National Program to Support the Administrative and Fiscal Management of Brazilian Municipalities

(BR-0286)

Executive Summary

Borrower:	The Federative Republic of Brazil
Executing agency:	The Ministry of Finance, through its Executive Secretariat
Financial agent/coexecuting agency:	Caixa Econômica Federal [Federal Savings Bank]
Beneficiaries:	Municipal governments
Amount and source:	(In millions of U.S. dollars)

	Stage 1	Stage 2	Stage 3	Total
IDB (OC):	300	450	350	1,100
Local:	300	450	350	1,100
Total:	**600**	**900**	**700**	**2,200**

Financial terms and conditions for each stage:

Amortization period:	20 years
Grace period:	4 years
Disbursement period:	4 years
Commitment period:	3 years
Interest rate:	variable
Inspection and supervision:	1%
Credit fee:	0.75%
Currency:	Currency pool

Objectives: The main objective of the program is to support the Brazilian government in achieving macroeconomic stability through a self-sustaining fiscal balance, bolstered by an efficient and transparent public policy for managing municipal income and spending.

The specific objectives to be achieved during the program are:

a. **With respect to efficient municipal management:** (i) increase in municipal financing of public spending using own revenues; (ii) economy in municipal public administration; and (iii) improved quality and availability of municipal public services.

b. **With respect to transparency in municipal management:** (i) regular information made available to the public on budget performance, public accounts and municipal management; (ii) effective participation by citizens in budget planning and definition and in the municipal investment plan; and (iii) evaluation and review of the actions of municipal governments, taking public opinion into account.

Description:

The program will finance two main components:

1. Coordination and technical assistance component (US$5 million for stage 1)

Loan proceeds will be used to strengthen the Executive Secretariat of the Ministry of Finance in the supervision, integration and coordination of the fiscal area on the national level. The secretariat will support the municipalities in preparing specific modernization projects and will conduct studies and offer national conferences and courses on aspects of municipal management.

2. Municipal institutional strengthening component (US$295 million for stage 1)

This component will finance projects to modernize municipal management in the administrative and fiscal areas (tax and financial administration) in particular, as well as projects to improve the municipalities' ability to serve the public.

The program will support the individual initiatives of each municipality under a common frame of reference, which will provide a basic structure for specific projects while leaving room to address needs that arise during each case study. Projects to modernize municipal management in the following fields will be financed: (a) **modernization of tax administration** (tax legislation and regulations, budget preparation, tax administration, financial administration, auditing and internal control); (b) **administrative modernization** (organization and

management, planning, human resources, services to citizens and information technology); and (c) **land use administration** (geographic information systems and referential databases).

This operation has been structured with three stages on the basis of the number of municipalities in the country and the Brazilian government's policy of making the program accessible to a large majority of municipalities.

The Bank's Sector Strategy: The country paper identifies four main areas for socioeconomic development in Brazil: (i) price stabilization; (ii) public sector reform; (iii) modernization of the productive sectors; and (iv) attention to social problems. The proposed program is compatible with the Bank's operating strategy since it is targeted to municipal reform.

Environmental and social review: While the program will not have a direct impact, it may play a significant role by promoting improved environmental management and transparency in municipal administration. The CESI's recommendations have been incorporated into the program (paragraph 4.14).

Benefits: The main benefits expected from the program are:

a. Better prospects for achieving a sustainable fiscal balance in the municipalities thanks to a reduction in tax evasion, with the consequent increase in tax revenues and better programming and control of public spending. This, in turn, translates into a more solid foundation for fiscal solvency on the national level.

b. Increase in the capacity of municipal governments to carry out economic and social development programs since they will have more funds to spend and tools to manage them more efficiently and effectively.

c. Substantial savings for the municipal governments as a result of the integration of national tax systems, and a reduction in the operating costs of monitoring compliance as a result of the introduction of integrated taxpayer and property rolls.

d. Reduction or elimination of tax distortions that affect domestic trade, through a reduction in the sharp differences in efforts to monitor compliance in the

different municipalities, which will lead to a reduction in inequities in the national tax system.

e. Strengthening of the mechanisms for dialogue on taxation between the federal and municipal governments.

f. Greater participation in and control over municipal management by society, with the introduction of measures to promote transparency recommended by the program.

Risks:

The following main risks have been identified in terms of program execution:

a. The possibility of inadequate project formulation by the participating municipalities during the program. To mitigate this risk, the Bank has developed an automated support system for preparing analyses and projects and will transfer its know-how to the technical experts of the program coordination unit (PCU) and the Caixa.

b. The possibility of unsatisfactory execution of specific projects owing to a lack of institutional capacity in the municipalities. This risk will be reduced by the criteria and rules established mainly for the simplified projects, which provide detailed definitions of all projects stages, with support provided by the Caixa, and the fact that each municipality must issue a resolution creating a municipal executing unit (MEU).

c. The possibility that technical yardsticks for measuring financial needs will not be used in distributing program funds to the municipalities. This risk is minimized by including explicit quantitative parameters in the program that have been defined by designing and reviewing the projects in the sample, which will be used as the basis for distributing funds to the municipalities.

