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COUNTRY PROGRAM EVALUATION:

# BRAZIL 2011-2014

Executive Summary

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# BRAZIL

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EXECUTIVE SUMMARY

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## *context*

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**Brazil is the world's fifth most populous country and seventh largest economy, and one of the most advanced nations in Latin America and the Caribbean (LAC).** With a population of nearly 202.8 million people and a GDP of US\$2,353 billion, Brazil is a large and diversified country with a high level of human development. Per capita GDP in purchasing power parity was US\$16,096 in 2014, almost twice as high as in 2000 and above the Region's average. The Brazilian economy is particularly sophisticated, with broad industrial and service sectors.

Brazil has experienced solid economic growth in recent years, but growth has slowed, and the country continues to face significant deficits in infrastructure and public services that limit its productivity and competitiveness.

Following decades of high inflation, the Government of Brazil adopted economic reforms that were crucial in stabilizing the macroeconomic situation.

These reforms together with a favorable external environment fueled Brazilian growth and contributed to improving the fiscal position at all levels of government and to reducing nominal interest rates. In this context, Brazil was very successful in reducing poverty, enlarging the middle class and decreasing regional differences. However, Brazil continues to face significant challenges: income and regional inequality and productivity, low level of investments, urbanization, quality of and access to social services (especially in education), and high crime levels. Brazil also faces difficult environmental challenges such as deforestation, pollution, biodiversity loss, and greenhouse gas emissions. Other challenges, particularly at the subnational level, include weak public management, rigidity and low transparency of public expenditures, and weak capacity to increase tax collections.

In the medium-term, Brazil will face challenges in achieving rates of growth and reductions in poverty similar to those achieved during the last decade. **The rate of growth will be affected by such factors as productivity gains, the pace of infrastructure investment, the rate of adoption of growth-enhancing structural reforms, improvements in the efficiency and quality of public expenditure, and labor market dynamics.**

The extremely heterogeneous needs across the country and the unequal capacity of subnational governments affect the management and implementation of social policies. Municipal and state governments have autonomy in the provision of many social services and face different challenges and their capacity to deal with these challenges varies greatly. Thus the quality of and access to social services is different from state to state, and tend to be worse in the poorer states of the north and the northeast.

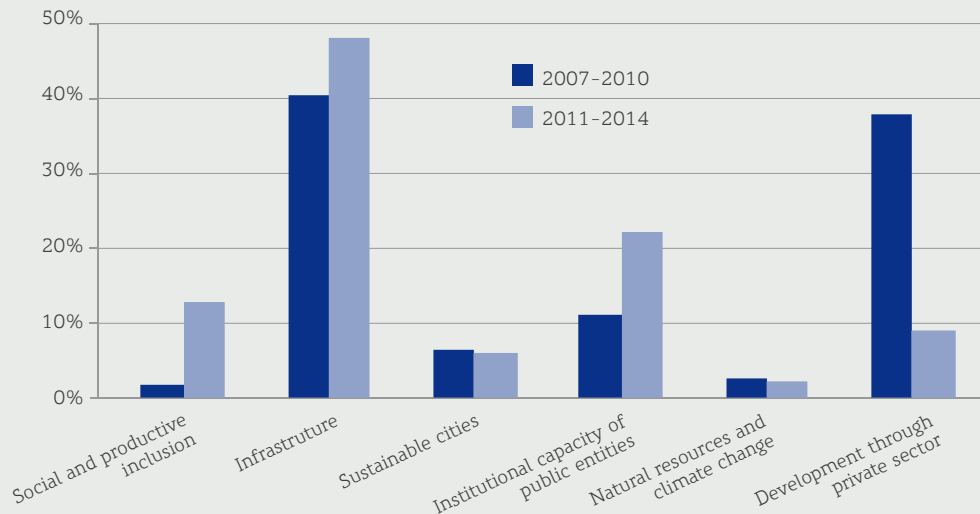
## program

The 2012-2014 CS of the Inter-American Development Bank (IDB, or the Bank) was relevant in that it reflected the priorities shared between the GOB and the Bank and Brazil's long-term development needs, but it was divided into 16 priority sectors with limited strategic complementarity.

