) the reduction in the corporate income tax rate from 25% to 15%, and 2) the creation of a simplified tax system for micro and small enterprises. The new tax procedure for micro and small companies will enable them to simplify their tax obligations significantly.

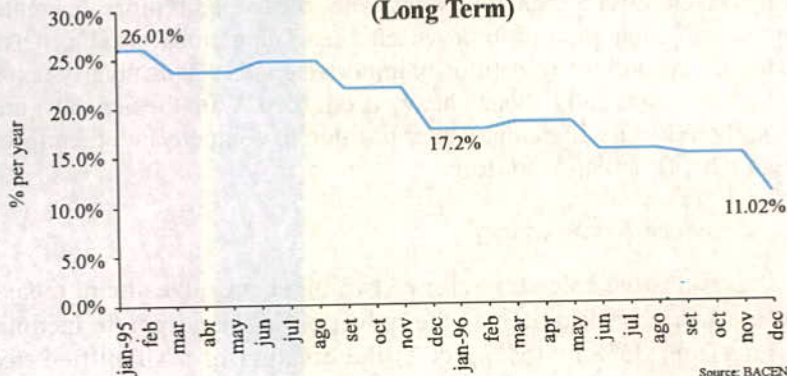
• Reduction of Financial Charges

The effective interest rate that the Central Bank pays on new government bonds fell from 4.2% per month in May 1995 to 1.8% in December 1996. Although this rate is still relatively high, the government-sponsored long-term interest rate for investments in January 1995 was about 26% per year, and the tendency is for it to continue falling.

**EFFECTIVE INTEREST RATE
(Federal Funds Market)**

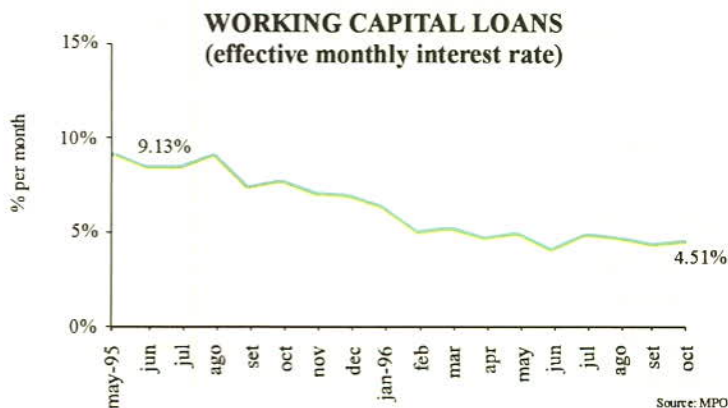


**GOVERNMENT-SUPPORTED INTEREST RATE
(Long Term)**



Besides the decline in interest rates, the availability of credit has also improved. The cost of credit declined noticeably throughout 1996

as the government eased monetary and credit policies. The cost of borrowing working capital, which was about 9% per month in mid-1995, declined to about 4.5% by the end of 1996.



• Reduction of Infrastructure Costs

Besides its fiscal and financial measures to promote growth, the government has made a major effort to reduce infrastructure costs. Over the past two years, it has transferred to the private sector a significant number of activities whose presence in the public sector is no longer justified.

a) Privatization

In 1995, the government created the National Council on Privatization (*Conselho Nacional de Desestatização*), dependent directly on the President's office, in order to facilitate the privatization process. Eight firms were sold that year for a total value of US\$1.63 billion, of which US\$1.0 billion were receipts and US\$0.63 billion represented debt transferred to the new owners of the firms.

The year 1996 represented a turning point in the privatization effort for several reasons.

First, the privatization of the petrochemical sector was completed with the auction of five firms (Deten, EDN, Polibrasil, Prolipropileno and Koppol). Thus the first phase of the program, initiated in 1991, came to an end. During that phase, a total of forty-five firms were transferred to private ownership. They were principally in the steel, petrochemical and fertilizer sectors.

Second, the procedure and timing for the privatization of Vale do Rio Doce were determined. This company should be auctioned off in 1997, thereby essentially finishing the privatizations in the industrial sector.

Third, the transfer of public services to the private sector was accelerated, via both concessions and leases.

In the electrical sector, the company Light was privatized in May 1996. At US\$2.35 billion, it was the largest single sale of the program to date. At the level of the states, which own most of the electrical distribution companies, CERJ (Rio de Janeiro) was sold in November for US\$587.4 million, i.e., a 30.27% premium over the minimum sales price. In addition, several other distribution companies are in the process of being privatized, such as COELBA in Bahia, CEMIG in Minas Gerais, COPEL in Paraná, CEMAT in Mato Grosso, and ENERSUL in Mato Grosso do Sul. The BNDES is giving technical and financial support to help these firms in the privatization process, just as it did with CERJ.

The sale of 35% of the voting shares of the Telecommunications Company of Rio Grande do Sul (CRT) for US\$655.5 million should be included among the privatizations at the state level.

