

CONFORMED COPY

LOAN NUMBER 7179 – BR

Loan Agreement

**(Second Programmatic Fiscal Reform Loan –
Fiscal Responsibility and Tax Reform)**

between

FEDERATIVE REPUBLIC OF BRAZIL

and

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

Dated August 11, 2003

LOAN NUMBER 7179 - BR

LOAN AGREEMENT

AGREEMENT, dated August 11, 2003, between the FEDERATIVE REPUBLIC OF BRAZIL (the Borrower) and the INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS (A) pursuant to the loan provided to the Borrower under the Loan Agreement dated June 5, 2001 (Loan No. 7046-BR), the Bank has provided assistance to the Borrower in support of the first phase of the Borrower's program of actions, objectives and policies for fiscal reform, covering fiscal sustainability, public expenditure management, and management of public liabilities (the Program), as such program was described in the letter, dated December 20, 2000, from the Borrower to the Bank;

(B) the Bank has received a letter, dated May 9, 2003, from the Borrower: (i) describing its macroeconomic framework and the Program as revised since the date of the letter referred to in (A) above, which Program consists of actions taken under the first phase referred to in (A) above, actions taken as described in Schedule 2 to this Agreement (the Second Phase of the Program), and actions and policies that the Borrower intends to take and adopt in the future; (ii) declaring the Borrower's commitment to the objectives of the Program; and (iii) requesting assistance from the Bank in support of the Program during the execution thereof;

(C) the Borrower has maintained a macroeconomic policy framework satisfactory to the Bank; and

(D) on the basis, inter alia, of the foregoing, the Bank has decided in support of the Second Phase of the Program to provide such assistance to the Borrower by making the loan provided for in Article II of this Agreement (the Loan) as hereinafter provided;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The “General Conditions Applicable to Loan and Guarantee Agreements for Fixed-Spread Loans” of the Bank dated September 1, 1999, with the modifications set forth below (the General Conditions) constitute an integral part of this Agreement:

- (a) Section 2.01, paragraph 41, is modified to read:

“‘Project’ means the second phase of the program, referred to in the Preamble to the Loan Agreement, in support of which the Loan is made.”;

- (b) Section 3.08 is modified to read:

“Each withdrawal of an amount of the Loan from the Loan Account shall be made in the Loan Currency of such amount. If the Loan Currency is not the currency of the deposit account specified in Section 2.02 (b) of the Loan Agreement, the Bank, at the request and acting as an agent of the Borrower, shall purchase with the Loan Currency withdrawn from the Loan Account the currency of such deposit account as shall be required to deposit the withdrawn amount into such deposit account.”;

- (c) Section 5.01 is modified to read:

“The Borrower shall be entitled to withdraw the proceeds of the Loan from the Loan Account in accordance with the provisions of the Loan Agreement and of these General Conditions.”;

- (d) the last sentence of Section 5.03 is deleted;

- (e) Section 9.07 (c) is modified to read:

“(c) Not later than six months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Bank, the Borrower shall prepare and furnish to the Bank a report, of such scope and in such detail as the Bank shall reasonably request, on the execution of the second phase of the program referred to in the Preamble to the

Loan Agreement, the performance by the Borrower and the Bank of their respective obligations under the Loan Agreement and the accomplishment of the purposes of the Loan.”; and

(f) Section 9.05 is deleted and Sections 9.06, 9.07 (as modified above), 9.08 and 9.09 are renumbered, respectively, Sections 9.05, 9.06, 9.07 and 9.08.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth, and the following additional terms have the following meanings:

(a) “Central Bank” means *Banco Central do Brasil*, the Borrower’s central bank;

(b) “CVM” means *Comissão de Valores Mobiliários*, the Borrower’s securities and exchange commission;

(c) “Deposit Account” means the account referred to in Section 2.02 (b) of this Agreement;

(d) “Federal District” means *Distrito Federal*, the Borrower’s Federal District;

(e) “GDP” means the Borrower’s gross domestic product;

(f) “LDO Bill” means the bill of the law establishing guidelines for the Borrower’s budget for 2004 (*Lei de Diretrizes Orçamentárias*), submitted to the Borrower’s Congress on April 15, 2003 (PL 2/2003 - CN);

(g) “Municipalities” means the municipalities in the States;

(h) “Primary Surplus” means the difference between the Borrower’s non-financial revenues and non-financial expenditures;

(i) “States” means the Borrower’s states; and

(j) “STN” means *Secretaria do Tesouro Nacional*, the Secretariat of Treasury in the Borrower’s Ministry of Finance.

