NORTHEAST TOURISM DEVELOPMENT PROGRAM

(BR-0204)

EXECUTIVE SUMMARY

BORROWER:	Banco do Nordeste do Brasil	
GUARANTOR:	Federal Republic of Brazil	
EXECUTING AGENCY:	Banco do Nordeste do Brasil	
AMOUNT AND SOURCE:	IDB:	US$400,000,000 (OC)
	Local counterpart funding:	US$400,000,000
	Total:	US$800,000,000
FINANCIAL TERMS AND CONDITIONS:	Amortization period:	25 years
	Disbursement period:	5 years
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%

OBJECTIVES:

The basic objective of the program is to reinforce the capacity of Brazil's Northeast to maintain and bolster its growing tourism industry, thereby contributing to the region's socioeconomic development. The Northeast, which has over 45 million inhabitants and covers 1.5 million sq.km., is the poorest area of the country. Targeted measures to address regional inequities include employment generation, increasing per capita income and augmenting state revenues by means of viable alternatives for economic growth. Among these, tourism has been identified as an alternative with indisputable potential, and is developing into an increasingly important sector in the region's economy.

Nonetheless, tourism activities are constrained by a lack of adequate infrastructure and services within the region. In consultation with the private sector, the regional states have undertaken an analysis of supply and demand factors within their tourism sectors, in order to determine needed public investments and activities with the highest potential yield and to prioritize institutional endeavors necessary to achieve the desired results.

Accordingly, the proposed program has been designed primarily to improve conditions in consolidated

tourism areas, or areas in the process of consolidation, where the capacity to provide adequate infrastructure has not kept pace with demand and could jeopardize existing tourism or hamper ongoing tourism growth. In a limited number of cases, the program will finance investments in relatively or totally new tourism sites in order to diffuse tourism activities from satiated urban areas. In both cases, the selection of investments for financing under the program is demand-driven.

Within this context, the program would: (a) strengthen the institutional framework for monitoring and fostering sustainable tourism, by means of institutional strengthening of state and municipal tourism entities, state environmental agencies, and local municipalities in the tourism sites selected; (b) improve the sanitary and environmental conditions of tourism areas, through investments in water supply and sewerage, solid waste management, and environmental reclamation and protection, as well as institutional strengthening of local municipalities, and the corresponding agencies in these sectors; (c) facilitate travel to and within the region, by improving airports, urban street systems, and secondary and access roads, complemented by strengthening the operational and maintenance capacity of the corresponding departments of transportation; and (d) improve and diversify the region's tourism products, through activities such as restoring and preserving historical sites and revitalizing surrounding areas, and improving beaches, parks, and other natural resources.

DESCRIPTION:

The program will finance three principal components as follows: (a) institutional development for the agencies indicated above, to enhance their capability to perform their respective functions; (b) a multiple works component which consists of a preliminary universe of about 160 projects in five sectors: sanitation (water supply and sewerage), solid waste management, environmental reclamation and protection, transportation (city street systems and roads), and historical preservation; and (c) the improvement of five airports in the region, four of which are federally operated (in São Luís, Maranhão; Fortaleza, Ceará; Natal, Rio Grande do Norte; and Aracaju, Sergipe) and one state airport (in Porto Seguro, Bahia).

Responsibility for program execution lies with the executing unit within the Banco do Nordeste do Brasil

(BNB), whose functions will be to coordinate and administer overall execution of the program, including the analysis and approval of individual projects under the institutional development and multiple works components. Implementation of the state subprograms will be coordinated and supervised by state executing units, with the participation of pertinent state agencies and municipalities. The federal airport infrastructure agency, INFRAERO, will be responsible for the construction, operation and maintenance of the four federal airports being improved under the program.

The institutional development and multiple works components will adhere to operating regulations, to be administered by the BNB, which establish eligibility criteria for both the states and for individual projects, as well as the procedures, terms and conditions of financing for these components. At the program's outset, each state will sign a financing agreement with the BNB which will define the states' subprograms, prepared in accordance with the tourism strategy of the state previously approved by the Bank. Financing for each individual project (or group of projects) will be administered through subloan contracts between the BNB and the states.

Separate subloans will be administered by the BNB for the five airport improvement projects, governed by the loan contract with the Bank. The respective states must present signed agreements with INFRAERO or, in the case of Bahia, with the state transportation and terminal authority (DTT) establishing the obligations to be assumed by these agencies for project execution, operation and maintenance.

ENVIRONMENTAL CLASSIFICATION: The Environment Committee, at its meeting of January 25, 1994, classified this as a Category III operation.

BENEFITS: The program will contribute to the socioeconomic development of the poorest region of Brazil, where more than half the population is below the poverty line. Multiple works under the program, specifically projects to provide water supply, sewerage, and solid waste management, will directly benefit low-income populations estimated at slightly more than 1.3 million persons, in over 40 municipalities or districts expected to participate in the program. State environmental agencies will receive training and support to better carry out their responsibilities in monitoring environmental quality,

and municipal governments will be trained to improve land use planning and financial management. For the long-term development of the region, the program provides a boost to the Northeast's evolving tourism industry, helping the states overcome existing barriers to tourism growth and supporting their efforts in meeting the demands of the international tourism market.

RISKS:

This program will basically support the region's first concerted effort to exploit its tourism potential. At the same time, the nature of the works to be financed will largely benefit low-income populations in tourism areas. The impact of the program's activities on tourism growth can be expected to differ among the states, depending on the initiative and leadership demonstrated by state and local governments, such that program benefits may be concentrated in a reduced number of states.

The main risks are related to the possibility that all of the region's states may not participate even minimally in the program, and that the investments to be made may not generate the ensuing response from the private sector on tourism activities. Due to institutional weaknesses, the quality of project preparation is often poor and some states may not be able to take full advantage of the resources available, losing out on the program's distributive benefits. Other states may be impeded from participation due to their financial ineligibility, or the ineligibility of their state water companies. For states with high tourism growth, these limitations would prove regrettable.

These risks are managed on two fronts. First, training in project preparation and analysis will be provided to assist the BNB and the states in accelerating the presentation of quality projects for financing. Second, the program is designed to accommodate limited delays in participation by the states, provided that overall program execution is not jeopardized. As an incentive for those states facing financial ineligibility, the program can recognize costs or reimburse expenses for approved projects once the state becomes financially eligible, subject to meeting all program and bidding regulations.

THE BANK'S COUNTRY AND SECTOR STRATEGY

The program is consistent with the Bank's mandate under the Seventh and Eighth Replenishments, to give priority to water supply and sewerage projects, environmental reclamation and protection, management

of natural resources and strengthening of public services which manage the environment. The program also reflects the overall strategy agreed upon by the Bank and Brazil during the 1993 and 1994 Programming Missions, to emphasize social needs which include programs to generate employment and increase incomes.

SPECIAL CONTRACTUAL CONDITIONS:

Conditions prior to first disbursement:

(a) establishment of the executing unit within the BNB with the technical and administrative capacity to coordinate the program in accordance with parameters agreed upon with the Bank (see paragraph 3.2);

(b) establishment of the interdepartmental environmental group within the BNB, in accordance with parameters agreed upon with the Bank, and initiation of training activities for the group (see paragraph 2.24);

(c) that operating regulations for the institutional development and multiple works components of the program, satisfactory to the Bank, have been put into effect (see paragraph 3.9);

(d) prior to first disbursement for any of the multiple works or institutional development projects, the BNB must present a signed financing agreement with the respective state, previously approved by the Bank (see paragraph 3.14); and

(e) prior to first disbursement for any of the airport improvement projects, the BNB must present: (i) evidence that the respective state meets the specific financial criteria regarding indebtedness limitations, and the federal government and the state of Bahia have earmarked funds for the respective local counterpart requirements; (ii) the respective state's tourism strategy and action plan for approval by the Bank; (iii) signed agreements between the state and INFRAERO or, in the case of Bahia, with the DTT, establishing the obligations to be assumed by these agencies; and (iv) necessary environmental permits for construction (see paragraph 3.23);

Conditions related to program execution:

(a) the obligation on the part of the BNB to present, within six months of the effective date of the loan contract, a work program for training in project preparation and analysis and, within twelve months of

the effective date of the loan contract, to have initiated the training program (see paragraph 2.26);

(b) the obligation of the BNB to establish an administrative margin not to exceed 1% of the loan resources used to finance airport improvement projects under the program (see paragraph 3.8);

(c) the obligation of the BNB to present for the prior approval of the Bank the resettlement plan for any project to be financed under the program which, due to land acquisition, results in moving the local population (see paragraph 3.12);

(d) inclusion in the multiple works component of the solid waste management sector and the historical preservation sector will be subject to approval by the Bank of at least one project in each sector as per the eligibility criteria established in the operating regulations (see paragraphs 3.28 and 3.32);

(e) the deadline for physical initiation of multiple works to be financed with resources of the loan will be 36 months from the effective date of the loan contract (see paragraph 3.36);

(f) procurement of services in excess of US$5,000,000 and of goods in excess of US$350,000 will be undertaken through international public bidding in accordance with bidding procedures approved by the Bank (see paragraph 3.39); and

(g) within ten months of the effective date of the loan contract, the BNB will present to the Bank a water demand study for the Northeast and updated estimates of the cost-efficiency indices for sewerage projects; within two months following approval of this study by the BNB and the Bank, the BNB shall provide evidence that it has applied the results of the study to its analysis of sanitation projects in the Program (see paragraph 5.11).

Conditions regarding the submission of reports:

(a) for a period of ten years following the year in which the first work is completed, the BNB shall submit annual maintenance reports for the Bank's review for the five airport improvement projects and for a representative sample of works to be agreed upon with the Bank from each eligible sector. (The operating regulations require the participating states to provide the BNB with annual maintenance reports for all works financed with program

resources, which will be available for Bank review. (see paragraph 3.44);

(b) beginning 15 months after the effective date of the loan contract and for two years thereafter, the BNB shall present program monitoring reports to the Bank in accordance with agreed-upon guidelines, to be used for joint reviews with the Bank on program execution (see paragraph 3.45); and

(c) the BNB shall present information necessary to carry out an ex post evaluation of the program's impact, as per agreed-upon guidelines to be included in the loan contract (see paragraph 3.47).

POVERTY TARGETING: In keeping with the guidelines of the Eighth Replenishment, this program, by focusing on areas with a predominantly low-income population, qualifies under criterion A.

I. FRAME OF REFERENCE

A. The development challenge in the Northeast

1.1 The Northeast region of Brazil encompasses nine of the country's 26 states: Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe and Bahia, covering 1.5 million sq.km. Based on projections from the 1991 census, the region has an estimated population of 45.3 million (approximately 58% urban and 42% rural), which represents about 30% of Brazil's total population. Industrial and service activities are largely concentrated in the respective state capitals, of which three have populations in excess of one million: Salvador (Bahia) with 2.1 million; Fortaleza (Ceará) with 1.8 million; and Recife (Pernambuco), with 1.3 million inhabitants.

1.2 In spite of being the country's first settled and economically-active region, the Northeast's position as a growth center was overshadowed during the industrialization of the southern and south-central regions of Brazil earlier this century. Development institutions were established during the 1950s to stimulate the area's economy, including the Banco do Nordeste do Brasil (BNB) and the Superintendência de Desenvolvimento do Nordeste (SUDENE). State intervention continued to predominate in the region through the 1970s, with the financing of major infrastructure investments and the introduction of fiscal incentives. The Fundo de Investimentos do Nordeste (FINOR) was established, which is currently administered by SUDENE and channels funds to the private sector for industrial investments; the Fund currently has liquid assets in excess of US$600 million.

1.3 These combined efforts resulted in solid growth rates in the region, which surpassed national indices. From 1970 until 1992, annual regional GDP grew by an average of 5.5%, compared to 4.5% nationally, and the Northeast's participation in the national economy rose from 12.3% to 16%. In 1992, the Northeast's total GDP was approximately US$65.8 billion, based on an economy significantly more diversified than its historic role of producer of traditional, primarily extractive, goods. The Northeast also achieved notable improvements in major social indicators: infant mortality dropped from 125 per 1,000 in 1976 to 53 per 1,000 in 1990, and life expectancy grew from 46 years in 1965 to 59 years in 1988.

1.4 Still, the inequitable socioeconomic conditions of the region call for continued efforts to address the region's needs. Income per capita in 1990, at US$1,702, was much less than the national per capita income of US$2,874. Less than 52% of households are connected to potable water; less than 8% of households are connected to a sewerage system and only 4% of sewage collected is actually treated. Declared unemployment rates average about 7%;

and illiteracy rates are nearly 40% (compared to 20% nationally). An estimated 23 million persons, slightly more than half the regional population, are below the poverty line. The 1994 United Nations Human Development Index, while ranking Brazil 63rd in the world in such areas as life expectancy, education, purchasing power, etc., indicated that the Northeast, if considered independently, would rank 111th.

1.5 Recent federal governments have renewed attention on the Northeast in an effort to reduce regional inequities and to work with these states to identify and support viable alternatives for economic growth, with a focus on employment generation, increased per capita income and additional state revenues. The Banco Nacional do Desenvolvimento Econômico e Social (BNDES) undertook studies on the competitiveness of the Northeast, and concluded that the most viable opportunities are in four sectors: irrigated agriculture (primarily fruit growing for national consumption and export), tourism, the textile industry, and ornamental stone mining. These four sectors are now the target for federal financing to the region for productive activities. 1/ Federal financing includes the resources channeled through the Fundo Constitucional de Financiamento do Nordeste (FNE), established in Brazil's 1988 Constitution, which is funded by monthly transfers of 1.8% of all federally collected income taxes and taxes on industrial products. In early 1994, the BNDES inaugurated the "Programa Nordeste Competitivo" with resources of about US$3 billion for the 1994-1998 period, to finance private sector activities in these four sectors as well.