In the transport sector, the privatization of the railroad system has made notable progress. Of the six networks in the federal system (RFFSA), five have been granted in concessions, generating receipts of US\$1.5 billion. They are the five principal railroad networks, responsible for transporting no less than 97% of the cargo carried by RFFSA and close to 30% of all the cargo transported by rail in the country (this percentage rises to 50% if one excludes the Carajás railroad operated by Companhia Vale do Rio Doce).

At the state level, in December 1996 a concession was granted for US\$24.9 million to a private enterprise to transport the rail cargo of the FERROESTE. The transaction raised the total receipts for state-level privatizations to US\$1.27 billion.

Foreign capital played a major part in the electric energy and the railroad privatizations. The leading role of foreign capital in these first infrastructure privatizations suggests a clear tendency for 1997. It also contrasts sharply with the first stage of the privatization program (until 1995) when domestic capital accounted for 95% of the transactions.

Highways were also privatized, with 860 km of federal roads being transferred to the private sector, including such important ones as the Via Dutra (connecting Rio de Janeiro and São Paulo) and the road between Rio de Janeiro and Juiz de Fora.

The inclusion of 31 ports in the National Privatization Program (*Programa Nacional de Desestatização*) is also worth mentioning. Seven of these 31 ports are already in the process of being privatized. Initially, the ports of Cabedelo in Paraíba, Itajaí and Laguna in Santa Catarina, and Porto Velho in Rondônia will be privatized. A second stage will include the ports of Recife, Maceió and Manaus. At the same time, an increasing number of private terminals are being leased at the ports.

Revenues from the National Privatization Program in 1996 totaled US\$4.08 billion. Adding this amount to the US\$1.27 billion obtained in 1996 by the states produces a total of US\$5.35 billion. This figure was more than twice the US\$2.63 billion obtained in 1993, which up to last year had been the largest amount obtained in a single year.

The National Privatization Program concluded its fifth year in 1996, having produced revenues of US\$14.96 billion and having transferred US\$4.56 billion in debts to the private sector. Thus, the total public sector financial benefit of the sales was US\$19.52 billion. This figure does not include the eventual transfers of debt as part of the privatization of CERJ, CRT and FERROESTE.

**Privatizations
1991-1996**

(US\$ millions)

Year	Number of companies	Government receipts	Debt transferred	Total
1991	4	1,614	374	1,988
1992	14	2,401	982	3,383
1993	6	2,627	1,561	4,188
1994	9	1,966	349	2,315
1995	8	1,003	625	1,628
1996	14	5,348	670	6,018
Total*	55	14,959	4,561	19,520

(*) Does not include possible debt transfers from the privatizations of CERJ, CRT and FERROESTE.

Source: BNDES

**Summary of Privatizations During the
Fernando Henrique Cardoso Administration**

Companies privatized

- | | |
|-------------------------|-----------------------------|
| 1. ESCELSA | 12. RFFSA (CENTRO-LESTE) |
| 2. COPENE | 13. RFFSA (MALHA SUDESTE) |
| 3. CPC | 14. LIGHT |
| 4. SALGEMA | 15. DETEN |
| 5. CRR | 16. POLIBRASIL |
| 6. NITROCARBONO | 17. EDN |
| 7. PRONOR | 18. RFFSA (TEREZA CRISTINA) |
| 8. CBP | 19. FRRSA (MALHA SUL) |
| 9. POLIPROPILENO | 20. FERROESTE |
| 10. KOPPOL | 21. CERJ |
| 11. RFFSA (MALHA OESTE) | 22. CRT |

Government receipts (1995-96): US\$6.35 billion

b) Brazil in Action

The program Brazil in Action consists of 42 priority development projects and activities valued at R\$79 billion. They are designed to

ensure the availability of the physical and human infrastructure needed to promote investment. These projects, only part of the government's total effort, were selected on the basis of their potential to stimulate productive investment and growth. The objectives are:

- to reduce production and marketing costs, and thus spark a series of other investments that will sustain economic development over the coming decades;
- to increase the effectiveness of government actions, concentrating on selected well-defined targets, and avoiding an ineffective dispersion of resources;
- to introduce a new management model (focused management);
- to seek the maximum degree of cooperation with the private sector; and
- to make the economic system increasingly receptive to private and public investment.

Brazil in action

	Projects	Outlays (R\$ millions)	(%) share
Agriculture	1	3,072.0	3.87
Communications	2	33,087.8	41.87
Education	3	1,417.2	1.79
Employment	4	7,718.9	9.77
Energy	6	4,608.8	5.83
Housing	3	5,176.6	6.55
Environment	2	2,767.2	3.50
Land reform	1	7,215.0	9.13
Health	4	5,047.5	6.39
Transportation	15	8,135.5	10.28
Tourism	1	800.0	1.01
Total	42	79,034.5	100.0

Source: MPO

The principal figures of the program for 1997-98 are:

Source of funds (1997-1998)	R\$ millions
Federal government investments	10,287.3
External financing	3,701.3
Private investments	12,766.7
State and municipal government investments	2,970.0
Government enterprise investments — Worker Support Fund (<i>Fundo de Amparo ao Trabalhador</i>) and the Guarantee Fund for Time of Service (<i>Fundo de Garantia por Tempo de Serviço</i>)	24,634.4
Total	54,359.7