ARTICLE II

The Loan

Section 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in this Agreement, an amount equal to four hundred four million forty thousand Dollars (\$404,040,000), as such amount may be converted from time to time through a Currency Conversion in accordance with the provisions of Section 2.09 of this Agreement.

Section 2.02. (a) Subject to the provisions of paragraphs (b) and (c) of this Section, the Borrower shall be entitled to withdraw the amount of three hundred ninety-nine million nine hundred ninety-nine thousand six hundred Dollars (\$399,999,600) from the Loan Account in support of the Second Phase of the Program.

(b) Prior to furnishing to the Bank the first request for withdrawal from the Loan Account, the Borrower shall open and thereafter maintain in the Central Bank a deposit account in Dollars on terms and conditions satisfactory to the Bank. All withdrawals of the amount referred to in paragraph (a) above shall be deposited by the Bank into the Deposit Account.

(c) The Borrower undertakes that the proceeds of the Loan shall not be used to finance expenditures excluded pursuant to the provisions of Schedule 1 to this Agreement. If the Bank shall have determined at any time that any proceeds of the Loan shall have been used to make a payment for an expenditure so excluded, the Borrower shall, promptly upon notice from the Bank: (i) deposit into the Deposit Account an amount equal to the amount of said payment, or (ii) if the Bank shall so request, refund such amount to the Bank. Amounts refunded to the Bank upon such request shall be credited to the Loan Account for cancellation.

Section 2.03. The Closing Date shall be December 31, 2003 or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower of such later date.

Section 2.04. The Borrower shall pay to the Bank a front-end fee in an amount equal to one per cent (1%) of the amount of the Loan. On or promptly after the Effective Date, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amount of said fee.

Section 2.05. The Borrower shall pay to the Bank a commitment charge on the principal amount of the Loan not withdrawn from time to time, at a rate equal to: (a)

eighty five one-hundredths of one per cent (0.85%) per annum from the date on which such charge commences to accrue in accordance with the provisions of Section 3.02 of the General Conditions to but not including the fourth anniversary of such date; and (b) seventy five one-hundredths of one per cent (0.75%) per annum thereafter.

Section 2.06. The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time, in respect of each Interest Period, at the Variable Rate; provided that, upon a Conversion of all or any portion of the principal amount of the Loan, the Borrower shall, during the Conversion Period, pay interest on such amount in accordance with the relevant provisions of Article IV of the General Conditions.

Section 2.07. Interest and other charges shall be payable semiannually in arrears on May 1 and November 1 in each year.

Section 2.08. The Borrower shall repay the principal amount of the Loan in accordance with the provisions of Schedule 3 to this Agreement.

Section 2.09. (a) The Borrower may at any time request any of the following Conversions of the terms of the Loan in order to facilitate prudent debt management:

- (i) a change of the Loan Currency of all or any portion of the principal amount of the Loan, withdrawn or unwithdrawn, to an Approved Currency;
- (ii) a change of the interest rate basis applicable to all or any portion of the principal amount of the Loan from a Variable Rate to a Fixed Rate, or vice versa; and
- (iii) the setting of limits on the Variable Rate applicable to all or any portion of the principal amount of the Loan withdrawn and outstanding by the establishment of an Interest Rate Cap or Interest Rate Collar on said Variable Rate.

(b) Any conversion requested pursuant to paragraph (a) of this Section that is accepted by the Bank shall be considered a "Conversion", as defined in Section 2.01 (7) of the General Conditions, and shall be effected in accordance with the provisions of Article IV of the General Conditions and of the Conversion Guidelines.