B. The tourism sector

1. Institutional framework for tourism development

1.6 The focus on tourism as one of the alternatives for economic growth in the Northeast accompanies a growing consciousness throughout Brazil of the potential of a coherent and marketable tourism industry. 2/ From an institutional point of view, new federal regulations were established in 1992 through the adoption of a

1/ There are also several social sector investments under way in the Northeast, including primary education and health programs being partially financed by the World Bank; the efforts of two states to reform the social sectors will be supported in a program currently in preparation for Bank financing in 1995.

2/ Tourism is an extremely dynamic sector in the global economy. In 1994, the industry generated 11.7% of all direct and indirect taxes worldwide and employed 204 million persons (1 in every 9 jobs). The World Tourism Organization estimates that tourism will grow at an annual average rate of 4.6% in the Americas during the next decade. Currently, Brazil's tourism industry ranks 8th in the hemisphere in terms of number of tourists, and 6th in terms of foreign exchange earnings.

national policy on tourism (Decree 448) to develop the tourism sector as a source of greater national income. The sector was also raised to ministerial level with the reorganization of the Ministerio de Industria, Comercio e Turismo (MICT). The Instituto Brasileiro de Turismo (EMBRATUR) has been charged with coordinating efforts at all levels to implement a national tourism plan, and a comprehensive institutional structure has been developed at the federal and regional levels to orient and facilitate tourism development, including the participation of the private sector. Of note is the Câmara Setorial de Turismo which is used as an instrument for strengthening the sector and formulating tourism policies. This chamber brings together leaders from the hotel sector, airline industry, travel agents and tourism operators, construction firms, investment banks, and car-rental ownerships, among others.

1.7 In the Northeast, the regional Comissão do Turismo Integrado do Nordeste (CTI/NE) was created to develop, monitor and provide feedback on regional tourism development strategies and plans. The Commission is made up of the secretaries of tourism of the regional states, and meets on a monthly basis. With contributions from the states, the Commission also promotes tourism to the Northeast, participating in international tourism fairs and carrying out advertising campaigns in targeted foreign markets. The CTI/NE was a catalyst in the preparation of the Programa de Ação para o Desenvolvimento Turístico do Nordeste (PRODETUR/NE), which the proposed program will partially support. To facilitate federal support for PRODETUR/NE, an advisory and coordination committee was created by inter-ministerial decree in March 1993, headed by the Secretary of Tourism/MICT with representatives of the Office of the President, the Ministries of Foreign Relations, Civil Aviation, and Regional Integration, EMBRATUR, SUDENE, CTI/NE and the BNB.

2. Tourism in the Northeast

1.8 The Northeast has traditionally been a national tourist destination, especially for the São Paulo and Rio de Janeiro markets. In recent years, however, with the advent of direct flights from Argentina and Europe, the Northeast has opened up to these regional and international markets. Tourism from the North American market is slight, especially in comparison to Brazil as a whole, precisely because of the limited direct access from the United States or Canada.

1.9 Due primarily to its inclination toward domestic tourism, the quality of the Northeast's limited tourism installations, especially as regards hotels, has not favored international standards. In 1992, the region had only 23,000 of the 138,000 hotel rooms classified by EMBRATUR, of which 37.5% (34% at the national level) were four and five star hotels, the category used by 80% of international tourists arriving in the country at that time. Currently within the region, Bahia, Ceará and Pernambuco are the states with the largest and best equipped hotel infrastructure;

Alagoas is demonstrating strong growth and results, not only in its hotel supply but also in its promotional capabilities in international markets.

1.10 International tourism now accounts for about 15% of total demand in the Northeast and, in many areas, is growing more rapidly than domestic tourism. For both markets, however, tourism activities in the region are constrained by a lack of adequate service and transportation infrastructure. Particularly critical is the lack of adequate water supplies and sewerage facilities, solid waste management, and easy access to and within the region. Tourism development in the Northeast, especially international tourism, will depend principally on the states' capacity for improving their conditions in infrastructure, services and air transport, complemented by their institutional ability to maintain and protect their natural resources and to attract investments for tourism installations and operations.

C. The proposed project: an integrated solution to the problem

1. Definition of activities proposed for Bank financing

1.11 The premise for program conceptualization was that all activities to be undertaken should respond to a tourism development strategy for each state. These strategies would analyze recent tourism trends in the state and identify barriers to achieving the state's tourism goals, especially those preventing improved or increased tourism operations by the private sector, since tourism itself is a private sector activity. The state strategies evolved significantly during program preparation, following orientations by the Bank, such that the actions defined for Bank financing meet the priority needs of each state and are demand-driven.

1.12 As part of their strategy development, each of the participating states undertook, in consultation with tourism operators and investors, an analysis of what has happened within its tourism sector during the past five to ten years in terms of both **supply factors** (transportation, accommodations, and the tourism product(s) of the state) and **demand** (a profile of the tourists visiting the state and changes in that profile during the analysis period). The states also determined the tourism areas with the highest potential return on additional investments. The corresponding action plans for these areas include initiatives and investments designed to address deficiencies in a comprehensive manner, while maintaining consistency with the goals and objectives of the tourism strategies.

1.13 As a result of the analyses, priority has been given to improving the conditions in consolidated tourism areas, or areas in the process of consolidation, where the capacity to provide adequate infrastructure has not kept up with demand and could jeopardize existing tourism or hamper ongoing tourism growth. These types of

improvements presuppose investments of low risk, with a proven demand, that will have a positive impact on the quality of life of the local population, especially as regards such services as water supply, sewerage, collection and disposal of solid wastes or improved roads. Such is the case of most, if not all, of the investments proposed for Maranhão, Piauí, Rio Grande do Norte, Alagoas, Sergipe and Bahia.

1.14 In Ceará, the proposed investments are located in relatively new tourism areas. Whereas the projects are justified based on existing demand, the state will have to demonstrate to investors the viability of the area in terms of its tourism potential and demand, in order to maximize returns and realize its tourism goals. The state has undertaken market studies to this effect, with positive signals from the private sector; but full development of the area will be a medium or long-term endeavor. In Paraíba and Pernambuco, the state programs include investments for tourism complexes in new areas, such that accompanying investments by the private sector are necessary for the projects' justification. In these cases, the public sector investment has greater risks, and analysis of the investments is dependent upon adequate demand studies and commitments from investors.

1.15 By far the most important elements of the state strategies and action plans are related to institutional issues, specifically the capacity of the participating entities to carry out their assigned functions within the overall context of sustainable tourism growth. This is especially critical for the state tourism and environmental agencies. Institutional development activities for other participating agencies, such as water and sewerage companies, state highway departments, etc., have been designed primarily to strengthen their operation and maintenance abilities with a geographic focus on program areas. As a result, a significant number of regulatory, promotional and operational activities will be strengthened and financed under the proposed program, considered essential to program execution.

2. <u>Complementary activities by federal, regional and state authorities</u>

1.16 There are several areas of complementary actions which, while not necessary for program viability and not included in program financing, will help determine if the region's expectations for tourism growth are realized. The federal PRODETUR/NE Committee, MICT and EMBRATUR have initiated or undertaken a series of activities and programs to facilitate and support tourism growth in Brazil, among them expediting the process to obtain tourist visas and simplification of entry procedures, deregulation of charter flights, developing fiscal incentives and arranging financial credit programs, promoting an awareness of the benefits of a tourism industry, and sponsoring investors forums, among others. In this regard, MICT is currently executing a private sector tourism promotion operation with the Multilateral Investment Guaranty

Agency (MIGA) of the World Bank, which incorporates policy implementation workshops, training on negotiations with foreign partners, and promotional activities to attract both national and foreign investors in tourism.

1.17 Within the Northeast, the previously mentioned CTI/NE, in addition to carrying out promotional campaigns and marketing activities, also coordinates endeavors within the region to respond to the needs of the tourism sector. Examples are the current push within the region to better standardize hotel classification (which is issued by EMBRATUR), enact mandatory hotel classification, and improve, standardize and regionalize data collection on tourism (an activity which will be financed at the state level under the program).

1.18 At the state level, activities complementary to Bank financing are considered important elements in each of the state tourism strategies, and range from strengthening security and police training in tourism areas to improving public information sources for tourists and supporting private sector training activities for the work force.

D. Bank strategy and previous experience in Brazil

1.19 The proposed program fits within the overall strategy adopted during the 1993 and 1994 Programming Missions. It was agreed that the 1993-1995 operative program would emphasize social needs which include programs to generate employment and increase incomes. The focus of the proposed program, which will finance social infrastructure, basic services and environmental activities with the objective of generating employment, also reflects the priority allotted by the Bank to investments in potable water, sewerage coverage, environmental reclamation and protection, management of natural resources, and strengthening of public services which manage the environment.

1.20 The program represents the Bank's first lending for tourism related activities in Brazil. In anticipation of this operation, the Bank sponsored a conference on the contribution of tourism to the sustainable development of Brazil's Northeast, held in Recife, Pernambuco, July 11-14, 1993. 3/ In June 1994, the Bank co-sponsored with the MICT and MIGA a seminar-workshop for both the public and private sector on tourism strategies and negotiating with tourism investors.

1.21 The Bank has extensive experience in the Northeast region, especially in water and sewerage programs which are the major basic services proposed for financing. The Bank has financed five sanitation operations in the Northeast for a total loan value of

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3/ Conference papers have been published by the Bank and are available through the External Relations Office.

US$381.7 million, of which four loans are fully disbursed, as well as three operations in transportation for a total loan value of US$233.2 million, of which two operations (in Ceará and Pernambuco) are in execution. The Bank has financed nine operations with the BNB, for a total loan value of US$306.5 million (primarily industrial lines of credit), which have been fully disbursed. The Bank-financed national fund for environmental projects should also be noted as a source of financing for complementary environmental activities by non-governmental organizations in the region's tourism areas.

II. THE PROGRAM

A. Program objectives and goals

2.1 Clear indications exist in the Northeast that tourism is developing into an increasingly important sector in the region's economy, although still incipient in global terms. The region is endowed with tremendous potential, and there are unequivocal expressions of interest on the part of national and international private investors and tourism operators in demand markets which could turn the area into an important tourism destination.

2.2 The basic objective of the program is to reinforce the Northeast's capacity to maintain and bolster its growing tourism industry, thus contributing to the socioeconomic development of the region. The program would provide basic infrastructure and public services in areas of existing tourism growth, where state capacity has not kept pace with demand; these investments will largely benefit the low-income populations of the selected areas. By upgrading the conditions in tourism areas, the program also aims to attract additional or improved private sector tourism activities, thus generating new employment opportunities, higher per capita income and increased state revenues.

2.3 The program intends to meet these objectives by assisting the northeastern states in implementing their tourism strategies over the next five years. As discussed in Chapter I, these strategies, developed in consultation with the private sector, have identified the problems and barriers facing the regional tourism industry, determined priority tourism areas to maximize returns, and have prioritized institutional endeavors and investments necessary to achieve the desired results. Within this context, the program contemplates the following actions:

(i) strengthening the institutional framework for monitoring and fostering sustainable tourism, by means of institutional strengthening of state and municipal tourism entities, state environmental agencies, and local municipalities in the tourism sites selected;

(ii) upgrading the sanitary and environmental conditions of tourism areas, through investments in water supply and sewerage systems, solid waste management, and environmental reclamation and protection, as well as institutional strengthening of local municipalities and the corresponding agencies in these sectors;

(iii) facilitating travel to and within the region, by improving airports, improving urban street systems, and upgrading secondary and access roads, complemented by strengthening the operational and maintenance capacity of the corresponding departments of transportation; and

(iv) improving and diversifying the region's tourism products, through activities such as restoring and preserving historical sites and revitalizing surrounding areas, and improving beaches, parks, and other natural resources.

B. Description of components

2.4 The proposed program has three principal components: institutional development, multiple works in basic infrastructure and public services, and airport improvement.

1. Institutional Development

2.5 This component is designed to enhance the capabilities of the beneficiary entities to perform their respective functions by providing technical assistance which emphasizes implementation, in the areas of: (i) organizational restructuring; (ii) development and implementation of administrative and financial support systems and operational instruments; (iii) strengthening regulatory and fiscal capacity (particularly of local governments); and (iv) personnel training. In summary, this component will finance, according to the type of entity:

- State Tourism Entities: tourism planning and monitoring systems, special studies and consulting advice on tourism strategies, and training (9 states: US$4,610,000);
- State Environmental Agencies: environmental planning and monitoring systems (involving environmental diagnostics, macrozoning and polluting activities control systems), reorganization and equipment of the agencies and a large training component (9 states: US$8,858,000);
- State Water and Sewerage Companies: improvement of administrative systems, water metering, and operational network improvements; establishment of decentralized service units in project zones; and training (7 states: US$4,730,000);
- State Road and Highway Departments: development of works and maintenance contracting systems, implementation of environmental procedures (4 states: US$980,000);
- State Planning Agencies and Executing Units: organizational support for establishment of state executing units, equipment and personnel training (9 states: US$720,000); and
- Municipal Governments: financial strengthening, including taxation instruments (cadastres, legal advice) and financial administration systems (for accounting and budgeting); economic strategic planning; land use/environmental planning - urban development plans and land use legislation; on-the-job-training and follow-up of implementation of all technical assistance projects (31 municipalities: US$9,900,000).