Special contractual conditions:

1. Conditions precedent to the first disbursement of the Bank loan:

a. Presentation to the Bank of the contract between the borrower and the financial agent/coexecuting agency (paragraph 3.13).

b. Presentation to the Bank of the final version of the model contract for subloans between the financial agent/coexecuting agency and the municipalities (paragraph 3.24).

c. Evidence that the Caixa and the PCU have compatible systems for financial administration (paragraph 3.7).

d. Entry in force of the Operating Regulations (paragraph 3.1).

2. Conditions precedent to signature of the contract for subloans between each municipality and the financial agent/coexecuting agency (see paragraphs 3.17 and 3.18):

   a. Evidence in the form of acceptable legal documents that the municipalities have created their executing units (MEUs).

   b. Evidence that the legislature has approved contracting of the subloans and granting of guarantees.

   c. Evidence that the counterpart funds have been allocated for the respective projects or evidence that the funds have been committed, thereby ensuring project execution during the first year.

   d. Presentation of a project that is eligible for financing under the program.

3. The Bank will recognize program-related spending after April 30, 1998, of up to US$30 million as part of the counterpart, provided it complies with requirements that are substantially similar to those stipulated in the loan contract (paragraph 3.41).

Poverty-targeting and social sector classification: This operation does not qualify as a social equity enhancing project, as described in the indicative targets mandated by the Eighth General Increase in the Resources of the Bank (document AB-1704).

Procurement of goods and services: The Bank's procedures will apply for the construction of works, procurement of goods and contracting of services to be financed from the prospective loan. International competitive bidding will be required for works costing US$5 million and over, goods costing US$350,000 and over, and services costing US$200,000 and over (paragraph 3.36).

Exceptions to Bank policy: None

I. FRAME OF REFERENCE

A. Background

1. Decentralization and fiscal federalism in Brazil

1.1 Brazil is organized as a federal republic with three levels of government: central (federal), intermediate (26 states and the federal district) and local (5,507 municipalities). The three levels have broad autonomy guaranteed by the 1988 Constitution which grants them the power to levy their own taxes and authority to define and implement their public spending policies.

1.2 In the field of government action, each of the levels of government has administrative autonomy in organizing public services in general and in their own financial management. The financial autonomy of each level of government basically takes the form of budget formulation, the power to collect the taxes to which they are entitled, and the ability to carry out public spending.

1.3 The constitution establishes that national defense, foreign affairs, the issuance of currency, control of the financial system, postal services and oil are the exclusive responsibility of the central government. Distribution of piped gas and public transportation are the specific responsibilities of the states and municipalities, respectively. All other functions involving the delivery of public services may be carried out by any of the three levels of government.

1.4 As for the national tax system, the constitution clearly establishes taxes by level of government. Federal law defines the general framework of the tax system, while the regulations are established in state and municipal laws. Table I-1 summarizes taxation powers and spending responsibilities by level of government, based on data for the last four years.

Table I-1
Main taxation and public spending powers by level of government

Level	Tax	Public Spending
Federal	Income, selective consumption tax, foreign trade, financial movements, rural property	Education, health care, social security, national defense, road infrastructure
State	Consumption (value added), vehicles, inheritance	Primary and secondary education, health care, public security, public transportation
Municipal	Urban property, property sales, services, municipal charges	Primary education, basic health care, urban development, sanitation, public transportation

Sources: Federal Constitution/Ministry of Finance

1.5 This federative structure with its high degree of decentralization is marked by deep socioeconomic, demographic and territorial differences among the states and the municipalities. There is a great contrast between states such as Amazonas whose territory covers over 1.3 million km^2 and Sergipe with no more than 27,000 km^2. Variations in population are equally marked. Cities such as São Paulo and Rio de Janeiro have populations of over 10 million, while there are 1,400 towns with fewer than 5,000 inhabitants.

1.6 Similarly, per capita family income also presents wide differences, ranging from four minimum wages in cities in the southern states to one-quarter of a single minimum wage in cities in the northeast. These economic disparities are apparent in sharp inequalities in development and in the fiscal capacity of the different states and municipalities.