Source: MPO

Total value of the projects, by sector (1997-1998)	R\$ millions
Agriculture	10,324.9
Communications	16,618.0
Education	1,783.0
Employment	7,138.9
Energy	3,429.0
Housing	5,176.6
Sanitation	2,664.7
Health	2,382.8
Transportation	4,640.8
Tourism	201.0
Total	54,359.7

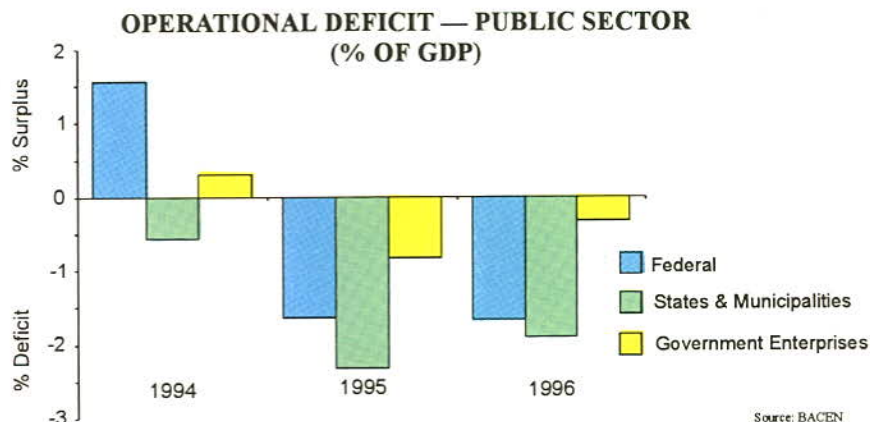
Source: MPO

The transport sector demonstrates how the Brazil in Action program can reduce infrastructure costs. One example is the Northwest Corridor (the Madeira river waterway and highway BR-364) which will cut the cost of shipping a ton of soybeans via the port of Santos from US\$102 to US\$66. On the Center-North Corridor (Araguaia-Tocantins rivers, North-South railway, the ports of Ponta da Madeira and Itaquí), the cost will fall from US\$87 to US\$38. Finally, on the Eastern Corridor (the Unaí-Pirapora and Minas-Vitória railways, and port of Tubarão), the cost will go from US\$62 to US\$38.

3. Fiscal Situation

The fiscal situation continues to be the principal challenge to the *Real* Plan and to sustained growth.

In 1996, the accumulated public sector operational deficit was equal to 3.89% of GDP. The states and municipalities accounted for the largest part of this deficit, i.e., 1.89% of GDP; the central government accounted for 1.67%, and the public enterprises for 0.33%.



The 1996 results stem from several factors. First, the operational deficit, which includes interest payments on the public debt, could not improve more, relative to 1995, because real interest rates remained high. They did so due to the rapid decline in inflation. That is, although nominal

interest rates fell throughout 1996, real interest rates remained high because of the faster drop in inflation.

Second, the 1996 operational deficit was not lower than in 1995 because the primary accounts did not produce a surplus as they had in 1995. Rather, they were in balance, generating neither a surplus nor a deficit. They did not produce a surplus principally because of the increase in personnel outlays that stemmed from the salary raises granted in 1995. These raises, affecting both state and local governments, had their full impact in 1996.

Finally, the volume of tax receipts in 1996 was disappointing. The small size of the increase was due to the relatively low level of economic activity (GDP grew only some 3%, which was less than that of 1995). Although the government had adopted additional measures in both 1995 and 1996 to improve tax collections, those measures did not have the expected immediate impact.

To resolve the public deficit issue, the government has been implementing a series of measures at the same time that it works with Congress to secure passage of the social security and the administration reforms. The passage of these two reforms is essential for any lasting solution to the public sector deficit.

With a view to improving the public sector primary and operational budget results in 1997, the government is implementing the following measures:

- a) Containment of personnel costs by using the Voluntary Retirement Program (*Programa de Demissão Voluntária*) to reduce the number of civil servants and by strengthening control of salary payment procedures;
- b) Acceleration of the privatization program with the consequent reduction of the debt and the public deficit, transferring to the private sector such significant economic activities as Vale do Rio Doce, the federal railway system, and the ports;