2. Multiple works in basic infrastructure and public services

2.6 This component includes investments in five sectors, as described below. A preliminary universe of about 160 projects has been

identified for possible execution under this component based on the states' tourism strategies and action plans, subject to meeting the program's other eligibility criteria.

a. Sanitation sector (8 states: US$209,150,000)

2.7 This subcomponent envisions about 83 water supply and sewerage projects which will improve this basic public service within the program area, benefitting approximately 950,000 people with water supply and 450,000 with sewerage systems. In most cases, the works will simultaneously expand the capacity of both the water supply and the sewerage systems, striving to make use of all existing facilities. In the potable water subsector, the works will include construction or rehabilitation of intakes, wells, conduits, purification plants, storage tanks, distribution networks and metered house connections. Pumps and other treatment and maintenance equipment are also included. In the wastewater subsector, sewers, interceptors, pumping stations and treatment plants will be constructed. In all cases, emphasis has been placed not only on improving hygienic and sanitary conditions but also on protecting the urban and the surrounding environment from degradation and pollution. In each case, the works proposed comprise a cohesive set of actions directed at the elimination of the shortages and deficiencies in the existing water supply and sewerage systems.

b. Solid waste management sector (6 states: US$14,600,000)

2.8 There are 19 municipalities which will benefit from the solid waste management projects identified to date within the program, as a direct result of which approximately 650/tons per day of solid waste will receive adequate treatment and disposal. It is expected that additional projects will be presented for the municipalities participating in the program. These projects have as their basic objectives: (a) suitable and efficient solid waste collection in urban areas; (b) effective and economical transport of such waste to final disposal sites; (c) ecologically safe, technically practical, and low-cost disposal; (d) broad environmental education programs geared to changing the public's attitudes so as to enlist its cooperation and make waste collection more efficient; (e) technically and financially stronger institutions to ensure cost-efficient operation and maintenance in the short and long terms; and (f) protection of workers' health and safety.

c. Environmental reclamation and protection (7 states: US$25,000,000)

2.9 A total of 15 environmental reclamation and protection projects have been identified thus far, their chief objectives being to promote formal and informal environmental education in tourism areas, to consolidate parks and conservation areas, to protect important, fragile ecosystems, to promote sustainable development of coastal ecosystems, and to reclaim degraded areas. An estimated

1,450 hectares are included in the project areas. Proposed activities should include methods or technologies that can be used to conduct similar projects elsewhere. The projects are also to include information that will serve as input for municipal master plans and are to encourage municipal governments to take part.

d. Transportation (urban street systems and roads and highways) (8 states: US$116,150,000)

2.10 The 43 projects planned in the transportation sector to promote tourism development fall into two subsectors: (i) construction, improvement, and reconditioning of approximately 400 km. of high-priority roads and highways in six states of the region, at a direct cost of US$79,465,000, to provide comfortable, reliable, and safe access to tourism areas in those states; and (ii) rehabilitation of some 150 km. of urban street and storm sewer systems in five states, at a cost of US$36,685,000, to improve the flow of urban traffic and ease congestion so as to make tourism areas easily accessible. The works will include the remodeling of streets and avenues, reconditioning of sidewalks, bicycle paths, and storm sewers in five cities of the region.

2.11 Despite the importance of investing in these areas in order to respond to identified needs, it is recommended that the operating regulations stipulate that transportation investments financed with program resources may not exceed US$130,000,000. This ceiling is based on the fact that other sources of financing are available for investments of this kind, and is designed to promote a balance in investments in the other sectors.

e. Historical preservation (6 states: US$58,500,000)

2.12 Seven projects are currently planned within the historical preservation sector, directly improving sites and surrounding areas covering some 35 hectares. The objectives of these investments are: (a) to restore historical sites, primarily those from the colonial period, as a focus for tourist attractions; (b) to revitalize the surrounding urban areas, which generally are degraded but have cultural, commercial, and residential potential; and (c) to promote private-sector participation in these activities.

3. Improvement of airports

2.13 There are five airports in the region to be improved under the program, four of which correspond to the Empresa Brasileira de Infraestrutura Aeroportuária (INFRAERO), the federal airport authority; the fifth is a state-controlled airport which corresponds to the Departamento do Transporte e Terminais (DTT) in Bahia. These projects are described briefly below:

a) Cunha Machado Airport (São Luís, Maranhão: US$7,210,000)

2.14 The existing terminal building, and the operational support and administrative buildings, will be expanded and remodeled. Access roads will be built and improved, and the parking area will be enlarged. A cargo terminal, together with accessory works, will be constructed. The project will enable the projected annual increase of 60,000 passengers by 1997 and 103,000 additional passengers annually by the year 2000.

b) Pinto Martins Airport (Fortaleza, Ceará: US$58,200,000)

2.15 With the current airport at its saturation point, the project contemplates the construction of new passenger and cargo terminals, support and administrative buildings, access roads, parking areas, an apron and taxiways for aircraft. These works will cover demand for the next 15 years, enabling a projected annual increase of 298,000 passengers by 1997 and 478,000 additional passengers annually by the year 2000.

c) Augusto Severo Airport (Natal, Rio Grande do Norte: US$15,700,000)

2.16 The project contemplates remodeling and enlarging the passenger terminal, constructing auxiliary buildings, enlarging the parking area and access roads, and necessary associated works. The project will enable a projected annual increase of 166,000 passengers by 1997 and 300,000 additional passengers annually by the year 2000.

d) Santa Maria Airport (Aracaju, Sergipe: US$ 6,710,000)

2.17 The runway was enlarged in 1993 to allow larger aircraft to operate and to accommodate more international flights during tourist season. The project will expand and modernize the passenger and cargo terminals and auxiliary buildings, access roads, parking areas, and related services, enabling a projected annual increase of 63,000 passengers by 1997 and 113,000 additional passengers annually by the year 2000.

e) Porto Seguro Airport, Bahia (US$5,700,000)

2.18 The existing infrastructure will be upgraded by enlarging the runway, pierheads, taxiways and apron. The plans also include works for storm sewers, landscaping, signal systems, security, and lighting. Based on projected demand, the passenger terminal will be doubled in size to accommodate all related services. The project will enable a projected annual increase of 35,000 passengers by 1997 and 82,000 additional passengers annually by the year 2000.

C. Size, cost and financing of program

2.19 The size of the program was determined by the estimated cost of each state's proposed subprogram, in which the states determined the investments necessary to meet the needs of the targeted tourism

areas in a comprehensive manner, combined with the cost estimates for the institutional development needs of the participating state and municipal agencies. The institutional development and airport improvement components consist of specific projects for which detailed cost estimates are available. The direct cost estimates for the multiple works component include contingencies and price escalation.

2.20 Within the multiple works component, a line item of US$79,622,000 which includes US$50,000,000 of Bank financing, is included to finance additional multiple works in the eligible sectors as demand warrants. As detailed in Chapter III on program Execution, these additional resources are included taking into consideration that most of the states have tourism action plans which exceed the preliminary universe of projects identified for program execution. As an incentive to accelerating implementation of their subprograms, these resources are available for financing additional works in any of the states, with the prior approval of the Bank, in accordance with their tourism strategies and action plans. The scheme for allocating resources among the states is detailed in paragraphs 3.14-3.17.

2.21 The distribution of program resources by investment category and source of financing is as follows:

PRODETUR/NE ESTIMATED TOTAL COST BY CATEGORY AND SOURCE OF FINANCING (in US$000)				
CATEGORY	SOURCE OF FINANCING			
	IDB	LOCAL	TOTAL	% TOTAL
1. Engineering and administration	0	59,410	59,410	7.4
1.1 Studies		9,300	9,300	1.1
1.2 Supervision		26,230	26,230	3.3
1.3 Administration		23,880	23,880	3.0
2. Institutional development	11,940	17,930	29,870	3.7
3. Direct costs of multiple works	328,050	174,972	503,022	62.9
3.1 Sanitation	131,780	77,370	209,150	26.2
3.2 Solid waste management	9,210	5,390	14,600	1.8
3.3 Environmental reclam./Protection	16,760	8,240	25,000	3.1
3.4 Transportation	77,250	38,900	116,150	14.6
3.5 Historical preservation	39,050	19,450	58,500	7.3
3.6 Additional works in above sectors	50,000	29,622	79,622	9.9
4. Airport Improvement	46,760	46,760	93,520	11.7
5. Operating costs	0	9,700	9,700	1.2
5.1 Land acquisition		8,000	8,000	1.0
5.2 Relocation of population		1,700	1,700	.2
6. Contingencies (inst. dev. & airports)	9,250	9,250	18,500	2.3
6.1 Contingencies	5,575	5,575	11,150	1.4
6.2 Price escalation	3,675	3,675	7,350	.9
7. Financial Costs	4,000	81,978	85,978	10.7
7.1 Interest		75,544	75,544	9.4
7.2 Credit fee		6,434	6,434	.8
7.3 Inspection and supervision	4,000		4,000	.5
TOTAL	400,000	400,000	800,000	100.0
Percentage of total	50.0	50.0	100.0	

2.22 The program would be partially financed by a Bank loan with the following financial terms and conditions:

Amount	US$400,000,000
Interest rate	variable
Credit fee	0.75% on undisbursed balance
Inspection and supervision	1% of loan amount
Disbursement period	5 years
Grace period	5-1/2 years
Amortization period	25 years

D. Recognition of costs

2.23 The participating states have incurred approximately US$6,400,000 to carry out feasibility and environmental studies as well as for the preparation of projects for the sample. These costs will be presented to the BNB and the Bank for recognition as local counterpart.

E. Complementary activities to be executed by the BNB

1. Strengthening of the BNB's Environmental Unit

2.24 The BNB's environmental unit will be responsible for analyzing the multiple works in environmental reclamation and protection and, even more importantly, for ensuring the quality and compliance of the environmental viability of all works financed under the program. The BNB has already taken important steps to improve its abilities in this area and, with the assistance of the Bank, has developed a strengthening program. The program consists of four strategic elements: (a) the administrative organization of an environmental unit, Grupo Interdepartamental de Meio Ambiente (GIMAM); (b) training for existing technical staff; (c) recruitment of additional, qualified senior personnel to develop and implement the BNB's new environmental policies; and (d) establishing an environmental documentation center, as part of the current Documentation and Information Center.

2.25 Given the important function of this unit, a recommended condition prior to first disbursement under the program is that the unit is duly established in accordance with the parameters agreed upon with the Bank, and that the training activities have been initiated. The estimated cost associated with the overall strengthening of the unit is estimated at US$952,900, to be financed by the BNB as part of its administrative overhead for program execution.

2. Training in project preparation and analysis

2.26 There are three activities contemplated to strengthen capabilities both within the BNB and within the region in project preparation and analysis, which will particularly emphasize project conceptualization and analysis of alternatives. Courses of short term (less than one month) and long term (approximately six months) will be offered to BNB staff and to employees of state and municipal agencies in the region involved in project preparation under the program. The courses will also be open to consulting firms in the region who work with the BNB or the states in these endeavors. A limited number of scholarships to attend specialized courses outside Brazil will also be provided to selected BNB staff.

2.27 The cost of the short- and long-term courses is estimated at about US$150,000 per year, and these will be financed by the BNB as part of its administrative overhead for program execution. As a recommended special condition for program execution, the BNB will

present for the Bank's approval, within six months of the effective date of the loan contract, a detailed proposal for the training activities to be initiated within twelve months of the effective date of the loan contract.

III. PROGRAM EXECUTION

A. The borrower, executing agency and co-executing agencies

1. Banco do Nordeste do Brasil

3.1 The borrower and executing agency for the program will be the BNB, which will transfer loan resources to the nine participating states under the same financial conditions as in the Bank loan contract, together with a spread to cover administrative costs.

3.2 The BNB will establish an executing unit for the program within its Department of Integrated Projects and Infrastructure (DEPRI), whose functions will be to coordinate and supervise overall execution of the program, including analyzing and approving individual projects under the institutional development and multiple works components and supervising the execution of all components including the airport improvement projects. Evidence that the executing unit has been established and that it has the technical and administrative capacity to execute the program, in accordance with parameters agreed upon with the Bank, is recommended as a condition prior to first disbursement under the program. The BNB is expected to reinforce its existing staff with consulting services to fully satisfy the requirements of program implementation. The BNB will be the sole interlocutor with the Bank for program execution.

2. State executing units

3.3 Execution of the individual state subprograms will be coordinated and supervised by state executing units, established within existing state institutions, supported by technical staff from the participating agencies. Guidelines for establishing the state executing units have been prepared and distributed by the BNB, and evidence that the units have been established and have the capacity to execute the state's subprogram will be a requirement for first disbursement to any state. If necessary, the BNB may require that the state executing unit hire management firms for support in carrying out their responsibilities, but in no case may this be in substitution of the state's executing unit.

3.4 The state executing units will be the only interlocutor with the BNB for the respective state, and will be responsible for maintaining the state's subprogram accounts. Unless otherwise delegated to another state or municipal agency, the state executing units will also be responsible for bidding and hiring of consulting services for the multiple works and institutional development components.

3. Participating state agencies and municipalities

3.5 Responsibility for executing projects under the multiple works component may be delegated to some of the participating state agencies and municipalities, such as the state or municipal water and sewerage companies, urban waste management companies, or the state highway and roads departments. Other participating entities are primarily the beneficiaries of the institutional development component, such as the state tourism and environmental protection agencies and the municipalities where the multiple works will be executed. In these cases, the purchase of equipment or hiring of consultants will be carried out by the state executing units, with the exception of the capital cities which have the demonstrated capacity to undertake bids or select and hire consulting services. Many of the municipalities will eventually receive the executed works, and be responsible for their operation and maintenance.