2. Public income and spending in Brazil

1.7 The national tax system is the main source of financing for public spending. It is based on general rules that have been codified since 1966 and the most recent breakdown of tax revenue sources established in the 1988 Constitution. Each level of government has its own fields of taxation and the main taxes are distributed among them as follows:

a. Federal —Taxes on personal and corporate income, imports and exports, sales of industrial products, financial transactions (credit, currency exchange and operations with stocks and bearer securities), rural properties and the social contributions charged on company sales.

b. State.—Taxes on movements of goods and transportation and communications services (ICMS), inheritances and donations, automotive vehicle ownership.

c. Municipal.—Taxes on urban property (IPTU), property sales (ITBI), services of all kinds (ISS) and charges of all kinds (trash collection, public lighting).

1.8 In 1998, the federal government collected 69% of total tax revenues (29.5% of GDP), the states collected 27% and the municipalities 4%. As can be seen in Table I-2, collections by level of government have remained relatively stable in recent years.

Table I-2
Tax revenues as a percentage of GDP by level of government

Level of government	1996	1997	1998
FEDERAL	**19.08**	**19.18**	**20.24**
Federal taxes and charges	7.17	7.11	7.54
Social security	9.94	10.15	10.66
Other	1.97	1.92	2.04
STATE	**7.76**	**7.52**	**7.98**
ICMS (VAT)	7.15	6.87	7.29
Other	0.61	0.65	0.69
MUNICIPAL	**1.22**	**1.21**	**1.28**
IPTU-ITBI	0.45	0.44	0.49
ISS	0.66	0.65	0.67
Other	0.11	0.12	0.12
Total	**28.06**	**27.91**	**29.50**

Source: Ministry of Finance

1.9 A large share of federal tax revenue is transferred to the lower levels of government (state and municipal) through the State Tax-Sharing Fund (FPE) and the Municipal Tax-Sharing Fund (FPM). Also, a large share of state taxes is transferred to the municipalities, applying rules established in specific legislation.

1.10 The main beneficiaries of the fiscal decentralization established in the 1988 Constitution are the municipalities, who saw their share of revenues rise from 2.41% of GDP in 1988 to 5.06% in 1998. The federal government has cut back its own available income, which was 2% less than the revenues it collected in 1988 and 4% less than the direct revenues collected in 1998. This has increased the impact of the subnational governments on the country's macroeconomic stability.

1.11 Table I-3 shows the distribution of tax pressure among the different levels of government over the last three years. The item 'direct collections' includes revenues collected directly by each of the levels of government in their spheres of competence and 'available revenues' shows the results for each level after the inter-governmental transfers stipulated in the 1988 Constitution and specific federal and state legislation.

Table I-3
Tax income by level of government
(percentage of GDP)

Level of Government	Direct collection			Available income		
	1988	1994	1998	1988	1994	1998
Federal	15.82	17.12	20.24	13.98	14.72	16.37
State	5.95	7.57	7.98	6.04	7.27	8.07
Municipal	0.66	1.16	1.28	2.41	3.86	5.06
Total	22.43	25.85	29.50	22.43	25.85	29.50

Source: Ministry of Finance

1.12 The degree of dependence of the lower levels of government on transfer payments to finance their public spending varies widely within the general figures shown in Table I-3. The south and southeast have the greatest self-financing capacity, since they are able to cover 76% and 88.2%, respectively, of public spending out of their own revenues. In the north and northeast, in many cases own revenues are less than 10% of total income.

1.13 The state and municipal governments combined bear the chief responsibility for different government spending items and public investments. Table I-4 shows the percentage of these costs broken down by the main functions of government.

Table I-4

Government Function	Percentage of public spending			
	Federal	State	Municipal	Total
Legislative Branch	21.0	44.0	35.0	100%
Judicial Branch	30.4	67.9	1.7	100%
National defense and public security	58.5	40.2	1.3	100%
Education and culture	28.8	44.1	27.1	100%
Housing and urban development	1.5	15.1	83.4	100%
Health and sanitation	52.0	25.6	21.8	100%
Social security	78.7	16.9	4.4	100%
Public transportation	22.5	36.3	41.2	100%
Average total public spending	50%	30%	20%	100%

Source: Ministry of Finance

B. The Brazilian municipalities

1. Municipal structure and distribution

1.14 Social and economic indicators and population distribution point to wide differences among the country's 5,507 municipalities. Approximately 50% of them have fewer than 10,000 inhabitants; most have fewer than 50,000 (5,015 cities) and just 144 have populations over 150,000, as is apparent from Table I-5.

Table I-5
Municipalities classified by population

Population	Number of municipalities	Percentage of total	Accumulated total	Percentage accumulated total
Up to 5,000	1,414	25.68	1,414	25.68
5,000/10,000	1,299	23.59	2,713	49.26
10,000/20,000	1375	24.97	4,088	74.23
20,000/50,000	927	16.83	5,015	91.07
50,000/150,000	348	6.32	5,363	97.39
Over 150,000	144	2.61	5,507	100.00

Source: IBGE [Brazilian Institute of Geography and Statistics]

1.15 Regardless of the size of the municipality, but depending on the region in which it is located, great contrasts can be found in development levels. There are municipalities with per capita incomes of under US$400 and others with over US$10,000; municipalities where the illiteracy rate is under 2% in contrast with others whose rate is over 80%; and development indicators such as the human development and quality of life indexes (education, health and income) that range from 0.250 to 0.900.