ARTICLE III

Particular Covenants

Section 3.01. The Borrower shall exchange views with the Bank on any proposed action to be taken after the disbursement of the Loan which would have the effect of materially reversing the objectives of the Second Phase of the Program, or any action specified in Schedule 2 to this Agreement.

Section 3.02. Upon the Bank's request, the Borrower shall:

(a) have the Deposit Account audited in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank;

(b) furnish to the Bank as soon as available, but in any case not later than four (4) months after the date of the Bank's request for such audit, a certified copy of the report of such audit by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and

(c) furnish to the Bank such other information concerning the Deposit Account and the audit thereof as the Bank shall have reasonably requested.

ARTICLE IV

Remedies of the Bank

Section 4.01. Pursuant to Section 6.02 (p) of the General Conditions, the following additional events are specified:

(a) The Borrower's macroeconomic policy framework has become inconsistent with the objectives of the Second Phase of the Program.

(b) An action has been taken or a policy has been adopted to reverse any action or policy under the Program, including any action listed in Schedule 2 to this Agreement, in a manner that would, in the opinion of the Bank, adversely affect the achievement of the objectives of the Second Phase of the Program.

ARTICLE V

Effective Date; Termination

Section 5.01. The following is specified as an additional matter, within the meaning of Section 12.02 (c) of the General Conditions, to be included in the opinion or opinions to be furnished to the Bank, namely, that this Agreement has been validly registered with the Central Bank.

Section 5.02. The date October 10, 2003, is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VI

Representative of the Borrower; Addresses

Section 6.01. The Minister of Finance of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministério da Fazenda
Procuradoria Geral da Fazenda Nacional
Esplanada dos Ministérios, Bloco "P" - 8º andar
70048-900 Brasília, D.F.
Brazil

Facsimile: (011-55-61) 412-1740

With copy to:

Ministério do Planejamento, Orçamento e Gestão
Secretaria de Assuntos Internacionais
Esplanada dos Ministérios, Bloco "K" - 5º andar
70040-906 Brasília, D.F.
Brazil

Facsimile: (011-55-61) 225-4022

For the Bank:

International Bank for
Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:

Telex:

Facsimile:

INTBAFRAD

248423 (MCI) or

(202) 477-

6391

Washington, D.C.

64145 (MCI)

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in the city of Brasília, Brazil, as of the day and year first above written.

FEDERATIVE REPUBLIC OF BRAZIL

By /s/ Sônia de Almendra Freitas Portella Nunes
Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Vinod Thomas
Acting Regional Vice President
Latin American and the Caribbean

SCHEDULE 1

Excluded Expenditures

For purposes of Section 2.02 (c) of this Agreement, the proceeds of the Loan shall not be used to finance any of the following expenditures:

1. expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;
2. expenditures for goods or services supplied under a contract which any national or international financing institution or agency other than the Bank or the Association shall have financed or agreed to finance, or which the Bank or the Association shall have financed or agreed to finance under another loan or a credit;
3. expenditures for goods included in the following groups or subgroups of the Standard International Trade Classification, Revision 3 (SITC, Rev.3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev.3 (1986) (the SITC), or any successor groups or subgroups under future revisions to the SITC, as designated by the Bank by notice to the Borrower:

<u>Group</u>	<u>Subgroup</u>	<u>Description of Items</u>
112	-	Alcoholic beverages
121	-	Tobacco, unmanufactured, tobacco refuse
122 manufactured	-	Tobacco, (whether or not containing tobacco substitutes)
525	-	Radioactive and associated materials
667	-	Pearls, precious and semiprecious

<u>Group</u>	<u>Subgroup</u>	<u>Description of Items</u>
		stones, unworked or worked
718	718.7	Nuclear reactors, and parts thereof; fuel elements (cartridges), non-irradiated, for nuclear reactors
728	728.43	Tobacco processing machinery
897	897.3	Jewelry of gold, silver or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971	-	Gold, non-monetary (excluding gold ores and concentrates)

4. expenditures for goods intended for a military or paramilitary purpose or for luxury consumption;