4. INFRAERO

3.6 The federal airport agency, INFRAERO will be a coexecuting agency under the program inasmuch as it is responsible for the bidding, construction, operation and maintenance of the four federal airports being improved under the program.

B. The transfer of resources to the states

3.7 Bank resources will be transferred to the states via subloan contracts to be signed with the BNB, with the same financial conditions as the Bank loan plus a margin to cover administrative costs including expenses incurred in analyzing projects under the multiple works and institutional development components, and supervising execution of all works including the airport improvement projects. Additional costs to be incurred by the BNB include institutional strengthening and training activities necessary and beneficial to program execution, as well as the costs of the outside consultants to prepare program monitoring reports. However, determination of the margin should also take into consideration the credit risk to the BNB, which in this case is minimal given that the states' subloans will be guaranteed by the federal government's "Fundo de Participação dos Estados", and that the exchange risk of the Bank's loan will be transferred to the states.

3.8 In view of the above, an administrative margin of 2.5% is recommended for loan resources utilized in the multiple works and institutional development components, to be reflected in the operating regulations and, as a special condition for program execution, a margin of 1% is recommended for loan resources used to finance the airport improvement projects. Projections based on these margins indicate that the income generated will permit the BNB to cover costs associated with program execution and to have a margin of security. The margin for multiple works will be reviewed

during program execution and adjusted should circumstances warrant, to a maximum margin of 3%.

C. The operating regulations for institutional development and multiple works

3.9 Administration and execution of the institutional development and multiple works components of the program will be governed by operating regulations. A draft of the main body of the regulations is attached as Annex III-1; a draft of the technical eligibility and evaluation criteria for each sector, which will be annexed as an integral part of the regulations, is on file for review. Presentation of the Regulations by the BNB, for approval by the Bank, is recommended as a condition prior to first disbursement under the program. The most essential aspects of the regulations are highlighted below:

1. Eligibility criteria

3.10 The regulations establish eligibility criteria for both states and for individual projects. For the **states** to be considered eligible for financing under the program, they must: (a) demonstrate financial equilibrium, with a real savings margin sufficient to meet the current debt service of the subloan and of other financial obligations, as well as for the local counterpart resources necessary for program execution; (b) meet the requirements established by Brazil's Senate regarding limits of indebtedness and payment capacity; if an exception to these limits is granted by the Senate, the state should maintain a savings margin available for investments of not less than 40%; (c) be in compliance with federally required contributions from the state; (d) have legislative authorization to assume the financing, transfer guarantees of payment, and not have unserviced loans from federal agencies; and (e) present a tourism strategy and action plan for approval by the BNB and the Bank.

3.11 In the event that a state does not meet the eligibility criteria at the time it presents projects for financing under the institutional development or multiple works component, the program will allow for these projects to be reviewed by the BNB and the Bank, and for the state to let and initiate the works under its own risk. Should the state become eligible for financing under the program within the time limits to avail itself of loan resources (see paragraph 3.17 below), the program will allow for a recognition of costs as local counterpart or for reimbursement of expenses, incurred during the 18 months previous to the state being declared eligible, provided that all program regulations and pertinent bidding procedures have been followed.

3.12 To be considered eligible for financing under the program, **institutional development and multiple works projects** must reflect the state's tourism strategy and be part of the action plan

approved by the Bank. The projects must also meet specific feasibility criteria established in detail for each sector and for the institutional development projects. In addition, the regulations establish criteria regarding the technical and financial capacity of the agency responsible for executing, operating and maintaining multiple works, and for cost recovery, where applicable. All environmental permit requirements are included in project eligibility, and any project involving population resettlement must provide a resettlement plan for the Bank's approval. There are currently only two projects contemplated in the program (neither of which is in the representative sample), which would involve resettlement of between 200 and 1,000 families living in urban shanty-towns. While neither case is considered difficult, given the potential complexity of this activity, the requirement that the resettlement plan be approved by the Bank is recommended as a special condition of program execution.

2. Review of subloan projects by the Bank

3.13 Those multiple works projects originally proposed for the representative sample but which did not meet the eligibility criteria will be reviewed again by the Bank once fully prepared in accordance with these guidelines. Also, the Bank will review ex ante the first two additional projects in each sector as well as integrated projects for tourism complexes. Likewise, the Bank will review the first two institutional development projects for each type of beneficiary. The Bank reserves the right to review any project approved for financing by the BNB to confirm that the eligibility criteria was applied satisfactorily.

3. Allocation of resources among the states - financing agreements

3.14 The regulations envision that, at the program's outset, the BNB will sign a financing agreement with each state, to be previously submitted to the Bank for non-objection as a condition prior to disbursements for multiple works and institutional development. These agreements will define the state's subprogram and establish the financing framework for its execution, based on cost estimates of the institutional development and multiple works contemplated in that state as per the state's tourism strategy and action plan.

3.15 The agreements will establish the availability of loan resources for each state to execute its subprogram, within the financing limits described in paragraph 3.17 below, for an initial period of 20 months from the effective date of the Bank's loan contract with the BNB. In the case that multiple works under any state subprogram have not been let for bids and awarded during this time period, the loan resources previously reserved for those projects will be made generally available to all states.

3.16 The purpose of this procedure is to give all states an equal opportunity to participate fully in the program, even though some

states are currently less advanced than others in the preparation of their projects. Also, some states are currently impaired from participation due to the financial situation of the state or of a participating agency; the time period contemplated should be adequate to allow these situations to be corrected. Conversely, overall program execution and disbursements should not be held up due to delays by any individual state(s). Most of the states have tourism action plans which go beyond the initial works contemplated under the program, and the operating regulations allow for modifications and additions to the state subprograms subject to prior approval by the Bank.

3.17 Limits to financing. During the 20-month period cited, the amount of loan resources available to each state for institutional strengthening and multiple works will be limited to US$45,000,000 equivalent. During the entire period of program execution, the amount made available to each state will not exceed: (a) 50% of the cost of all projects being financed under the program to that state, including airports if applicable; or (b) any amount which would require the annual local counterpart of the state to exceed 25% of its annual real savings margin. The latter limit is to permit a surplus for the state to finance other obligations.

4. Financing of individual projects - subloan contracts

3.18 Based on the financing agreements, the BNB and states will subsequently sign subloan contracts to finance the individual projects included in the respective state's subprogram.

5. Agreements with participating agencies and municipalities

3.19 The regulations require the states to sign agreements with those state or municipal agencies which will execute, cofinance and/or operate and maintain projects and works within the state's subprogram. These agreements will set forth the obligations assumed by the participating agency, such as maintaining a qualified internal executing unit, adhering to program regulations, and providing for adequate operation and maintenance of the completed works. The states can also require that the state or municipal agency provide part of the local counterpart resources and service part of the respective debt. Model agreements have been prepared by the BNB, based on Bank guidelines.

6. Precedence of institutional development

3.20 The program is committed to assisting the participating state agencies and municipalities to better carry out their respective functions in pace with the execution of the physical works of the program. Consequently, the regulations will require that the institutional development activities of the state tourism entities and environmental protection agencies be contracted prior to the first disbursement for any of the multiple works in that state. Similarly, the regulations will require that the consulting

services for a local executing agency (i.e. a state water and sewerage company), and for the municipality where the work is located, be contracted prior to first disbursement for the corresponding work.

D. Execution of the airport improvement projects

3.21 The four federal airport improvement projects will be executed, operated and maintained by INFRAERO. The Porto Seguro airport will be executed, operated and maintained by the DTT in Bahia. In each case, the coordination and supervision of project execution vis-à-vis the BNB will pertain to the respective state executing unit for the program.

3.22 Loan resources will be transferred by the BNB to the states in separate subloan contracts for the airport improvement projects, with the same financial conditions as established in the Bank's loan contract with the BNB, plus a commission not to exceed 1%, to cover administrative costs during program execution. The states will assume exchange risks, and their debt service will be guaranteed by their participation in the Fundo de Participação dos Estados (FPE). The federal government is committed to financing the local counterpart for the four federal airports (see paragraph 4.25).

3.23 Prior to first disbursement for any of the airport improvement projects, the respective state must: (a) demonstrate that it meets financial eligibility criteria regarding indebtedness limitations and, in the case of the federal airports, demonstrate that the federal government has earmarked funds for the local counterpart; (b) present their tourism strategy and action plan for approval by the Bank; (c) present signed agreements with INFRAERO or, in the case of Bahia, with DTT, establishing the obligations to be assumed by these agencies; and (d) present the necessary environmental permits for construction.

E. Status of components

1. Institutional development

3.24 The institutional development component has been analyzed and found satisfactory by the Bank on the basis of work plans prepared for each state, which include the projects for municipal governments. These work plans contain the general terms of reference (TORs) and costs of each project, and will form an integral part of the financing agreements to be signed between the states and the BNB. The final versions of the terms of reference for the contracting of each project will be reviewed by the BNB's executing unit when the individual projects are presented for financing. These TORs should adhere to the guidelines and cost limits laid out in the work plans, although minor changes, agreed upon between the states and the BNB, can be accepted to adjust projects to changing needs or priorities of the beneficiary agencies.

2. Multiple works component

3.25 Sixteen projects from the universe have been found to fully meet the eligibility criteria of their respective sectors, as highlighted below. These projects have a combined direct cost of US$70,340,000, which represents 14% of the total budget for multiple works.

a. Sanitation sector

3.26 From the 83 proposed projects for financing under this sector, a representative sample of 9 water supply projects and 10 sewerage projects was analyzed by the Bank. Of these 7 projects fully met the eligibility criteria. The direct costs of these seven projects total US$40,700,000, approximately 20% of the total estimated cost of this sector. The 12 projects that did not meet all the eligibility requirements, including those relating to a state's or a company's financial eligibility, are expected to qualify in the medium term.

3.27 During the analysis of the projects contained in the sample, the suitability and technical justification of the proposed solutions were evaluated, and particular care was taken to identify potential environmental problems that could arise during construction. The purpose of the analysis was twofold: to determine whether the projects qualified and to establish the criteria by which to evaluate the remaining projects in the program.

b. Solid waste management sector

3.28 The projects proposed for financing under this sector are in various stages of preparation, following orientations provided by the Bank. A representative project proposal has been reviewed in greater detail by the Bank to confirm that the guidelines of the Bank are being applied and that the specific technical requirements of the project itself will be satisfactorily addressed. In view of the fact that an approved project for this sector has not been finalized, inclusion of the solid waste management sector in the program is subject to approval by the Bank of at least one project in accordance with the eligibility criteria established in the operating regulations. This requirement will be included as a special condition for program execution.

c. Environmental reclamation and protection

3.29 Of the fifteen projects proposed for financing under this sector, four have been analyzed by the Bank as a representative sample. This sample, amounting to US$2,940,000, corresponds to 12% of the total projects identified to date in this sector. These include the environmental education project in Ceará, the "Parque das Dunas" in Natal, Rio Grande de Norte, a beach and dunes reclamation and protection project in Pecém, Ceará, and a dune stabilization project in Paracuru, Ceará.

d. Roads and urban street systems

3.30 This sector has an adequate representative sample of works, and eligibility criteria have been developed for the remaining projects contemplated. Ten of the 36 projects contemplated (with a total cost of US$116,150,000) have been analyzed, of which five road projects meet all the eligibility requirements; the socioeconomic studies for the urban street system project analyzed are expected to be completed in the near future. The total investment cost of the five complete projects is US$26,700,000, representing 23% of the total budget for this sector. The technical designs for the projects in the sample are finished and the construction plans, bidding documents, and technical and environmental specifications are ready.

3.31 Most of the road construction work will be done within the rights-of-way of existing roads. In cases where land needs to be acquired for program works, the borrower will present the Bank with proof of legal ownership, easements, and any other rights to the properties needed for construction to begin.

e. Historical preservation

3.32 The projects proposed for financing under this sector are in various stages of preparation, following orientations provided by a Bank-financed consultant who visited most of the historical centers with projects in the program. A representative project proposal has been reviewed in greater detail by the Bank to confirm that the general guidelines of the Bank are being applied and that the specific technical requirements of the project itself will be satisfactorily addressed. In view of the fact that an approved project for this sector has not been finalized, inclusion of the historical preservation sector in the program is subject to approval by the Bank of at least one representative project in accordance with the eligibility criteria established in the operating regulations. This requirement will be included as a special condition for program execution.

3. Airport improvement projects

3.33 Both coexecuting agencies — INFRAERO and DTT (in the case of Bahia) — have the technical studies, engineering designs, general and particular technical specifications, and other documents needed to build the works. All are far enough advanced to allow a reliable estimate of costs and to invite bids according to the proposed timetable. In preparing these designs, topographical surveys were done, along with geotechnical and hydrological analyses, studies to locate the sources of materials, and other studies that this kind of construction work normally requires. The Bank has examined these studies and finds them to be adequate.

3.34 The land needed for construction of the enlarged runways, taxiways, aprons, passenger and cargo terminals, and parking facilities is

currently available for all the projects. In the case of Fortaleza's Pinto Martins Airport, the legal formalities have yet to be finalized for the Ministry of Aeronautics and INFRAERO to complete the land swaps to determine which area will be used for civil aviation and which area will be used by the Air Force. It should be noted that no program investments will benefit the Air Force. In all cases – and in keeping with the standard clauses that the Bank includes in every loan contract, before the executing agency can call for bids it will have to supply the Bank with proof of legal ownership, easements, and other rights to all the properties upon which the works planned for each airport are to be built.

F. Disbursement period

3.35 It is expected that the activities and investments of the program will be executed within a period of 54 months from the effective date of the loan contract, resulting in a disbursement period of 60 months. This period is based on the implementation and execution schedules of the institutional development and airport improvement components, and the status of preparation and estimated execution periods for the investments contemplated under the multiple works component.