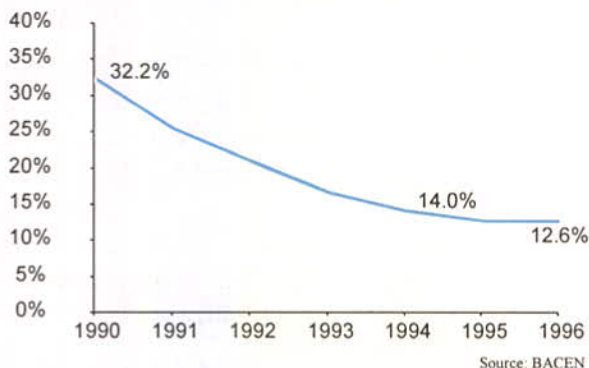
- c) Improvement of the fiscal provisions regarding personal income taxes and social levies on net corporate profits;
- d) Incentives for the states to adopt fiscal reform programs;
- e) Reform of the budgetary process for 1997, providing more realistic projections for receipts and expenditures, including a projection for a federal government primary surplus equal to about 0.8% of GDP;
- f) Approval of the Global Expenditure Program (*Programa de Dispendios Globais*) of federal government enterprises, seeking to obtain an improvement in the primary results of these firms equal to 0.25% of GDP;
- g) Implementation of the Brazil in Action program so that the allocation of 1997 budget resources will encourage more public sector investment;
- h) Increased social security tax receipts by expanding the tax base and by raising the tax rate charged on sales of agricultural products; and also constrain outlays by modifying the legislation governing social security benefits.

The implementation of these measures to contain expenditures, to improve public sector efficiency and to increase receipts at all levels of government will require a marked improvement in the performance of the tax authorities. These measures, combined with the benefits from privatizations (which should reduce the public debt), will help to make the government's activities more dynamic and more compatible with a modern economy, something Brazilian society deeply desires.

4. Foreign Sector

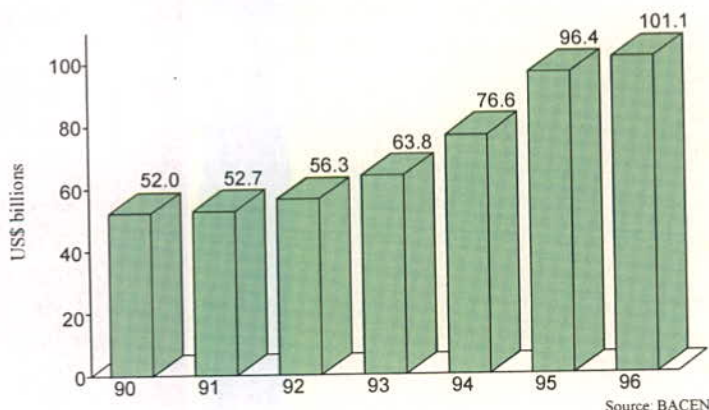
The economic liberalization process provided access to imported raw materials, semi-manufactures and, above all, machines and equipment at reduced prices, thereby increasing the competitiveness of all economic sectors.

AVERAGE NOMINAL IMPORT TARIFF



Brazil's international trade virtually doubled in five years, going from US\$52.1 billion in 1990 to US\$101.1 billion in 1996. Both exports and imports increased.

BRAZIL'S TOTAL FOREIGN TRADE

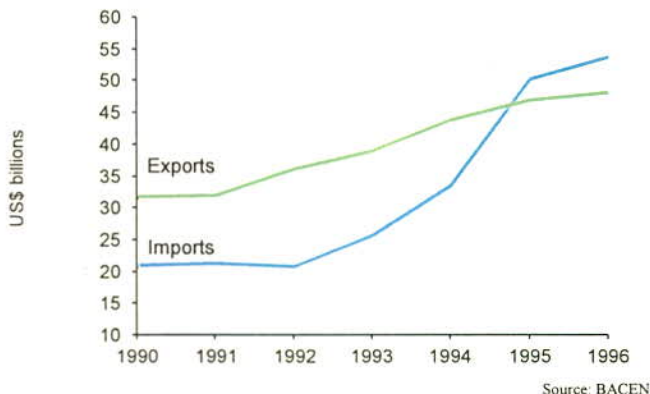


■ Trade Balance

Although exports increased in 1995 and 1996 (6.8% and 2.7%, respectively), a larger increase in imports (50.7% and 6.9%, respectively) caused a deficit in the trade balance. In 1996, the trade deficit was US\$5.5 billion, which represents less than 1% of Brazil's GDP.

It is worth asking what we are importing. Basically, the increase in imports is due to a growth in capital goods purchases. These are machines and equipment. This signals a change in Brazil's relationship with the international economy. In truth, we are preparing to increase our productivity and production and, after that, our exports.

BRAZIL'S TRADE BALANCE



The government is adopting various measures to stimulate exports and, consequently, to eliminate the trade deficit. Brazil wants to balance its foreign trade accounts.

Pro-export measures

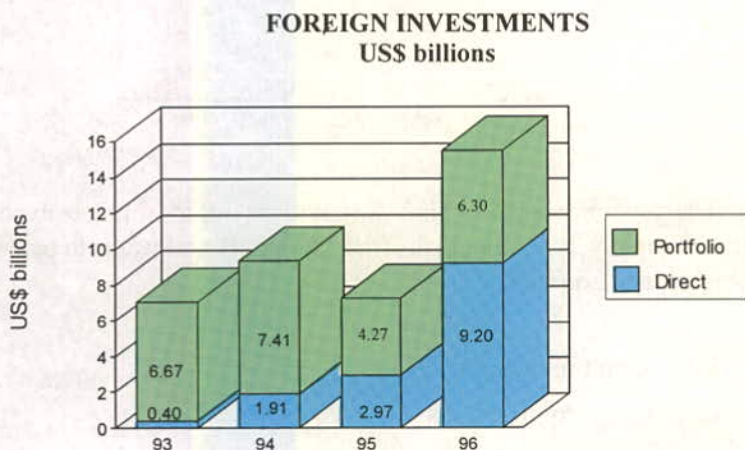
- insuring export credits
- expanding PROEX (credit for exports)
- removing the ICMS
- reducing the Brazil Cost