The CS identified six strategic objectives:

- **promoting social and productive inclusion,**
- **improving the country's infrastructure conditions,**
- **supporting the development of sustainable cities,**
- **strengthening the institutional capacity of public entities,**
- **promoting better management of natural resources and climate change, and**
- **stimulating development through the private sector.**

EVOLUTION OF BANK LENDING IN BRAZIL BY CS STRATEGIC OBJECTIVE



Source: OVE.

It also proposed to work at all three levels of government (but with a stronger focus on the subnational level), with a geographical bias toward the north and northeast regions, and with a greater effort to take gender and racial issues into account. Though the CS identified two or more Bank sectors for work under each of the six CS objectives, it did not encourage sectors to complement each other to achieve common goals. In fact, the CS did not identify common goals but rather provided separate objectives/indicators for each of the 16 priority sectors.

## To remain relevant, the Bank continued to adapt its lending patterns during the period.

While the proportion of federal and municipal lending remained approximately the same in 2011-2014 as in the previous period, lending to the states increased, and lending to the Brazilian Development Bank (BNDES) stopped. At the same time, lending to the private sector fell and shifted from real sector operations to the financial sector: the Bank found a market niche in trade finance, where there was high demand for its hard currency/long tenor loans.

The Bank continued to be an important source of international financing to Brazil. The IDB has become Brazil's largest multilateral lender (in terms of debt stock). During 2011–2014, the Bank approved 175 operations (loans, guarantees and grants) totaling US\$10.45 billion (a level comparable to that of the preceding four years, when the Bank approved 206 operations for US\$10.16 billion). Lending was channeled through sovereign-guaranteed (SG) investment loans (74% in value), policy-based loans to states (20%), and non-sovereign guaranteed (NSG) investments (6%). US\$90.8 million in grants was approved during the period, an increase over the US\$78.5 million approved during 2007–2010.

## In terms of sectors, the Bank's program focused on relevant development challenges such as infrastructure and fiscal/institutional issues.

Because of substantial investment in technical cooperation and dialogue, it was able to engage states and municipalities in the health and education sectors. Infrastructure projects at the state level remained a core area of work. **The bulk of the infrastructure lending went for transport projects that could eventually help improve productivity and competitiveness.** Almost a third of infrastructure lending went to water and sanitation, in line with the country's urbanization challenges. While energy lending took only 8% of infrastructure approvals, it was directed to highly strategic projects. Most of the infrastructure lending went to the states in the south and southeast regions, though a fifth went to the poorest states of the north and northeast, in line with the CS intent and country needs. **Fiscal concerns and the need to improve fiscal management at the state level justified Bank support to public finances,** predominantly through policy-based operations to states (PROCONFIS) and support to subnational fiscal reform (PROFISCO). The Bank's provision of substantial technical cooperation (TC) in the health and education sectors opened the possibility of lending to states and municipalities in these sectors; during the period, the Bank approved five health and five education projects for a total of over US\$1 billion.

As envisioned in the CS and in line with country needs, **the program increased its focus on the poorest regions of the country and made some efforts to include gender and diversity as a cross-cutting issue.** Though half of the lending during the period went to higher-income states in the south and southeast, lending in the north and northeast almost doubled. The portfolio has been increasing its focus on less developed states since the 1999 crisis, and this trend intensified in the latest strategy period. Lending in the social sectors also focused on poorer states, in consonance with country needs. About one-fifth of SG loans included gender- and race-specific indicators in their results matrices (as a first step to address diversity issues), an improvement over previous periods but still far from the original CS goal of 100%.

## *implementation and results*

**Bank performance shows the implications of shifting lending from the federal to subnational governments.** The overall preparation times of Bank investment projects in Brazil remained constant and above the Bank's average, and preparation and execution costs increased over those of the previous strategy period, though these averages hide important differences across borrowers and instruments. The combined time between start and eligibility remained around 40 months in Brazil, while the Bank's average decreased slightly to just above 30 months. This lengthier preparation time is in part explained by the meticulous federal review process to which Bank borrowers (subnational governments) are subjected before approval. Average preparation and execution costs per US\$1 million approved increased from US\$2,002 and US\$3,566, respectively, to US\$2,477 and US\$6,160, still above Bank averages, which also increased since 2010.