G. Initiation of works

3.36 As indicated previously, the operating regulations will establish an initial period of 24 months from the effective date of the loan contract for adjudication of the multiple works included in each state's financing agreement with the BNB, after which time any loan resources reserved for those works will be made available for eligible projects from any of the participating states. The loan contract with the BNB will establish as a special condition for program execution a universal period of 36 months from the effective date of the loan contract for the material initiation of all multiple works to be financed with loan resources.

H. Program investment schedule

3.37 The investment schedule is based on the execution program for the airport improvement projects (total cost of US$93,500,000) which are expected to be bid and initiated in the first half of 1995, and for the multiple works projects which have fully met the eligibility criteria (total cost of US$70,300,000) and can also be bid and initiated in 1995. Together, these projects represent 27.5% of the combined direct costs of both components, which is twice the expected investment in the first year as shown in the following table:

In US$000 or equivalent						
	YR 1	YR 2	YR 3	YR 4	YR 5	TOTAL
Bank financing	60,000	100,000	140,000	60,000	40,000	400,000
Local counterpart	47,300	84,900	154,200	66,300	47,300	400,000
TOTAL	107,300	184,900	294,200	126,300	87,300	800,000
Percentage	13.5	23.1	36.7	15.8	10.9	100.0

I. Procurement plan and procedures

3.38 Procurement under the program will be undertaken by the states or, in the case of the four federal airports, by INFRAERO, following the Bank's standard bidding procedures. Procurement of works in excess of US$5,000,000 equivalent, and of goods in excess of US$350,000 equivalent, will be undertaken through international competitive bidding (ICB); these amounts will be reflected as a special condition for program execution. Procurement of services or goods in lesser amounts will follow national bidding procedures, without restrictions on the participation of bidders from the Bank's member countries. Selection of consultants under the program will likewise adhere to standard Bank guidelines.

3.39 The thresholds for the procurement of goods and services were determined based on the nature and location of the multiple works to be undertaken, taking into consideration: (a) the confirmed capacity of local contractors to undertake works of this type; and (b) the historical tendency of foreign contractors and suppliers to not express interest in bids of less than these amounts.

3.40 The procurement plan for the five airport improvement projects and for the multiple works contemplated under the program is outlined in the table below.

MAJOR PROCUREMENT ITEMS	FINANCING %		METHOD	PRE-QUALIFICATION	SPECIFIC PROCUREMENT NOTICES		
	IDB	LOCAL			SEMESTER/YEAR	INTL. PRESS	NAT PRESS
<u>Airport Improvement</u> No. of projects: 5 No. of lots: 5 Total amount: US$93.5	50%	50%	ICB	NO	(3 lots)IV/1994 (2 lots)I/1995	X X	X X
<u>Sanitation Multiple Works</u> Est. no. of projects: 83 Est. no. of lots: 17 Total amount: US$209.2	63%	37%	11 lots ICB 6 lots NAT.	NO	I/1995 (4 lots) II/1995 (2 lots) I/1996 (6 lots) II/1996 (3 lots) I/1997 (2 lots)	X for 3 X for 1 X for 4 X for 2 X for 1	X X X X X
<u>Solid Waste Mgt. Multiple Works</u> Est. no. of projects: 19 est. no. of lots: 7 Total amount: US$14.6	63%	37%	NAT	NO	II/1995 (2 lots) I/1996 (1 lot) II/1996 (3 lots) I/1997 (1 lot)		X X X X
<u>Environmental Reclamation & Protection Multiple Works</u> Est. no of projects: 13 Est. no. of lots: 9 Total amount US$25.0	67%	33%	NAT	NO	I/1995 (2 lots) II/1995 (1 lot) I/1996 (2 lots) II/1996 (2 lots) I/1997 (2 lots)		X X X X X
<u>Transportation Multiple Works</u> Est. no. of projects: 43 (roads & street systems) Est. no. of lots: 18 Total amount US$116.2	66%	34%	10 lots ICB 8 lots NAT	NO NO	I/1995 (4 lots) II/1995 (4 lots) I/1996 (5 lots) II/1996 (5 lots)	X for 3 X for 2 X for 3 X for 2	X X X X
<u>Historic Preservation Multiple Works</u> Est. no of sites: 7 Est. no. of lots: 28 Total amount: US$58.5	67%	33%	NAT	YES**	II/1995 (4 lots) I/1996 (4 lots) II/1996 (12 lots) I/1997 (8 lots)		X X X X

** For works directly related to the restoration and preservation of historic buildings or monuments.

J. <u>Disbursement procedures</u>

3.41 Under the program, the Bank can advance to the BNB up to 10% of the loan value, as a revolving fund, contingent upon disbursement forecasts to be presented by the BNB based on signed subloan contracts with the states. In turn, the program will allow for the BNB to advance to the states with signed subloan contracts up to 10% of the value of these contracts. When receiving an advance of funds, the states will use the resources to pay contractors, suppliers or consultants whose contracts have received the non-objection of the BNB and the Bank, and will subsequently present

the required documentation supporting the payments to justify the advance, in accordance with the operating policies of the Bank. The program also allows for the BNB to choose to be directly responsible for all disbursements under the program.

K. Operation and maintenance

3.42 Different state or municipal agencies will be responsible for operating and maintaining the works built under the program. In the case of the sanitation sector, responsibility will be borne by the state companies that now operate the water supply and sewerage systems. In the transportation sector, responsibility will rest with the highway departments of the participating states, to which the roads built under the program will be transferred. Through their public works departments and sanitation departments or companies, the municipal governments will be responsible for maintaining the urban street systems, storm sewer systems, and solid waste management systems, respectively. Lastly, the airport-improvement projects will be administered and operated by INFRAERO, a federal agency — except for the Porto Seguro airport, which will be run directly by the Bahia State Department of Transportation and Terminals.

3.43 All these agencies have the organization, staff, experience, and resources needed to perform the necessary functions either themselves or through contracts with private companies. As noted earlier, the institutional-strengthening component will significantly enhance the participating agencies' capacity to manage and maintain the works.

3.44 To ensure proper follow-up for this phase of the program, the loan contract will include a special condition for program execution requiring the BNB to submit to the Bank, for a ten-year period following completion of the first work under the program, the annual maintenance plans for the five airport projects and for a representative sample of works agreed upon with the Bank in each of the eligible sectors, together with a report on the maintenance performed during the previous year and the condition of these works and equipment. Furthermore, the operating regulations will require the States to submit to the BNB the annual maintenance plans and records for all multiple works financed under the program, which will be available for Bank review.

L. Monitoring program execution

3.45 A periodic monitoring and assessment of program implementation will be carried out during program execution, which will not only review compliance with program objectives but also appraise movements in the region's tourism which could have an impact on the program's design. This is especially important given that the participating states may need to adjust their strategies and modify their action plans during the course of program execution. Special consideration will also be given to reviewing the environmental

impact of program execution. This monitoring will be carried out jointly by the Bank and the BNB, with the participation of the federal PRODETUR/NE Committee and the regional CTI/NE, based on periodic reports to be prepared by the BNB's executing unit with the assistance of outside consultants.The cost of report preparation is included in the administrative overhead of the BNB. The loan contract will include a special condition regarding the program monitoring reports.

3.46 The initial report will cover the first 15 months of program execution, from the effective date of the loan contract, and should be presented to the Bank within the following 60 days. Thereafter, the reports will be prepared on an annual basis, for two more years, and presented within 60 days following the close of the review period. The Reports will focus on, but not be limited to, the following areas: (a) the effectiveness of the program's focus and of the state's strategies; (b) the impact of the program on the administrative and operative situation of the entities benefitting from subloan financing; (c) the impact of the training programs on beneficiary personnel, including quality enhancement of project preparation and analysis; (d) compliance and effectiveness of environmental protection and control measures; (e) cost recovery of investments, when applicable; (f) the costs of investments and of institutional development projects; (g) qualitative aspects of operation and maintenance of financed projects; and (h) the targeted impact of the overall program.

M. <u>Ex post evaluation</u>

3.47 To assess both the direct benefits of the works and activities to be executed as well as the program's impact on the tourism sector in the Northeast, BNB officials agreed to an ex post evaluation of the results of the proposed operation, which is included as a special condition for program execution. Accordingly, the BNB will compile and make available to the Bank general data on the program's overall impact as well as an in-depth evaluation of a sample of projects agreed upon with the Bank in each sector.

3.48 The general information to be provided will include the following: (i) statistics on anticipated and actual costs of the works, the number of projects projected and executed in each sector, and the number of beneficiaries from water supply and sewerage projects, the tons per/day of solid waste treated and disposed, the extension of roads improved, and the number of hectares benefiting from environmental and historical preservation projects; (ii) results of the institutional strengthening activities (municipal governments, state agencies, water companies, etc.); (iii) statistics on the number of domestic and foreign tourists, length of stays, and amounts spent, identifying -- whenever possible -- factors that influenced those figures but were unrelated to the program; (iv) a description and evaluation of the major problems detected during program execution and the corrective measures taken or proposed; (v) the adequacy of the tourism strategies and action plans; (vi)

costs and effectiveness of the measures taken to mitigate negative environmental impact, as recommended in the environmental management plans and the environmental impact assessments and studies.

3.49 The following reports are planned as part of the evaluation process: (i) An initial report, prepared within 12 months of the contract signature date, will contain a detailed description of the system that will be used to compile and process the necessary data and the sample of projects for the ex post evaluation; ii) Progress reports, to be presented within 18 months of the effective date of the loan contract and every year thereafter until the second year following the final disbursement; the first of these reports will include the initial baseline data to be used in the ex post evaluation according to the methods and indicators outlined in the initial report and agreed upon with the Bank; subsequent reports will present updated data and information on the progress achieved; and (iii) An ex post evaluation report, presented within the three years following the final loan disbursement, will focus on all aspects covered in the initial report and agreed upon with the Bank.

N. Environmental impact

3.50 At its meeting of January 25, 1994, the Bank's Environment Committee classified this project as a Category III operation. The environmental summary, approved on October 4, 1994, describes in detail the studies done, the environmental impact assessment, measures to mitigate that impact, and the environmental institutional-strengthening programs.

IV. THE BORROWER AND EXECUTING AGENCIES

A. The borrower, executing agency and co executing agencies

4.1 The borrower and executing agency will be the Banco do Nordeste do Brasil (BNB), which will transfer the loan proceeds to the states participating in the program. The states will be responsible for executing their respective subprograms and for providing the corresponding local contribution. For the federal airport improvement projects, the local contribution will come from the federal government, which will also be the guarantor of this operation.

B. The Banco do Nordeste do Brasil

1. Institutional aspects

4.2 The BNB is a corporation whose principal shareholder is the federal government, which holds 57% of the share capital directly through the National Treasury and through BNDES Shares, Inc., a BNDES subsidiary that is wholly owned by the federal government.

a. Organization

4.3 The BNB is managed by an administrative council. The council, whose members are elected by the general stockholders meeting and which is presided over by a representative of the Finance Minister, establishes the BNB's operating and administrative policies and guidelines. The BNB's functions and responsibilities are distributed among directorates and superintendencies. The heads of these offices, together with the BNB's president, constitute the board of directors, which is the bank's top decision-making body, although superintendents do not have a vote on the board.

4.4 The directorates for lending operations are classified by type of operation: rural, industrial and infrastructure (considered development credit) and general credit and import/export financing (considered commercial credit); each directorate has a development department for its areas of activity. Within the infrastructure lending directorate is the Integrated Projects and Infrastructure Department (DEPRI), which is where the executing unit for this program will be established.

4.5 The BNB has the following superintendencies: (a) Finance, which oversees the bank's borrowing, manages its financial operations, and keeps its books; (b) Operations Monitoring, which manages the loan portfolio; (c) Planning and Institutional Development, which conducts economic studies of the region and is responsible for

overseeing the Bank's organizational structure; and (d) Regional Offices, which is in charge of all matters related to the management of — and support for — the BNB's branch offices.

b. Personnel

4.6 The BNB's staff numbered 5,584 in June 1994, compared to 5,670 in December 1993. Since 1990, staff levels have dropped by 1,164 positions (a 17 percent reduction) as the result of the BNB's policy of streamlining and automating its operations to increase productivity. Current staffing levels are considered adequate.

c. Internal auditing

4.7 The Internal Auditing Office is part of the system of internal controls; the office answers directly to the administrative council which reflects an adequate hierarchical position within the organization. The structure of this office and the way its activities are planned enable it to discharge its functions properly.

d. External control

4.8 The BNB's annual financial statements are audited by an independent firm of public accountants, which has issued unqualified opinions. As a special condition of program execution, it is recommended that the BNB's annual financial statements be audited, for the duration of program execution, by an independent firm of public accountants acting under the supervision of the Federal Controls Secretariat, which will send directly to the Bank a statement on the audit report. During the life of the loan, the borrower's financial statements will be audited by a firm of public accountants acceptable to the Bank.

2. Financial aspects

4.9 The analysis of the BNB's financial condition was based on the audited financial statements for the last three fiscal years and those for the first six months of 1994.

4.10 The statements show that as of June 30, 1994, the BNB's assets stood at US$3,101,000,000 equivalent, as compared to US$1,963,000,000 equivalent as of December 31, 1991. In other words, assets increased by 58% during the period.