■ Foreign investment

Brazil and Mercosul have become principal destinations for foreign direct investments. Currency stabilization, economic growth and

the further consolidation of Mercosul, all of which occurred in 1995, proved to be important factors in attracting these investments. Average annual direct investments in Brazil during the period 1990-94 were around US\$1 billion, rising to US\$2.9 billion in 1995 and reaching US\$9.2 billion in 1996.

One significant economic fact was the change in the foreign investment profile. In 1993 and 1994, almost all of the inflow went into the stock market. Since 1995, the majority of the inflow has been going into production. In 1996, foreign capital totaling US\$9.2 billion went into direct investments. This change signals foreign investor confidence in the Brazilian economy.

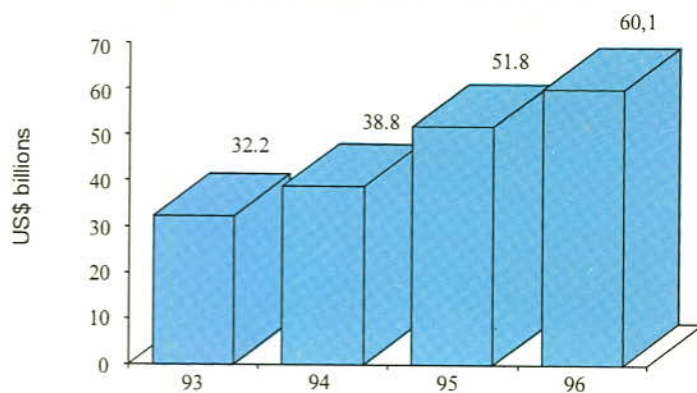


Source: BACEN

■ International Reserves

As a result of the economy's good performance, Brazil's international reserves have increased continuously since 1993, reaching US\$60.1 billion in 1996. With the substantial international liquidity that these reserves provide, the Brazilian economy is prepared for eventual problems originating abroad.

INTERNATIONAL RESERVES



Source: BACEN

PART II — THE SOCIAL AREA

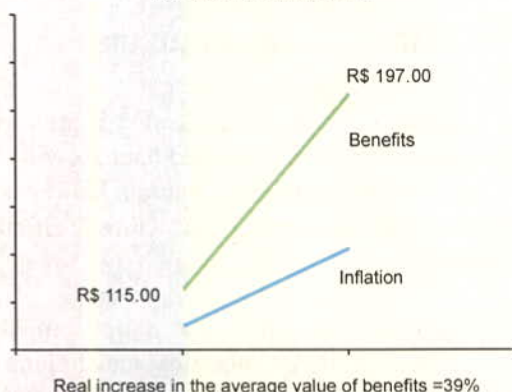
We achieved our successes in the economic area without forgetting about social policy. We have presented data showing the impact of stabilization on the well-being of the population. However, these results do not free the State from the need to restructure itself and to promote specific social policies.

The government has had a series of accomplishments in the social area: reducing significantly infant mortality; developing the National Human Rights Program (*Programa Nacional de Direitos Humanos*), the first of its kind in Latin America; and resettling 100,000 families and expropriating three million hectares of land in just two years. The social security system increased the average value and number of benefits paid. The Minimum Income Program (*Programa de Renda Mínima*), which this administration implemented, is quite active. Legislation passed at the initiative of Congress guarantees the rights of children and adolescents. The government is endeavoring to eliminate slave and child labor. We have nearly completed the demarcation of Indigenous lands. The administration has again taken up the issues of blacks and women. We have accomplished all this in an environment of complete democracy and total freedom.

■ Social security

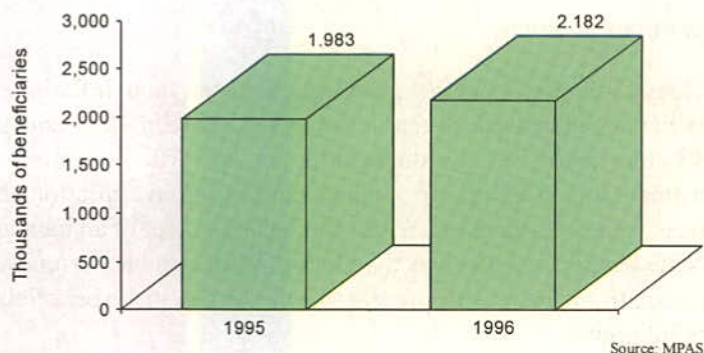
Social security benefits grew much faster than inflation. The average benefit increased, in real terms, 39% between 1994 and 1996. This 39% increase, given the stable currency, is worth much more than an adjustment increase because of an unstable currency. Inflation and an unstable currency begin reducing the purchasing power of an increase as soon as the beneficiary receives the money. With a stable currency, this does not occur: the increase represents a genuine rise in the beneficiary's purchasing power.