**The use of umbrella-type operations did not counterbalance the expected higher costs of dealing with institutionally weaker and less experienced subnational governments.** To compensate for the expected higher costs of dealing with subnational governments, the Bank developed new instruments –the use of the conditional credit line for investment projects (CCLIP) was expected to streamline project preparation and approval–and decentralized execution to the country office. However, preparation times/costs and execution costs worsened for the three programs that used CCLIPs, while they generally improved for non-umbrella-type state and municipal borrowers.

## **Bank experience shows that longer-term partnerships with a selected number of sub national governments may increase portfolio efficiency and effectiveness.**

Some of the drivers of project preparation and execution costs were the **new clients' lack of previous working experience with the Bank and their relatively weaker institutional capacity.** As new subnational borrowers gained experience they became more proficient in dealing with the Bank, and preparation costs declined by half for repeat customers. Many new borrowers were institutionally weaker and tended to have more difficulty dealing with Bank processes, which also affected implementation costs, as loans with lower-capacity municipalities had average execution costs up to seven times higher than those with the most capable municipalities. Repeated engagement with the Bank has facilitated policy dialogue and coordination between the Bank and subnational governments, which may lead to better planning and outcomes.

## **Results of the program appear to have been mixed, with some significant successes.**

Social protection projects are providing popular social infrastructure, but it is not clear if they will yield the results expected. Except for the successful Fortaleza and São Bernardo health projects, the projects OVE reviewed in education and health are in relatively early stages. The GOB and subnational governments alike appreciate the Bank's re-engagement with these sectors. Transport and water and sanitation projects, primarily at the state and municipal levels, appear to have had substantial positive impacts. Urban development projects (PROCIDADES or stand-alone loans) are highly relevant, and the Bank has the necessary expertise to provide support. However, some projects have serious efficiency and implementation problems, and, because of delays and weak monitoring and evaluation (M&E), little can be said about their effectiveness. Public sector management projects at the federal level are disbursing too slowly to gauge their effectiveness. The portfolio in environment and natural resources has been relatively modest in size but appears to have been diverse, and TCs in particular have supported a variety of institutional strengthening and knowledge initiatives. Bank SG lending to the tourism sector through PRODETUR is facing major implementation problems; despite high demand, lending using this modality has stopped. Support to fiscal reform at the state level through PROFISCO has had mixed results. The PROFISCO program has been successful at disseminating experiences and best practices across states, but few projects have progressed far enough to have clear evidence on results. Policy-based lending through PROCONFIS has helped states set a reform agenda and improve fiscal management, but only two of the five operations were found to be clearly financially relevant, and all had only modest policy depth.

## The Bank had little private sector engagement in the productive sectors, focusing most of its NSG lending on financial intermediaries.

This was in part because of the ready availability of private sector project finance in Brazil through public development banks (notably BNDES) during the period. Financial sector clients appear to value the terms and reputational effects of IDB support. The Bank provided tenors not available in the domestic market (or available internationally but at a higher cost). Its due diligence process provided a stamp of quality for most banks, helping them to negotiate better deals with foreign banks and/or to reach new sources of funding. To a lesser extent, the Bank has been effective at bridging information asymmetries between banks in trade finance deals. However, the weakness of M&E arrangements in private sector operations makes it difficult to fully assess their effectiveness.

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## *conclusions*

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**Brazil has experienced solid economic growth in recent years, but growth has slowed and the country continues to face significant deficits in infrastructure and public services that limit its productivity and competitiveness.** Given tight fiscal constraints and expenditure rigidities, addressing the infrastructure and social services gaps will require both public and private sector engagement. The country's regulatory framework has not been fully conducive to private sector investments, but the Bank has been working with Brazil to address some aspects of the problem, and new opportunities may arise. Given the complexity and cross-sector nature of these challenges, collaboration across sectors and coordination between the public and private sides of the Bank Group will be critical.