3. Loan portfolio

4.11 In the period examined, the BNB's portfolio history was as follows:

BNB lending portfolio (US$000s)				
Development credit	12/31/91	12/31/92	12/31/93	6/30/94
Rural	350,438	425,583	546,337	586,670
Agribusiness	38,179	92,421	105,179	112,026
Industrial	598,257	834,271	860,641	862,319
Infrastructure	431,870	573,198	660,819	763,354
Subtotal	1,418,744	1,925,473	2,172,976	2,324,369
Commercial credit				
General credit	70,016	73,427	225,796	275,379
Import/export fin.	122,110	106,416	112,993	137,221
FNE transfers to banks	5,946	8,382	20,170	18,353
Subtotal	198,072	188,255	358,959	430,953
TOTAL	1,616,816	2,113,698	2,531,935	2,755,322

4.12 The BNB's portfolio grew by 70% over the period; by June 30, 1994, it represented the equivalent of US$2,755,000,000, or 89% of the bank's total assets. Loans to the private sector account for 77% of the portfolio, with the majority falling under the heading of development credit. As of June 30, 1994, these loans – granted for medium and long terms – accounted for 85% of the portfolio.

4.13 Industrial development is the biggest lending category in the area of development operations, especially the textile, mineral, and construction sectors. Next in order of importance are infrastructure loans, which include financing for electric power projects, roads and highways, and water and sewerage systems.

4.14 The portfolio has an acceptable recovery rate. As of June 1994, loans less than 60 days in arrears represented 5.8% of the portfolio, whereas those over 60 days in arrears accounted for 1.2%. The BNB has established the reserves required under the standards set by the Central Bank. During the period examined, loans totalling US$14,000,000 were classified as uncollectible.

4. Sources of revenue

4.15 During the period examined, the BNB's chief source of funds was the Fondo Constitucional de Financiamiento do Nordeste (FNE), established under Brazil's Constitution and managed by the BNB. During this time, the FNE saw an increase of 70% – from US$626,000,000 as of December 31, 1991, to US$1,060,000,000 as of June 1994, when it accounted for 34% of the BNB's assets.

4.16 Transfers of funds for onlending are another major source of resources. As of June 30, 1994, the BNB had received transfers from FINAME, BNDES, CEF, FINEP, the World Bank, and the IDB totalling US$740,000,000.

4.17 The BNB has also raised funds by floating bonds on foreign markets. In 1993, it floated bonds for US$175,000,000 that will mature in 1995 and 1996; a 1994 bond issue for 6,000,000,000 yen will mature in 2002. The proceeds from these operations are earmarked for commercial loans.

4.18 Deposits are another important source of funds, totaling US$447,000,000 as of June 30, 1994 – up 120% over deposits at the end of 1991.

4.19 The analysis shows that the BNB's resources for supporting its lending operations have increased each year, and that the funds available through the FNE will enable the BNB to expand its lending portfolio.

5. <u>Operating income</u>

4.20 The BNB's income statements show that income from the bank's activities as financial intermediary has always been sufficient to cover the costs of its borrowing, although levels have varied from year to year. It is worth remembering that the funds received from the FNE – currently the BNB's main source of revenue – do not entail any financing costs for the BNB.

4.21 Overhead costs were higher in fiscal 1992 owing to salary adjustments that took place that year. There were no further salary adjustments in 1993 and 1994.

4.22 Net earnings increased during the period as a result of the expansion in the BNB's operations. However, these earnings represented a smaller portion of the funds available to the BNB for financing its additional operations.

4.23 In sum, the BNB's financial statements show that in the period examined its loan portfolio grew substantially and delinquency ratios were low. The FNE, deposits, and transfers from local and international financial institutions have been important factors in this expansion.

C. <u>Coexecuting agencies</u>

4.24 The states of the region will act as coexecuting agencies for the program and will be responsible for carrying out the state subprograms, which include multiple works and institutional development activities. The states will assume a commitment with the BNB to provide the local contribution for their respective sub-programs, although they may reach agreements with participating

agencies or municipalities whereby the latter agree to pay some portion of the local contribution.

4.25 INFRAERO will provide technical support for execution of the federal airport improvement projects and will be responsible for their operation and maintenance. The federal government has pledged to finance the local contribution for the federal airports, for up to 12.5% of the total cost of the program and 50% of the cost of each airport project. The state of Bahia is responsible for providing the local counterpart for the airport project in Porto Seguro.

4.26 The BNB has presented an analysis of the financial condition of the regional states. The purpose of this analysis is to establish the states' financial eligibility and to draw up the eligibility criteria that will be included in the program's operating regulations and in the loan contract. The methodology and parameters used by the BNB to evaluate the states' financial condition and to determine their eligibility to receive financing under the program are considered acceptable.

4.27 The analysis shows that all the states have a positive adjusted real savings margin 4/, which varies according to each state's financial capacity. For a 12-month period, the adjusted real income and savings margins were as follows:

(US$ 000,000)		
State	Adjusted real income	Adjusted real savings margin
Bahia	1,761	715
Ceará	918	440
Maranhão	528	185
Paraíba	521	264
Pernambuco	862	68
Rio Grande do Norte	383	46
Sergipe	316	117
Alagoas	305	51
Piauí	326	119

4.28 During the one-year period, all the states showed a margin of current savings. Bahia had the largest margin (US$715,000,000),

4/ Real savings margin: Real net income less net current expenditures. Real net income is the total income less proceeds from loans, and statutory or grant transfers to municipalities. Net current expenditures are the current expenditures paid less financing costs and transfers to municipalities.

while Rio Grande do Norte had the smallest (US$46,000,000). To ensure that execution of each subprogram at the state level does not limit the funds available for other investments, one of the eligibility requirements for the states is that the local contribution that they are to make to the program out of their own resources may not exceed 25% of their adjusted real savings margin. The operating regulations for the multiple works projects allow the states to conclude agreements with agencies or municipalities participating in their subprograms whereby the latter would pay some portion of the local contribution. Any such contributions would not be included in the aforementioned 25% ceiling.

4.29 In determining the states' eligibility, guidelines set by Brazil's Senate have been applied, which establish that a state may not incur additional debt if its reserve for paying its current internal and external consolidated debt exceeds 15% of the state's adjusted real net income.

4.30 At the present time, all the states except Alagoas and Paraíba are eligible to receive financing; these two states could qualify in one or two years, respectively. Since there is a possibility that the Senate might waive the indebtedness limit described in paragraph 4.29 above, the operating regulations stipulate – in order to keep debt at acceptable levels – that the margin available for investment shall always be at least 40% of adjusted real savings.

4.31 The analysis undertaken by the BNB shows that all the eligible states have an acceptable margin of available net savings that could be used for investment purposes. 5/

D. Participating state agencies

4.32 In each state, depending on the type of works included in the state's subprogram, there will be participating state or municipal agencies, including the respective state or municipal water and sewerage companies, the state road or transportation departments, municipalities, and municipal enterprises.

1. Water and sewerage companies

4.33 The water and sewerage companies that participate in the program will not assume any financial responsibility to the BNB, since the respective state will be responsible for both the local contribution and debt service. States may require, however, that their water and sewerage companies be responsible to them for part or all of the local contribution and debt service.

5/ Margin of available net savings: Margin of real savings less debt-service payments.

4.34 For these companies to participate in the program by executing works and subsequently operating and maintaining them, the revenue produced by the rates they charge must cover their operating and maintenance costs (depreciation excluded) as of the date the respective subloan is approved, as established in the Bank's tariff policy. (This requirement does not apply to eligibility for the institutional-strengthening component.) Based on an analysis of their financial statements, at the present time the state companies of Piauí, Ceará, Paraíba, Pernambuco, Sergipe and Bahia are eligible to participate in the multiple-works component. The state companies of Alagoas, Rio Grande do Norte, and Maranhão do not currently meet this requirement. Should this situation continue and prevent program financing for water and sewerage projects in these three states, the remaining investments contemplated would still be beneficial and viable.

4.35 The water and sewerage companies that meet the minimum tariff eligibility requirement should obtain, over a reasonable amount of time, rate structures that conform to Bank guidelines. As a special condition for program execution, the borrower must require these companies to take measures necessary to ensure that, within four years, their tariff structure covers their full operating costs, including management, operation, maintenance, and depreciation, and still show a reasonable return on the sunk investment. This rate of return will be established in such a way that the company's internally generated funds will be sufficient to service its debt and to finance its expansion program.

2. State and municipal transportation departments

4.36 The state highway departments will be responsible for physical execution, and subsequent operation and maintenance, of the road and highway projects planned under the program, whereas the public works departments of the participating municipal governments will be responsible for the urban street and storm sewer works. Having examined the technical capacity of these entities, the Bank finds that they have the structure, organization, and technical capacity needed to execute and maintain their respective components.

4.37 Through its Department of Transportation and Terminals, the State of Bahia will be responsible for the construction and subsequent operation and maintenance of the state-run Porto Seguro airport. The state is also responsible for providing the counterpart resources for this airport.

E. INFRAERO

4.38 INFRAERO is responsible for operating and maintaining all federal airports. The local contribution for projects involving federal airports is the responsibility of the federal government. The sum of US$18,000,000 was earmarked in the Ministry of Industry, Commerce, and Tourism's 1994 budget to cover that year's local contribution for the airports in São Luís, Natal, and Aracaju. The

sum of US$22,000,000 is being proposed for the 1995 and 1996 budgets to cover the local contribution for the Fortaleza airport.

4.39 Estimates are that INFRAERO will have the additional funds needed to operate and maintain these works, since revenues from its current rates are sufficient to cover all its operating costs, with a substantial amount left over for investment.

V. PROGRAM VIABILITY

A. Tourism development in the Northeast

5.1 This program has been designed to assist the Northeastern states to implement tourism strategies and action plans which have evolved significantly during program preparation, following orientations by the Bank, and generally may be considered satisfactory. The goals established within the strategies are realistic, and the corresponding action plans are demand-driven. Priority has been given to meeting the needs of the existing tourism areas with the highest return in each state, where the capacity to provide infrastructure and public services has not kept pace with demand. The limited number of investments going to relatively new tourism areas will be justified based on proven demand projections.

5.2 The major challenge facing the Northeast in implementing its tourism strategy is to upgrade its service and transportation infrastructure to the requirements of the international market. Sanitary conditions, especially a safe water supply and environmentally clean surroundings, as well as easier air transport access to the region, are fundamental to meeting the region's tourism goals. While there are clear indications of interest on the part of tourist operators and investors which support projections for continued growth in the region, the impact of this program will be differentiated among the participating states depending on the initiatives and leadership being taken to stimulate tourism activities.

B. Financial viability

5.3 The states participating in the program assume responsibility for providing the local contribution for their respective multiple-works and institutional-strengthening subprojects and, in Bahia's case, the state airport. They will receive the proceeds from the Bank loan under the same financial terms and conditions that the IDB establishes in its loan to the BNB, plus a spread for administrative costs. The BNB has established the procedures it will use for evaluating each state's financial condition, i.e., the state's borrowing capacity and its ability to provide the local contribution. A review of the states' present financial standing based on budget execution and indebtedness levels indicates that they will be able to handle the financial obligations that the program involves. The exceptions are the states of Paraíba and Alagoas, where debt service as a percentage of revenue exceeds the allowed limit. However, this is a temporary situation and is expected to be remedied within 24 months at the latest.

5.4 Eligibility for state water and sewerage companies to participate in the program depends on their being able to cover all their operating and maintenance costs with the revenue from the rates

they charge as of the date of approval of the subloan for this component. All the companies qualify on this point, except for those of Maranhão, Rio Grande do Norte, and Alagoas.

5.5 The local contribution for the federal airport projects will come from appropriations under the MICT budget. The necessary budgetary appropriations are already being made and, given the priority attached to this program, future appropriations should pose no problems. INFRAERO, a federal agency, will be responsible for operating and maintaining these works and has ample experience in this area; its income structure will allow it to cover any additional costs the project may involve.

C. Institutional viability

5.6 The program's executing agency, the BNB, has an adequate organizational structure and suitable internal control procedures. It has properly managed the funds it has received both from the federal government and from local and international financial institutions. The size of its loan portfolio indicates that it will be able to efficiently administer and lend the proceeds of the IDB loan.

5.7 The BNB will set up an executing unit for the program, which will have the necessary capacity to evaluate and monitor the program's projects. To perform its activities, the unit will use DEPRI's regular staff, and will also receive support from consultants who will assist in evaluating project financing requests.

5.8 Within each state, activities will be coordinated by state executing units which will operate according to guidelines established by the BNB and acceptable to the Bank, which includes the participation of state and municipal agencies participating in the program. These units will be in charge of project management at the state level, with support from management firms.

5.9 Those agencies which will assume responsibility for operating and maintaining a project once execution has been completed either have sufficient capacity to do so, or will be the beneficiaries of institutional development support under the program to enhance this capability.

D. Economic viability

5.10 To determine the socioeconomic viability of each project in the sample, the following aspects were examined: that the dimensioning of the project is based on existing and realistically forecasted demand, and that the technical solution adopted by the project is the least-cost alternative. The costs used in the evaluation were calculated at efficiency prices. Cost-benefit analyses were used in all sectors except for the sewerage and environmental projects, which were evaluated on the basis of cost-efficiency.

5.11 The Bank's SIMOP model was used for the <u>water supply and combined water supply-and-sewerage projects</u>. The cost-efficiency ratios of projects that did not include sewerage services were analyzed to determine that they were within established acceptable limits. A total of ten projects were evaluated, with a total cost of US$77,000,000. Of these, four projects totaling US$41,000,000 proved to be viable. In order to standardize and facilitate the application of demand and cost efficiency ratios, a special condition for program execution will be included in the contract as follows: *within ten months of the signing of the loan contract, the BNB will — using methods agreed upon with the Bank — submit the following to the Bank's satisfaction: (i) a study of water demand in northeastern Brazil; and (ii) an updated estimate of the cost-efficiency ratios for the sewer projects.* Two months from the time the BNB and the Bank approve the studies' findings, the BNB will apply the results in its analysis of the program's sanitation projects.

