

CASE STUDY

Customizing the Debt Repayment Schedule to Improve Fiscal Sustainability in Brazil

OVERVIEW

The Brazilian State of Rio Grande do Sul needed to improve its debt profile and achieve a more stable and sustainable fiscal position to grow and improve the quality of life of its people. The state's debt profile showed that repayments of about 18% of state revenue were clustered in 2008 and 2012. A US\$1.1 billion World Bank Development Policy Loan reduced the state's debt service obligations in the short-term and a customized repayment schedule served to reduce and stabilize debt service payments over the long run.



Background

Rio Grande do Sul is the fourth largest state economy in Brazil and has the fifth largest population. Despite its relatively favorable social and economic position in the country, continuous fiscal deficits and excessive indebtedness were hampering the state's ability to promote economic growth. Rio Grande do Sul was one of the few states in Brazil with debt service exceeding the 15% limit set by the country's Fiscal Responsibility Law. This affected social service efficiency and reach and the state's quality of life indicators were receding relative to the rest of the country.

Financing Objectives

Rio Grande do Sul's debt profile showed that there was a strong concentration of debt repayments

between 2008 and 2012, corresponding to about 18% of state revenue (see Figure 1). Of particular concern to the state was the debt above the law's limit, which carried large financial penalties. The debt burden was hampering the state's efforts to achieve a more stable and sustainable fiscal position, improve its debt profile, reduce social security imbalances, enhance the efficiency of the state public sector, and increase productive public investments. A fiscal sustainability program that included lengthening the maturity of the debt and smoothing out debt payments would help the state achieve these objectives.

IBRD loans offered longer maturity periods and lower interest rates compared to loans that the state could get from other funding sources. The repayment flexibility and risk management options of IBRD loans could further strengthen Rio Grande do Sul's fiscal

responsibility framework.

IBRD Financial Solution

In July 2008, the World Bank approved a US\$ 1.1 billion Development Policy Loan for Rio Grande do Sul's Fiscal Sustainability Program. It was delivered in two tranches with a total term of 30 years. The state selected a customized repayment schedule (see Figure 2) with no grace period and established a monthly billing and repayment cycle to demonstrate long-term commitment to fiscal prudence. The state also received World Bank technical assistance in public debt management to build its capacity to manage the risks of the debt portfolio. In addition, the state retained the right to convert and repay the loan in local currency (depending on IBRD's ability to execute relevant swaps) and fix interest rates over the life of the loan, which could allow Rio Grande do Sul to manage its exposure to exchange rate and interest rate fluctuations.

Outcome

The IBRD loan not only reduced the state's debt service obligations in the short-term by prepaying more expensive debt, but the repayment schedule was structured to help Rio Grande do Sul reduce and stabilize debt repayments at around 15% of state revenue (the ceiling for Brazilian states) over the long run (see Figure 1). As a result, the state achieved a more uniform distribution of debt over time. The technical assistance component was also valuable in helping Rio Grande do Sul to achieve the objectives of the fiscal sustainability program.

A stronger fiscal position is expected to generate the resources needed to jump start productive public investments and the prompt delivery of public services needed to ensure future economic growth in the state.

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Figure 1: Rio Grande do Sul's debt service exceeding the limit before and after IBRD loan

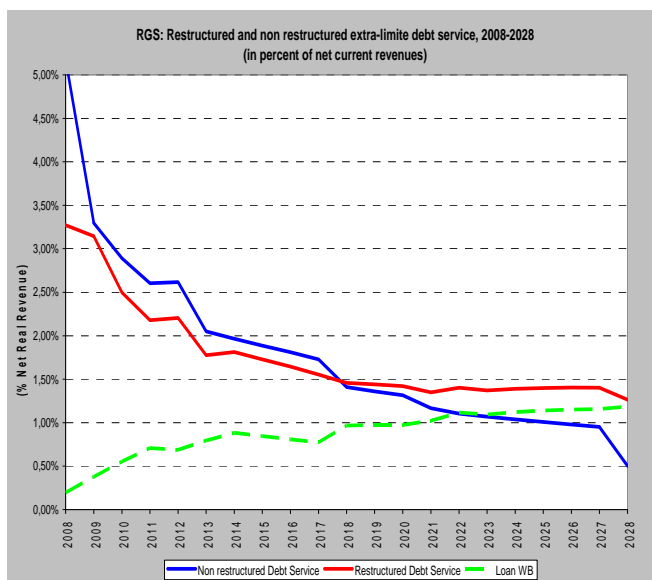


Figure 2: Rio Grande do Sul's customized repayment schedule for the IBRD loan