SOCIAL SECURITY



In 1995, there were 1,983,000 new social security beneficiaries and, in 1996, 2,182,000. Subtracting the cancellations and discontinuances due to death and other causes, the net increase in social security beneficiaries in 1996 was around 800,000. These numbers demonstrate that the social security burden is very large in that both the average benefit value and the number of beneficiaries are growing. In spite of all the government's efforts to avoid a deficit, social security reform is becoming ever more urgent. Without this reform, Brazil could have serious difficulties guaranteeing the continued payment of benefits over the medium term.

NEW RECIPIENTS OF SOCIAL SECURITY BENEFITS 1995-1996



Another important aspect of social security is the Minimum Income Program (Programa de Renda Mínima), which was approved by Congress and implemented during our administration. The program assists 280,000 physically handicapped people, 40,000 senior citizens, and 340,000 children and adolescents. Moreover, we have already initiated the "Child Citizen" scholarship program (bolsa "Criança Cidadã"), which seeks to eliminate child labor in the coal mines of Mato Grosso do Sul (560 scholarships). Soon it should be extended to children who work in the sugar fields of Pernambuco and in the sisal plantations of Bahia.

The program's objective is to provide an income to those who do not have one and who have never contributed to the social security system. The government reaffirms its obligation to support these people because they are Brazilian citizens. In this manner, the welfare system fulfills a redistributive function. In other words, it takes from those who have and gives to those who have little or nothing.

■ Health

The administration has made good progress in decentralizing health services. The number of municipalities benefiting from the Unified Health Service (*Serviço Único de Saúde — SUS*) reached 3,078 in 1996, which means that 61.85% of all Brazilian municipalities are now included in the program. The number of health centers also grew significantly, reaching 3,031 during 1996. The introduction of SUS requires the full participation of society in creating health centers and appointing representatives for these centers. The administration firmly supports these initiatives.

Decentralization

Stage of implementation	Municipalities benefited	
	1994	1996
Half complete	24	137
Partially complete	537	618
Beginning	1,832	2,323
Total	2,433	3,078
% of Brazilian municipalities	61.85%	

Decentralization

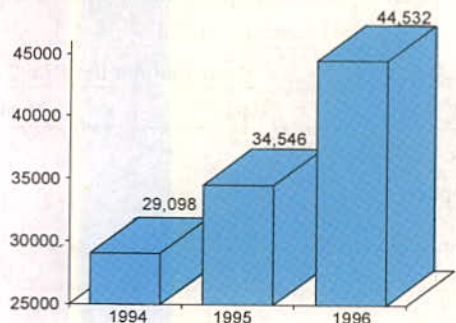
Health centers	1994	Sept./1996
City	2,433	3,031
State	19	27

A fundamental program for the poorest regions of the country is that of the Community Health Agents (*Agentes Comunitários de Saúde*). This program trains people, who are recruited by the local municipalities, to assist the population in elementary health matters: hygiene, nutrition and minor medical care. The number of these community agents has been growing significantly, surpassing 44,000 during 1996. This work is having an immense positive impact on the population's health.

The Family Health Teams (*Equipes de Saúde da Família*) Program is another important project targeted at the poorest Brazilians. The beneficiaries of this program have more than tripled in number, increasing from 1.3 million in December 1994 to 3.3 million, in 228 municipalities, in December 1996.

The government is endeavoring not only to provide first-world medical treatment, but also to care for the neediest members of society. This depends on the emphasis given to fighting endemic diseases, to the campaigns against epidemics, to the family programs, to the community agent programs, and to nutrition.

COMMUNITY HEALTH AGENTS



Source: MS

Family health teams

Year	Teams	Municipalities	People treated (million)
December 1994	321	65	1,3
December 1995	724	179	2,3
December 1996	847	228	3,3

Source: MS

Infant mortality fell significantly in the last two years. The decrease varied from 8.1% to 45.5% in eight of the poorest states in Brazil. This is a substantial reduction. The Church and international organizations are monitoring these data. The improved nutrition and health conditions of the poorest Brazilians could result in an even further reduction in infant mortality over the next few years.

The administration wants 1997 to be the Year of Health and will mobilize for this effort.

**Infant mortality
Northeastern States with PACS
(Community Health Agents Programme)**

State	1994 ¹	1995 ¹	Reduction (%)
Alagoas	*	104,2	—
Bahia	110.9	63,4	42.8
Ceará	80.0	49,7	37,9
Maranhão	71.2	55,8	21,6
Paraíba	90.5	49,3	45.5
Pernambuco	101.4	62,2	38.7
Piauí	67.3	52,8	21.6
Rio Grande do Norte	*	62,0	
Sergipe	93.6	86,0	8.1

(*)States without data for 1994.

(1) Infant Mortality Rate/1,000 born alive.