5.12 In the environmental sector, three investment projects were examined: two beach preservation projects at a cost of US$820,000 and a third project for a state park for dune conservation at a cost of US$1,000,000. The first two projects were found to be the least-cost alternative and an acceptable means of protecting sizeable investments in property and urban infrastructure. The third project was also the least-cost alternative. In addition, the findings of a willingness-to-pay analysis for the state park indicate adequate return rates, based on which the park should establish an effective fee system.

5.13 The HDM model (Highway Design and Maintenance Standards Model) was used to estimate savings in vehicle-operation and road-maintenance costs for the two road projects in the sample. Another factor considered was savings in time, whose value was measured in terms of drivers' salaries. Traffic counts and origin-destination surveys were used to determine flows of normal and diverted traffic. Projections were based on population and income growth in the service area. Generated traffic estimates were based on expected tourism development (hotels and summer homes) in the service areas of the various projects. During the analysis, the proposed projects were updated in accordance with traffic projections and to ensure that all stretches had an economic internal rate of return of at least 12%. By adjusting and/or scaling back the end stretches of the proposed roads in the first project, the investment of US$31,100,000 initially planned was optimized to US$23,200,000. The second project, which was to cost US$12,700,000, was not viable under the high technical standards being proposed, but can and will be modified to fully meet the eligibility criteria.

5.14 The airport improvement works in São Luís, Aracaju, and Natal are intended to afford users greater comfort and safety by expanding and upgrading the passenger terminals. At the Porto Seguro and Fortaleza airports, there is the additional aim of improving

aircraft operations by widening runways or relocating the passenger terminal. With the first group of projects, the users' willingness to pay in order to have more comfortable passenger terminals was estimated. With the second group of projects, the benefits of lower aircraft operating costs were factored in as well. All the projects evaluated had an economic internal rate of return greater than 12%, the minimum required by the Bank. Although the return on the Fortaleza project was only slightly above the minimum (12.4%), the benefits that would accrue from constructing the terminal access road were not considered. Similarly, should airfares come down, the rate of return will be higher.

5.15 Other projects presented and analyzed as part of the initial sample were not at a stage of preparation to meet the eligibility requirements. These were: (i) a solid waste management project, which needs to devise a comprehensive solution that includes waste collection and disposal and environmental education; and (ii) an historical preservation project, which should be presented as an integrated program, with completed designs for the planned infrastructure and a selection and cost estimate of the restoration work needed. These projects must be reformulated and completed so that they can be reviewed by the BNB and the Bank, with the expectation that these two sectors can then be declared eligible under the program. There are also two comprehensive tourist complexes proposed under the program, which are to be examined in light of the entire package of works and measures necessary to yield benefits (infrastructure, superstructure, marketing, etc.). These integrated projects will be analyzed by both the BNB and the Bank.

5.16 The results of the analysis undertaken of the projects which were considered eligible to be included in the sample are presented below:

Project and sector	Direct cost** (US$000)	Economic internal rate of return (%)
Paraipaba (CE) — water and sewer	2,300	13.0
Paracuru (CE) — water and sewer	3,806	14.0
Aracaju (SE) — water and sewer	34,247	12.0
Atalaia Nova (SE) — water	345	26.0
Ceará — roads	26,729	21.3
State dune park (RN) — environment	1,165	1/
Protection Pecém beach (CE) — environment	420	1/
Environmental education (CE) — environment	805	1/
Protection Paracuru beach (CE) — env.	551	1/
Subtotal — Multiple works	70,340	
Natal (RN) — airport	15,700	22.1
Fortaleza (CE) — airport	58,200	12.4
Aracaju (SE) — airport	6,710	18.7
São Luís (MA) — airport	7,210	17.7
Porto Seguro (BA) — airport	5,700	25.4
Subtotal — Specific works	93,520	
Total	163,860	

**/ For the multiple-works projects, the direct cost includes cost escalation and contingencies.
1/ Least cost.

E. Technical viability of works

5.17 The analysis of the sample of projects from the multiple-works subprogram (sanitation, roads, urban streets, storm sewerage, and environmental protection) and the assessment of the airport projects indicates that the works proposed in the various sectors are both technically and operationally feasible. Each project responds to amply justified needs to build and/or expand existing facilities, improve service levels, or protect the environment.

5.18 This conclusion is mainly based on the following: (i) the engineering designs and specifications have been prepared by consulting firms according to appropriate standards that are consistent with generally accepted engineering practices; the dune management projects are based on pilot experiments that yielded positive results; (ii) the estimated costs were considered reasonable and comparable to recent costs for similar works; also, funding has been included for contingencies and possible increases in the cost of works during execution; (iii) the proposed five-year timetable for execution is considered realistic; (iv) the executing agencies have sufficient experience to contract out and supervise the construction work and to perform all the duties related to the operation and maintenance of the works; the institutional-

strengthening program will enhance their administrative capacity; (v) contractors and suppliers of equipment and materials are expected to be sufficiently interested to make bidding competitive; (vi) because the proposed works are relatively simple, no technical problems are anticipated during construction that could adversely affect costs or the term for execution; and (vii) the program's executing unit within the BNB will have qualified staff to review future projects, using as a guide the technical eligibility criteria set forth in the program's operating regulations.

5.19 For those sectors that did not have fully developed projects in the program's sample, such as urban solid waste management and historic preservation, the available studies were evaluated and provided confirmation of the importance of including these two sectors in the program. The Bank will review the studies for the first projects in each sector as soon as they have been completed. As with the other sectors, the technical eligibility criteria will ensure a proper selection of projects.

F. Environmental viability

5.20 The program's environmental viability stems largely from the fact that the states will pursue tourism strategies that assign high priority to preserving and enhancing the natural, cultural, and historical resources and the fact that it includes projects that will improve sanitation and public health while also protecting the environment.

5.21 Brazil's environmental policy and regulations are consistent with the Bank's policy of guaranteeing the environmental quality of the projects. The environmental licensing process was begun at the same time the projects in the sample were being prepared, and the operating regulations include eligibility criteria to guarantee that environmental considerations are taken into account when designing and executing the projects.

5.22 Since the state environmental protection agencies of northeastern Brazil display varying degrees of development and institutional strength, an important institutional-strengthening component has been included and environmental control mechanisms have been instituted in the executing agency. These measures will help to ensure that a proper system of environmental licensing and control – that is consistent with domestic law and Bank policy and procedures – will be put into place.

5.23 The projects in the sample have been analyzed from an environmental standpoint. The environmental licensing procedures have been followed, and in each case modifications and/or requirements have been introduced to mitigate the environmental impact, to revitalize degraded areas, and to educate the public.

G. Focus and distributional impact

5.24 According to the Brazilian statistics institute (IBGE), over 55% of Brazil's total population living below the poverty line are in the Northeast. This group represents 45% of the region's total population. Additionally, more than 60% of the population living in the communities to benefit from the sanitation, roads and environmental reclamation projects evaluated in the preparation of the program, is in the low-income bracket (in some cases, that figure is as high as 100%). Thus, in keeping with the guidelines of the Eighth Replenishment, this program, by focusing on areas with a predominantly low-income population, qualifies as targeted under criterion A. At the same time, it should be noted that over 50% of the direct benefits generated by the program as a whole will accrue to low-income groups. Estimates are that the infrastructure works will not affect women more than other groups.

NORTHEAST TOURISM DEVELOPMENT PROGRAM
PRODETUR/NE

OPERATING REGULATIONS

I. PURPOSE AND DEFINITIONS

A. Purpose

1.1 The purpose of these Regulations is to establish the terms and conditions that shall govern the multiple-works and institutional-development components of the Northeast Tourism Development Program (PRODETUR/NE). These Regulations shall determine the relationships between the program's funding and executing agencies and specify general rules on financing, eligibility, and conditions for program execution.

B. Definitions

1.2 In these Regulations, the following terms shall have the meaning indicated below:

a. **IDB**
Inter-American Development Bank

b. **BNB**
Banco do Nordeste do Brasil S.A., acting as the borrower, executing agency, and financial intermediary. under the program's Operating Regulations.

c. **STATE**
Each of the states in the Northeast region that participates in the program.

d. **PROGRAM**
Northeast Tourism Development Program (PRODETUR/NE), financed with proceeds from the loan and the local counterpart.

e. **SUBPROGRAM**
Each participating state's group of projects to be financed under the program.

f. **PROJECT**
The work or service to be provided as part of each state's subprogram.

g. **LOAN**

Financing from the IDB to the BNB, under the terms of the loan contract(s) ....., concluded on . . . .

h. **SUBLOAN**
A loan granted by the BNB to a state, in accordance with the program's operating regulations, to finance projects in each state's subprogram.

i. **FINANCING AGREEMENT**
The agreement concluded between the BNB and the state stipulating the general conditions for program execution.

j. **SUBLOAN CONTRACT**
Legal instrument whereby subloans are formalized.

k. **CENTRAL EXECUTING UNIT**
The unit created within the BNB to manage the program, including analysis and approval of loan requests and program supervision and monitoring.

l. **STATE EXECUTING UNIT**
The unit created at the state level to coordinate, supervise, and financially manage the respective state's subprogram.

m. **LOCAL EXECUTING AGENCIES**
State water and sewerage companies, state highway departments, and other state or municipal agencies responsible for physical execution of the works and services financed under the program.

n. **BENEFICIARY AGENCIES**
State or municipal agencies that receive the works, equipment, or services financed under the program, even when those agencies have not been directly responsible for their execution.

II. PROGRAM OBJECTIVES AND DESCRIPTION

A. Objectives

2.1 The basic objective of the program is to reinforce the capacity of Brazil's Northeast to maintain and bolster its growing tourism industry, thereby contributing to the region's socioeconomic development. The program's principal goal is to supply basic infrastructure and public services in areas of existing tourism growth, where state capacity has not kept pace with demand; these investments will largely benefit the low-income population in the selected areas. By upgrading conditions in tourism areas, the program also aims to attract additional or improved private sector tourism activities, thereby generating employment opportunities, raising income levels, and increasing state revenues.

2.2 This objective will be pursued by implementing the tourism strategies developed by the states and transformed into action plans that combine priority projects in infrastructure, public services, and institutional development, in a general effort to galvanize tourism activities and the private sector's participation in the sector.

B. Program description

2.3 The program will finance multiple works in basic infrastructure and public services, five specific airport-improvement projects, and institutional-development projects considered pivotal for promoting tourism in the region.

2.4 These Operating Regulations shall apply solely to execution of the program's multiple works and institutional-development components, with a view to ensuring that the intended objectives are achieved.

1. Multiple works: eligible sectors

2.5 Works and investments in the following sectors shall qualify for program resources, provided the sector has been declared eligible by the BNB and the IDB:

a. Sanitation (water supply and sewerage systems)
b. Solid waste management
c. Environmental reclamation and protection
d. Transportation (urban street systems and roads)
e. Historic preservation

2. Institutional development

2.6 This component will finance technical assistance to agencies participating in the program, the preparation and implementation of urban and environmental development plans, and human resource training.

III. ELIGIBILITY

A. Eligibility of states

3.1 States meeting the following requirements shall be declared eligible to receive financing under the program:

a. demonstration of financial equilibrium, with a real savings margin sufficient to cover debt service on the subloan and all other financial obligations, as well as the local counterpart resources needed to execute the project and other works for which it is responsible;

b. compliance with federal Senate guidelines, including those related to borrowing limits and payment capacity; should the Senate grant a waiver for these limits, the state is to maintain a savings margin of not less than 40% for investments;

c. compliance with the PIS/PASEP, FINSOCIAL/COFINS, INSS and FGTS;

d. possession of specific legislative authorization to assume the loan and to assign FPE or FPM quotas of sufficient value to service the financial obligation assumed, in addition to guaranteeing the availability of local counterpart in its current and future budgets;

e. does not appear in the registry of unpaid loans from federal entitites (CADIN); and

f. has a tourism strategy and action plan approved by the BNB and the IDB.

B. Eligibility of projects

3.2 Projects meeting the following requirements shall be eligible for the program financing:

a. the project must reflect the state's tourism strategy and be part of the action plan approved by the BNB and IDB;

b. the Local Executing and/or Beneficiary Agency must demonstrate that it has the technical and organizational capacity and the financial equilibrium to guarantee that the planned projects will be carried out, operated, and maintained. Should there be any financial shortcomings, the agency must show that it is undertaking adjustments to achieve equilibrium, including institutional-development measures available under the program;

c. the project must meet all technical and legal requirements under the polluting activities licensing system [*sistema de licenciamento de atividades poluidoras*, SLAP]), presenting all required permits (preliminary, installation and, where necessary, the operating permit) and adopting all necessary environmental protection and management measures;

d. whenever a project involves expropriations that necessitate relocating the local population, the resettlement plan must be presented;

e. whenever a project opens up a new tourism area, plans must be presented on averting any negative impact that could ensue when people migrate to the area in search of employment, especially during the construction of tourism complexes;

f. the conditions for recovering costs are to be submitted, when appropriate; and

g. the project must demonstrate technical, socioeconomic, and environmental viability following the eligibility and analysis criteria that appear in Appendices A, B, C, D, and E to these Regulations.

IV. TERMS, CONDITIONS, AND PROCESSING OF SUBLOANS

4.1 Subloans will be processed in accordance with the provisions of the loan contract, observing the procedures and conditions summarized below.