5. expenditures for environmentally hazardous goods (for purposes of this paragraph the term "environmentally hazardous goods" means goods, the manufacture, use or import of which is prohibited under the laws of the Borrower or international agreements to which the Borrower is a party);

6. expenditures: (a) in the territories of any country which is not a member of the Bank or for goods procured in, or services supplied from, such territories, or (b) on account of any payment to persons or entities, or any import of goods, if such payment or import is prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations; and

7. expenditures under a contract in respect of which the Bank determines that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Loan during the procurement or execution of such contract, without the Borrower having taken timely and appropriate action satisfactory to the Bank to remedy the situation.

SCHEDULE 2

Second Phase of the Program

1. The Primary Surplus targets for the period 1999-2002 have been met.
2. The Borrower has established, in Annex III.B of the LDO Bill, an annual Primary Surplus target for the period 2003-2006 of 4.25 percent of GDP in each such year, and set a clear medium term objective of debt reduction as a share of GDP.
3. A substantial increase has occurred in the number of States which have been meeting the parameters established by the Borrower's Complementary Law No. 101, of May 4, 2000 (Fiscal Responsibility Law) for the ratios between debt stock and net current revenues, and between personnel expenditures and net current revenues.
4. The Borrower's Senate has issued: (a) Resolution No. 40, of December 20, 2001, establishing global ceilings for the indebtedness of the States, Federal District and Municipalities; and (b) Resolution No. 43, of December 21, 2001, regulating the internal and external credit operations of the States, Federal District and Municipalities, including the issuance of guarantees, credit limits and other conditions.
5. The Borrower's National Monetary Council has decided, on December 26, 2001, as announced by the Central Bank Resolution No. 2920, of December 26, 2001, to establish new limits for credit operations between financial institutions and the Borrower, at the federal level, the States, the Federal District, the Municipalities, and the entities owned or controlled by any of them.
6. STN has consolidated the accounts of the Borrower, at the federal level, the States, the Federal District and the Municipalities, and made public such consolidation through STN's *Portarias* No. 239, of June 28, 2001, with respect to 2000, and 301, of June 27, 2002, with respect to 2001.
7. The Borrower has incorporated a substantial amount of previously undisclosed liabilities (2.3 percent of GDP in the last two years) into official debt figures, as shown in the Central Bank's website.
8. The Borrower has included its contingent liabilities in Annex V (Fiscal Risks) of the LDO Bill.

9. The Borrower has started to report its fiscal statistics based on the methodology of the Special Data Dissemination Standards of the International Monetary Fund.
10. STN has been issuing annual debt borrowing plans for the Borrower, at the federal level, which highlight the importance of risks relating to the incurrence of debt.
11. The Borrower has completed the consolidation of issuance responsibilities under the STN of the domestic debt of the Borrower, at the federal level, and initiated changes in STN organizational arrangements and the governance of the Borrower's debt management, at the federal level.
12. The analytical capacity of the office in STN in charge of analysis and preparation of the Borrower's strategy for debt management (the Middle Office) has been strengthened.
13. A code of conduct for the managers of the Borrower's debt, at the federal level, has been issued, pursuant to STN's *Portaria* No. 44, of February 20, 2001.
14. STN has mapped the processes and information flows that take place in STN's debt management office.
15. STN has issued, through *Portaria* No. 554, of December 12, 2001, as amended by *Portaria* No. 44, of January 23, 2002, regulations for retail sales of public bonds through the internet (*Tesouro Direto*).
16. The Central Bank and STN have jointly issued regulations (*Ato Normativo Conjunto* No. 1, dated March 20, 2003) for the selection of primary market and specialized dealers authorized to place public bonds in the primary market and to negotiate such bonds in the secondary market, respectively.
17. The Borrower has adopted improved methods for issuance of its securities, including publication of the issuance calendar on the internet, reduction in the frequency of auctions, and use of exchange auctions to reduce fragmentation.
18. The regulation and supervision of collective investments schemes for investments in fixed income securities (including public bonds) has been transferred to CVM, pursuant to the Borrower's Decree No. 3995, of October 31, 2001.