Source: MS

■ Education

The government had designated 1996 to be the Year of Education. With the support of Congress, the administration enacted a constitutional change that will have a fundamental impact on education — the Teacher Appreciation Program (Programa de Valorização do Magistério), which altered the distribution of education resources among states and municipalities.

After languishing in Congress for eight years, the Minimum Standards Law (Lei de Diretrizes e Bases), whose sponsor was Sen. Darcy Ribeiro, was passed. This was a very valuable contribution by Congress.

The textbook distribution and the school lunch programs each benefited more than 30 million students.

Another important act was the enactment of the national standardized test (*prova*). The government believes that quality in education is fundamental for both teachers and students. That is why we must develop new evaluation methods, like the final exam, to monitor the quality of university education. The national standardized test represents an improvement in the quality of education.

Basic education data

Teacher appreciation fund

- Annual investment per student = R\$300.00

Textbooks

- 32 million students
- 87,200,000 books
- 220,000 schools

School lunch

- The number of municipalities covered by the program increased from 3,912 to 4,208.
- During the 180 school days, 33 million grade school students in the state, municipal and philanthropic schools received school lunches.

School TV

- 51,820 schools accredited
- 38,846 TV kits distributed
- 1.5 million professors included
- 24 million students served

Education evaluation

- Number of SAEB students in 1995: 90,499 (Source: SAEB report)
- National Course Examination — ENC

Courses	# of courses	Students enrolled
Administration	348	27,522
Law	178	27,038
Civil engineering	101	4,569
Total	627	59,129

Note: 55,526 students attended.

■ **Employment**

The government strove to create effective employment and professional training programs. It invested substantial resources in two Ministry of Labor programs: R\$1.7 billion in the Program to Increase

Employment and Improve the Workers' Quality of Life (*Programa de Expansão do Emprego e Melhoria da Qualidade de Vida do Trabalhador* — PROEMPREGO) and close to R\$1.6 billion in the Program to Create Employment and Income (*Programa de Geração de Emprego e Renda* — PROGER). PROEMPREGO seeks to create direct and indirect employment in environmental sanitation, tourism infrastructure, public urban transportation, and industrial parks. PROEMPREGO's goal is to create and maintain 2.7 million jobs over the next few years. PROGER benefited 296,000 people in 1996. In addition, over R\$260 million were utilized for instruction and professional training, benefiting 1,014,000 workers. These numbers are significant, but the administration foresees even larger results in 1997.

Employment and professional training 1996

Program	Expenditures in R\$ millions	Employment /training
PROEMPREGO	1,700.0	
PROGER	1,589.3	292,000
Professional training	265.8	1,014,000

■ Agrarian reform

The last two years have witnessed notable progress in agrarian reform. Three million hectares were expropriated. On an annual basis, it was almost twice as much as during previous governments. This allowed for the resettlement of 100,000 families. The historical average of resettlements in Brazil is 12,000 families per year. This administration quadrupled the historical average, resettling an average of 50,000 families per year. Our goal is to resettle 280,000 families by the end of 1998.

Congressional cooperation was decisive in the administration's efforts to resolve land problems. The Congress passed three modernizing laws:

- a) that which requires public prosecutors to monitor the expropriation process;
- b) that which accelerated legal procedures, speeding up the process for expropriating rural land; from now on a federal judge will issue his decision on an initial petition within 48 hours and set a hearing for the landowner to respond to the petition;
- c) that which changed the Rural Land Tax (*Imposto Territorial Rural — ITR*); the new ITR establishes a progressive tax on unproductive land. Its annual rate can be as much as 20% of the value of the property. After a few years, the amount paid in taxes could be more than the value of the land. Those who do not use their land will be induced to sell it. Even more important, the tax is based on the owner's declared value of his property, which will serve as the base price for the eventual expropriation of the land. The new ITR will promote a true rural revolution. In practice, this will mean taking land from those who have it but do not use it, and giving it to those who want to produce but do not have land.

Congress' work on land reform is a milestone in contemporary Brazilian history.

■ Community Solidarity

The Community Solidarity Program (*Programa Comunidade Solidária*) expanded its activities significantly in 1996. The municipalities covered by the program more than tripled, increasing from 302 in 1995 to 1,111 in 1996. Another important fact was the distribution of 7.5 million basic food baskets in 1,094 municipalities, indigenous communities and landless rural worker settlements. The infant assistance program fed close to 1.2 million children in 802 municipalities.

Community Solidarity

Basic data for 1996

Municipalities in the program

- 1995 = 302
- 1996 = 1.111

Sanitation and housing

- potable water for 263,000 families
- sewer systems for 228,000 families

Nutrition

- 7.5 million basic food baskets distributed in 1,094 municipalities, indigenous communities and landless peasant camps.

Infant malnutrition

- 1.2 million children treated
 - 802 municipalities served
-

■ Culture

Culture has become an indispensable factor in defining the new model of citizenship.

Under this administration, all Brazilian states have received, for the first time, federal resources for cultural investment.