The focus on subnational governments and on the infrastructure, fiscal management and social sectors (with an increased emphasis on the poorer regions) was generally relevant to country needs and government priorities, but, in OVE's view, a more strategically integrated portfolio could have produced a stronger impact for the country.

Bank portfolio performance shows the implications of shifting from working with the federal government to working with subnational ones. Bank experience shows that longer term partnerships with a selected number of sub national governments may increase portfolio efficiency and effectiveness.

# recommendations



1. **Work with the client to define a limited set of strategic thematic priorities to structure and integrate the Bank's program, taking into account country demands and the Bank's comparative advantage.** While it is understandable, given Brazil's size and heterogeneity of borrowers, that the Bank should support a number of themes and activities, strategic prioritization is still important for Bank effectiveness. Increasing the program's focus on poverty, including on poorer areas of the country, could be one strategic priority to consider.



2. **Seek long-term partnerships with subnational governments (both states and municipalities) where possible, and devote substantial resources to cross-learning.** Because the lack of previous experience in working with the Bank and weaker institutional capacity appear to be factors behind higher costs, longer-term relationships (such as CCLIPs with specific subnational governments) can reduce preparation and implementation costs and enhance institutional capacity. Heightened attention to sharing experiences across programs, states, and municipalities (for example, replicating mechanisms similar to PROFISCO's Finance Secretaries Commission) can enhance effectiveness while also controlling costs.



3. **To the extent demanded by clients, continue to work with states and municipalities on deepening public finance reform.** A better fiscal position, more efficient public spending policies, and stronger public expenditure management will be critical to subnational governments if they are to extend the coverage and improve the quality of public services and infrastructure. The Bank has strong multi-sector expertise that can contribute to those reforms. Policy-based lending to states –particularly those with immediate financial need– appears to be an efficient and effective instrument for support, supplemented where appropriate with technical cooperation and/or investment lending. Given the breadth of important fiscal issues, programs of fiscal support should engage multiple Bank divisions to help clients identify some of the most pressing expenditure rigidities and inefficiencies and design appropriate solutions.



4. **Seek ways to work with the Brazilian authorities to help strengthen regulatory frameworks for public-private partnerships at various levels of government.** Facilitating private investment in the delivery of public services will be essential to meeting the country's growing infrastructure needs, and can also be instrumental in increasing investments in the social, environment, and other areas.



5. **Develop a concrete plan to promote more effective cross-sector and public-private collaboration in the country program.** Such collaboration will be essential to the achievement of the goals of strategic prioritization and support for integrated fiscal reform at the subnational level, as envisioned in the prior recommendations.



6. **Continue to strengthen the monitoring and evaluation of the Bank's portfolio.** The evaluability of the Bank's approved portfolio has improved significantly, as evidenced by higher Development Effectiveness Matrix scores in recent years. Carrying these improvements through to project completion and ex-post evaluation can help the Bank learn more from experience and fine-tune future interventions.

PROCIDADES is a conditional credit line for investment projects (CCLIP) for US\$800 million approved by the Bank in 2006 (BR-L1043) to lend up to US\$50 million each to intermediate-sized municipalities to finance urban development and/or municipal strengthening activities that are part of a municipal development plan. It required counterpart resources equal to 50% of the total amount of the project.

PROFISCO is a CCLIP for US\$500 million approved by the Bank in 2008 (BR-X1005) to lend up to US\$50 million to individual states to help them achieve and maintain their fiscal targets established in the Program to Support State-level Fiscal Restructuring and Adjustment by improving their tax and expenditure systems. It lends continuity to the National Fiscal Administration Program for the Brazilian States (PNAFE) financed by the Bank in 1999, aimed at enhancing municipal public management and transparency. In May 2013, the Bank approved an additional US\$200 million for the CCLIP.

PRODETUR is a CCLIP for US\$1 billion approved by the Bank in 2008 (BR-X1008) to support the achievement of the objectives set up in the National Tourism Plan for 2007-2070, in a context of important tourism growth. It envisioned lending of up to US\$150 million to the federal and individual state governments to finance tourism operations in municipalities with more than 1 million inhabitants.



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