A. Formalization of the financing agreements

4.2 States shall present their subprograms to the BNB, which are to be consistent with the state's tourism strategy and action plan and include the work plan previously approved by the BNB and the IDB for the institutional-strengthening component.

4.3 The BNB shall prepare the financing agreement to be signed with the state. This agreement will stipulate the following commitments on the part of the state:

a. to execute the subprogram in accordance with the approved documents, timetables, and work programs;

b. to submit the following documentation as a condition precedent to the first disbursement:

(i) evidence that the state has established a state executing unit with sufficient technical and organizational capacity to guarantee normal execution of the subprogram;

(ii) the names and signatures of the state's legal representatives for execution the subprogram;

(iii) evidence that the state has an environmental protection agency capable of operating the polluting activities licensing system (SLAP), as defined under federal law;

(iv) evidence that the consulting contracts have been signed for the institutional-development projects involving the state tourism and environmental agencies;

(v) evidence that the environmental construction permits have been obtained from the competent authorities in each state for all the multiple works projects slated for the program's first year of execution;

(vi) an updated plan showing how funds will be used under the subprogram, indicating the sources of funding (IDB

or local) for investments financed under the program; and

(vii) evidence that the state executing unit has a code of accounts for the subprogram that meets program requirements.

c. Progress reports detailing the subprogram's progress as of June and December of each year, are to be submitted within 30 days of those dates and for the duration of the subprogram's execution, addressing those matters required by the BNB.

d. Input for the ex post evaluation is to be submitted on the performance of the state's tourism sector and on those projects in the state's subprogram to be included in the ex post evaluation, within the time frame and with the information required by the BNB.

e. Maintenance reports are to be submitted annually to the BNB for the first ten years following the completion of works for all works and equipment financed with program resources.

4.4 The financing agreement will stipulate that loan proceeds will be available for 20 months following the effective date of the loan contract(s) between the BNB and the IDB, to finance up to 50% of the total estimated cost of the state's subprogram, provided said cost does not exceed the loan limits established in Chapter VI of these Regulations.

4.5 If the multiple works planned under a state's subprogram cannot be contracted within the time frame stipulated in paragraph 4.4 above, the loan proceeds reserved to finance those works will be released and made available to all states participating in the program.

4.6 Prior to signature, the BNB will send a copy of the financing agreement to the IDB for its no-objection, with the understanding that financing for any individual project in the subprogram will be contingent upon BNB and, in some cases, IDB analysis and approval.

4.7 Provided that clearance has been given by the IDB, the financing agreement may be amended while the program is in progress, in order to introduce any changes and/or additions in the subprogram being financed.

B. Applications for subloans

4.8 As projects are being designed and prepared, the BNB undertakes to supply all guidance and support necessary to ensure that the requirements for their approval are met. The central executing unit (CEU) shall examine each project carefully, make observations, and point out any deficiencies that cause the project to fall short of the program eligibility requirements as stipulated in these Regulations.

4.9 Multiple works projects submitted by states to the CEU for analysis are to be in final form and should contain all information needed to evaluate them, including a study of the projects' technical, financial, economic, environmental, institutional, and legal viability. If the works are located at a new site (tourism complex), all the works planned for the site are to be presented as a package to enable the BNB and IDB to analyze them as a unit.

4.10 In the case of institutional-development projects, states are to submit to the CEU the terms of reference for the respective services.

4.11 If the requirements listed above have been met and the project has been found to be in need of some modification or addition, the CEU will return it to the state, specifying what changes must be made before the project can be approved.

4.12 If the analysis finds that the project is technically, economically, financially, environmentally, institutionally, and legally viable, the CEU will submit the project to the BNB for consideration and final approval; all multiple works which were previously analyzed by the IDB for possible inclusion in the representative sample, but did not fully meet the program's eligibility criteria, will be sent to the IDB for review and approval. The first two additional multiple-works projects in each sector, and the first two institutional development projects by type of beneficiary, will also be presented to the IDB for review and approval. The IDB reserves the right to review any other project approved by the BNB.

C. Formalization of the subloan contract

4.13 Once a project (or group of projects) has been approved by the BNB and, if necessary, by the IDB, the BNB and the state shall enter into a subloan contract, whose principal terms, clauses, and conditions are described below. A copy of the subloan contract is to be forwarded to the IDB for its information and review.

4.14 All subloan contracts are to be formalized through the signature of the respective legal instruments, in keeping with the standards and procedures established in these Regulations.

4.15 In cases where a municipality is participating in a project, the state will submit the agreement it has concluded with the respective municipality. This agreement is to stipulate the terms and conditions for project execution, financing, and transfer upon completion.

1. Financial terms and conditions of subloan contracts

4.16 The subloan contracts will adhere to the following financial terms and conditions:

a. all terms and conditions will be stipulated in the valid currency of the Federative Republic of Brazil or the equivalent in United States dollars.

b. they shall be guaranteed through a transfer of the shares of the State Revenue-Sharing Fund [Fundo de Participação dos Estados] to which the respective state is entitled.

c. interest rates on subloans will be equal to the cost of the IDB loan proceeds plus an annual 2.5% fee charged every six months.

d. subloans will have an amortization period of up to 25 years, including the grace period.

2. Operating conditions for subloan contracts

4.17 The basic conditions set in the IDB's operating policies will be extended to the state – through the BNB – including the following obligations which the state shall assume in the subloan contract:

a. to take adequate measures regarding rate adjustments as may be necessary to achieve acceptable levels of operating efficiency;

b. to maintain works financed under the program and, during the first ten years following completion of the project,to submit to the BNB annual plans for operation and maintenance of those works and annual reports on the previous year's maintenance work;

c. to submit the project's financial statements, audited by independent public accountants, to the BNB each year; and

d. to keep project records available for BNB and IDB review and inspection.

4.18 The subloan contracts for sanitation projects are also to contain the cost-recovery provisions detailed in Chapter VI.

3. Other provisions related to subloan contracts

4.19 Subloan contracts will also stipulate the following:

a. the state's obligation to observe the technical guidelines for the execution of works and the use and preservation of natural resources and the environment, which shall include presenting the environmental licenses to the BNB;

b. the state's obligation to use all goods and services financed with program resources exclusively for execution of the respective project;

c. the state's obligation to furnish the local counterpart resources required for project execution; the state may

conclude agreements with the local executing agencies or beneficiary municipalities stipulating that they provide the local counterpart financing.

d. the disbursement mechanism to be used;

e. the BNB's right to suspend disbursements or to declare the debt due and payable immediately upon demand should a state fail to honor its obligations under the financing agreement or the subloan contract;

f. the BNB's authority to suspend disbursements should the IDB suspend the BNB's right to use the resources from the loan or halt the release of resources earmarked for the subloan contract;

g. the right of the BNB and the IDB to inspect the project being financed, with full access to project-related works and offices and to accounting and technical documentation;

h. the state's obligation that – from the time they are delivered – the physical infrastructure, equipment, and other assets of the systems and services corresponding to works executed with program resources shall be administered, operated, and maintained in accordance with the proper technical standards;

i. the state's obligation to submit progress reports detailing a project's standing as of June and December of each year, within 30 days of those dates and for the duration of project execution, covering those aspects required by the BNB;

j. the state's obligation to adopt the measures necessary to ensure that the bidding procedures and Operating Regulations established for the program are observed when contracts are let for works, services, or procurement with program resources;

k. the state's obligation to inspect and supervise works financed with program resources;

l. the state's obligation to retain a firm of independent auditors to audit operations at the state level; and

m. the state's obligation to see that the local executing agencies put into practice all recommendations resulting from the technical assistance and institutional development provided by the central executing unit.

D. Restrictions on the use of program resources

4.20 Program resources may not be used to: (a) refinance debt; (b) purchase used goods; (c) pay administrative costs; (d) underwrite working capital; or (e) purchase or lease real property,

except for such property as may be needed to execute the project and which is to be acquired with local counterpart resources or the resources of the local executing agency involved.

V. PROGRAM EXECUTION AND MONITORING

A. State executing units

5.1 Each state government will create a state executing unit attached to one of its secretariats. This unit will be headed by an executive secretary who will be appointed by the state governor to manage the program during the implementation phase, coordinate the projects carried out by the local executing agencies, submit reports to the BNB, and file requests for disbursements against the loan. The state executing unit will be the BNB's sole program liaison at the state level.

B. Bidding process

5.2 Once the subloan has been signed, the state executing unit — or, as appropriate, the local executing unit or municipality to which such responsibility may be delegated — will invite bids for the works, services, materials, and equipment to be purchased as part of the projects, in accordance with the general bidding provisions approved by the IDB and the BNB, which appear in Appendices F and G hereto and are an integral part of these Regulations.

5.3 As a general rule, the state executing unit will execute and monitor institutional-development projects directly. Delegation of this responsibility is recommended when the project beneficiary is the government of a state capital, provided its capacity to execute the projects in question has been established.

C. Disbursements and financial records

5.4 The only projects eligible to receive disbursements against the loan will be those whose contract awards have been approved by the BNB and the IDB.

5.5 The local executing agencies will execute the project using loan proceeds and local counterpart resources. They will send a monthly rendering of accounts to the state executing unit, which will in turn submit them to the BNB in order for the project to qualify for future disbursements.

5.6 Each month the state executing unit will also forward to the BNB invoices for expenses to be covered with program resources, subsequent to their clearance by the program auditors, the project auditors, and the director of the state executing unit.

5.7 Once it has been established that the disbursements requested are appropriate for the physical status of the project being financed, the BNB will release the funds to the specified contractors or suppliers of goods or services and will send copies of the paid invoices to the state executing unit to be recorded and posted.

5.8 The state executing unit will be responsible for analyzing reports on project funds and will always keep its accounting records available for the BNB and the external auditors to review. While the subloan contract is in effect, the BNB and/or the IDB may, at their discretion, make inspection tours of the offices and check the books and controls of the state executing unit and the local executing agencies associated with the project.

D. Reports on program execution

5.9 In order to assess the extent to which the physical and financial objectives of the program are being achieved, the states are to supply to the BNB progress reports on their subprograms, the corresponding financial statements, and all the information requested for the ex post evaluation.

VI. GENERAL PROVISIONS

A. Financing limits

6.1 During the 20-month period following the effective date of the loan contract(s) between the IDB and the BNB, the total amount of IDB resources made available to each state through subloan contracts will be limited to either US$45 million or the amount stipulated in paragraph 6.2, whichever is smaller.

6.2 The amount of IDB loan resources to be lent to each state through the subloan contracts is limited, **for the entire period of program execution,** to any amount that would cause the annual counterpart contribution required of the state to exceed 25 percent of that state's adjusted real savings margin.

6.3 To compute the limit to which paragraph 6.2 refers, the only counterpart funds considered shall be those from the state itself.

6.4 If the IDB and the BNB so agree, the amount and time period stipulated in paragraph 6.1 may be changed once the program is in progress provided the new amount does not exceed the sum specified in paragraph 6.2.

6.5 The total program resources provided by the IDB and the states for financing projects in the transportation sector may not exceed US$130 million.

B. Cost-recovery mechanisms

6.6 Investments financed with program resources will be recovered through the collection of service charges, general taxes, special taxes, or assessments for improvements.

6.7 In the case of state or municipal water and sewerage companies, states will be required to take all necessary measures to ensure that the revenue generated through the payment of rates will be sufficient to cover the service's full operating costs, including management, operation, maintenance, and depreciation, and still allow a reasonable return on the investment.

6.8 Target rates of return will be established in such a way as to allow water and sewerage companies to generate sufficient resources to service their debt and contribute to financing their works programs.

6.9 Adjustment plans may be established for water and sewerage companies that qualify to participate in the program, with adjustment targets to be reached within a period of no more than four years.

6.10 The rates charged for program-financed public services are to generate sufficient revenue to cover, as a general rule, all operating, management, maintenance, and investment costs. In exceptional cases, especially if the income level of the target population so warrants, general state or municipal revenues may be used to pay a portion of those expenses, although it must be demonstrated that the project will not create a current account deficit for the state or municipality concerned.

6.11 If, in urban areas, service users or a project's direct beneficiaries cannot be clearly identified, costs may be recovered through property taxes, by updating assessments of properties benefited by the works.

C. Management of program resources

6.12 The BNB will set up a special account, which the central executing unit will administer and into which program resources and subloan repayments will be deposited. A separate, detailed ledger is to be kept for this account.

6.13 Any balance carried in excess of the amount needed to service the IDB loan may only be used to award new loans that substantially conform to the standards established for the program, unless the IDB and the BNB mutually agree — once five years have passed since disbursement in full — to use subloan repayments for some other purpose that does not deviate from the program's basic objectives or cut short the life of the loan.

D. Legal effect and amendments

6.14 The BNB and the states may suggest amendments to these Regulations in order to adjust them to new circumstances or conditions that may arise during program execution, while working to ensure that the objectives are accomplished. The amendments shall take effect once the IDB and the BNB give their consent.

APENDICE I

PROPOSED RESOLUTION

BRAZIL. LOAN /OC-BR. TO THE BANCO DO NORDESTE DO BRASIL S.A.
(Program for Tourism Development in the Northeast)

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with BANCO DO NORDESTE DO BRASIL S.A., as Borrower, and the Federative Republic of Brazil, as Guarantor, for the purpose of granting the former a financing to cooperate in the execution of a Program for the Development of Tourism in the Northeast. Such financing will be for the amount of up to four hundred million dollars of the United States of America (US$400,000,000), or its equivalent in other currencies, except that of Brazil, which are part of the Ordinary Capital resources of the bank, and it will be subject to the "Special Contractual Conditions" and the "Terms and Financial Conditions" of the Executive Summary of the Loan Proposal.