In 1996, the demand for resources from the National Fund for Culture (*Fundo Nacional de Cultura*) doubled. This fund emphasizes the preservation of Brazil's cultural heritage, financing 80% of the value of projects presented by non-profit organizations. With respect to Brazilian historical heritage, the state enterprises were directed to earmark part of their advertising budgets for monument restoration projects and for support of artistic and cultural activities. They are benefiting cultural activities greatly.

Four recent legislative modifications had major repercussion in the cultural area:

- a) regulating the conversion of external debt to support Brazilian audiovisual projects of independent producers;
- b) increasing from 1% to 3% the corporate income tax reduction for investing in such audiovisual projects;

- c) increasing the amount of resources obtained from lotteries and raffles for the National Fund for Culture; and
- d) establishing the Motion Picture Commission (*Comissão de Cinema*).

■ Environment

The administration has an ongoing concern about environmental issues. This year in Rio de Janeiro, Brazil will host a conference on the environment. The conference will be called Rio Plus 5, i.e., five years after the 1992 Conference. The environment has become a pervasive theme throughout all levels of government and in the most diverse segments of society.

Among the most recent accomplishments in the environmental area, one should note the R\$100 million sustainable development program of the National Program for the Environment (*Programa Nacional do Meio Ambiente*). For its part, the National Environment Fund (*Fundo Nacional de Meio Ambiente*), with a budget of R\$8 million, financed 102 projects in 1996. Some 80% of these projects were initiatives of non-governmental organizations and small municipalities (less than 120,000 inhabitants).

With respect to the Amazon, the National Integrated Policy (*Política Nacional Integrada*) will be active in the areas of forest protection, ecotourism and the use of renewable resources. Moreover, the administration has earmarked US\$200 million from the Pilot Program for the Protection of Brazilian Rainforests (*Programa Piloto para a Proteção das Florestas Tropicais do Brasil — PPG-7*).

■ National defense

The administration has again taken up national defense as a topic of interest to everyone. Brazil today has a clear national defense policy. Not only the military ministers, but also the Ministers of Justice, of the President's Household, of Foreign Relations and of Strategic Issues contributed to the development of the national defense policy.

There have been other achievements in this area. The government created the National Authority (*Autoridade Nacional*), which is charged with implementing the provisions of the Convention to Ban Chemical Weapons. Brazil placed a high priority on controlling the exportation of sensitive technologies, participating in the Missile Technology Control Regime and in the Nuclear Suppliers Group. The participation of Brazilian troops in UN peace-keeping missions also deserves mention.

■ Human rights

The Ministry of Justice, in cooperation with other ministries, undertook a number of activities and programs in the human rights area in an attempt to combat drugs, to curb forced labor, to improve the condition of blacks, to eliminate job discrimination, to promote women's rights and to eradicate child labor. These activities are part of the National Human Rights Program (*Programa Nacional de Direitos Humanos*), which went into effect in May 1996. Australia and the Philippines are the only other countries that have adopted such a program.

One relevant issue was Law No. 9,140/95 — the indemnity payments, totaling R\$15 million, made to the families of persons who disappeared between 1968 and 1979 because of political activities. Payments totaling R\$29 million are foreseen for 1997.

■ Indigenous issues

The government has again taken up the issue of the demarcation of indigenous lands and has done so in an indisputably legal manner. The administration has demarcated more land than any previous Brazilian government. Brazilian indigenous people, who today number close to 300,000, possess 11% of the national territory.

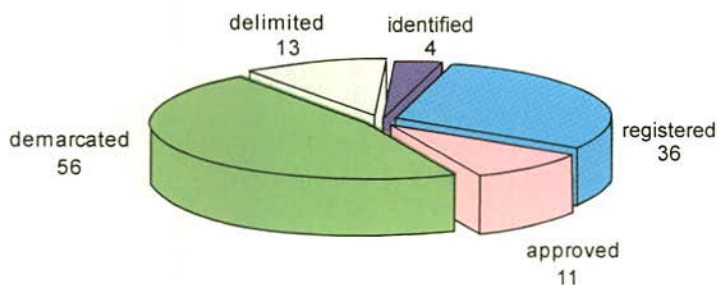
Applying the five phases of the Administrative Procedures for the Regulation of Indigenous Lands (*Procedimento Administrativo de Regularização de Terras Indígenas*), the government has dealt with 120 (22%) of the 556 Indigenous lands existing in Brazil:

• Registered	36
• Approved	11
• Demarcated	56
• Delimited	13
• Identified	4

The 120 lands going through the demarcation process during 1995-96 total 37 million hectares, or 44% of the total indigenous lands recognized by the federal government.

STATUS OF INDIGENOUS LANDS 1995 - 1996

total of lands under demarcation process = 120



Source: FUNAI

FINAL OBSERVATIONS

The government has clearly made substantial progress during its first two years. Brazil is back on track. We are growing again. We have begun to reform the State. We initiated a new phase of privatizations. Our social policies are producing positive results. But this is not enough. We must continue to advance. The government is committed to meeting the needs of the people. The important consideration is — BRAZIL.

PRESIDÊNCIA DA REPÚBLICA
Secretaria de Comunicação Social

Apoio Institucional
Ministério das Relações Exteriores
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