19. The Central Bank and CVM entered into an agreement, dated July 5, 2002, providing, inter alia, for the sharing of information and cooperation between those institutions regarding regulation and supervision of exchanges and investment funds.

20. Law No. 10637, of December 30, 2002, has been enacted, providing, inter alia, that the contributions for the *Programas de Integração Social (PIS)* and *Formação do Patrimônio do Servidor Público (PASEP)* are partially transformed into value-added taxes.

21. A bill for the amendment of provisions of the Borrower's Constitution on the Borrower's tax system was submitted to the Borrower's Congress on April 30, 2003 (*PEC No. 41/03*), such amendment to include, inter alia, measures to harmonize the States' legislation on the value-added tax (ICMS), reduce the payroll tax, increase progressivity of the States' inheritance tax, and allow flexibility to gradually reduce the tax on financial transactions (CPMF).

SCHEDULE 3

Amortization Schedule

1. The following table sets forth the Principal Payment Dates of the Loan and the percentage of the total principal amount of the Loan payable on each Principal Payment Date (Installment Share). If the proceeds of the Loan shall have been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined by the Bank by multiplying: (a) the total principal amount of the Loan withdrawn and outstanding as of the first Principal Payment Date; by (b) the Installment Share for each Principal Payment Date, such repayment amount to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.

<u>Payment Date</u>	<u>Installment Share</u> <u>(Expressed as a %)</u>
On each May 1 and November 1	
Beginning May 1, 2009 through November 1, 2013	10%

2. If the proceeds of the Loan shall not have been fully withdrawn as of the first Principal Payment Date, the principal amount of the Loan repayable by the Borrower on each Principal Payment Date shall be determined as follows:

(a) To the extent that any proceeds of the Loan shall have been withdrawn as of the first Principal Payment Date, the Borrower shall repay the amount withdrawn and outstanding as of such date in accordance with paragraph 1 of this Schedule.

(b) Any withdrawal made after the first Principal Payment Date shall be repaid on each Principal Payment Date falling after the date of such withdrawal in amounts determined by the Bank by multiplying the amount of each such withdrawal by a fraction, the numerator of which shall be the original Installment Share specified in the table in paragraph 1 of this Schedule for said Principal Payment Date (the Original Installment Share) and the denominator of which shall be the sum of all remaining Original Installment Shares for Principal Payment Dates falling on or after such date, such repayment amounts to be adjusted, as necessary, to deduct any amounts referred to in paragraph 4 of this Schedule, to which a Currency Conversion applies.

3. (a) Withdrawals made within two calendar months prior to any Principal Payment Date shall, for the purposes solely of calculating the principal amounts payable on any Principal Payment Date, be treated as withdrawn and outstanding on the second Principal Payment Date following the date of withdrawal and shall be repayable on each Principal Payment Date commencing with the second Principal Payment Date following the date of withdrawal.

(b) Notwithstanding the provisions of subparagraph (a) of this paragraph 3, if at any time the Bank shall adopt a due date billing system under which invoices are issued on or after the respective Principal Payment Date, the provisions of such subparagraph shall no longer apply to any withdrawals made after the adoption of such billing system.

4. Notwithstanding the provisions of paragraphs 1 and 2 of this Schedule, upon a Currency Conversion of all or any portion of the withdrawn principal amount of the Loan to an Approved Currency, the amount so converted in said Approved Currency that shall be repayable on any Principal Payment Date occurring during the Conversion Period, shall be determined by the Bank by multiplying such amount in its currency of denomination immediately prior to said Conversion by either: (i) the exchange rate that reflects the amounts of principal in said Approved Currency payable by the Bank under the Currency Hedge Transaction relating to said Conversion; or (ii) if the Bank so determines in accordance with the Conversion Guidelines, the exchange rate component of the Screen Rate.

5. If the principal amount of the Loan withdrawn and outstanding from time to time shall be denominated in more than one Loan Currency, the provisions of this Schedule shall apply separately to the amount denominated in each Loan Currency, so as to produce a separate amortization schedule for each such amount.

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