1.16 Table I-6 gives examples of these divergencies and is a telling indication of how they are directly reflected in the levels of development of the municipal public sector.

Table I-6

Cities with better indexes	Indicators	Cities with worse indexes
Rio Fortuna (Santa Catarina) 4,240 inhabitants	**Demographic**	**Mari (Paraiba) 20,237 inhabitants**
74 years	Life expectancy	50 years
4.9 per 1,000	Infant mortality	176 per 1,000
Niterói (Rio de Janeiro) 456,894 inhabitants	**Social**	**Itamarati (Amazonas) 6,759 inhabitants**
4%	Percentage illiteracy	86%
8.8 years	Average years of study	0.3 years
Aguas São Pedro (São Paulo) 18,756 inhabitants	**Economic**	**Tarrafas (Ceará) 7,683 inhabitants**
4 minimum wages	Per capita family income	0.14 minimum wages
4.8%	Population with insufficient	97.1%

Source: IPEA [Institute of Applied Economic Research]/IBGE/UNDP

2. Own income and transfer payments to municipalities

1.17 The main municipal taxes are the urban property taxes (IPTU/ITBI) and the tax on services of all kinds (ISS) which together make up 80% of the municipalities' own income.

1.18 When the make-up of this income is compared with other countries, the property taxes that Brazilian municipalities are entitled to levy are insignificant, since just 0.5% of GDP comes from the IPTU/ITBI. Furthermore, the results from tax on services (ISS) which is also a municipal entitlement are considerably lower that they could be potentially when looked at from the standpoint of the indicators generated by the other taxes collected by the federal and state governments.

1.19 Own tax collection potential varies widely in the different regions owing to the large socioeconomic disparities described earlier. This is why it has been necessary to establish a transfer payment system to boost the resources of municipalities with lower collection capacity.

1.20 Average own municipal income as a percentage of transfer payments to the municipalities nation-wide is 25%. However, the ratio between own income and transfers can range from 1% to 90%. Different analyses demonstrate that a number of municipalities would have difficulty in collecting more than 10% of the funds they need to finance their spending, while many municipalities collect or have the economic potential to collect up to 100% of that figure.

1.21 The transfer payment system minimizes regional inequalities and helps to improve income distribution in the country. The economic and financial viability of a municipality is directly related to the amount of funds it has available and their associated management costs. The most relevant factor is the municipality's capacity to deliver good services to its citizens through efficient administrative and financial management.

3. Municipal public finances

1.22 Although some municipalities have a surplus in their public accounts, the municipalities that posted significant deficits were found to have high payroll costs that in many cases accounted for more than 90% of their total income, which has been a major factor in their lack of funds for investment programs. Accordingly, these municipalities have had to borrow to finance their investments and, in many cases, even to finance their recurrent costs. These debts and high market interest rates have been the principal causes of the public deficit.

1.23 High payroll costs are mainly linked to payments for retirees who, owing to the lack of a municipal social security system, are financed out of the recurrent costs budget. Although many municipalities have established their own social security funds and introduced mechanisms to finance them, tools are needed to support the lower levels of government in defining strategies to guarantee that those funds will be viable.

1.24 An analysis of the total debt of the municipalities indicates that interest and capital are being repaid regularly to the federal treasury on over 40% of the debt. Most of the remaining debt is being renegotiated and over 50% of it is for the cities of São Paulo and Rio de Janeiro. The municipalities account for less than 5% of the total public sector debt nation-wide, as can be seen in Table I-7.

Table I-7
Public sector debt balances

Item	1997		1998	
	R$ millions	%GDP	R$ millions	%GDP
Total debt	308,426	35.58	388,667	43.11
Federal government and Central Bank of Brazil	167,742	19.35	231,258	25.65
State governments	100,257	11.57	113,160	12.55
Municipal governments	15,635	1.80	17,745	1.97
Federal public companies	8,906	1.03	7,377	0.82
State public companies	15,077	1.74	17,836	1.98
Municipal public companies	810	0.09	1,291	0.14
Total municipal debt	**16,445**	**1.89**	**19,036**	**2.11**

Source: Central Bank – Depec-Difin-Sufip

4. The municipal public sector

1.25 The Bank, in conjunction with the Ministry of Finance, carried out an analysis of the municipal public sector based on information available in the municipal databank and information obtained from the city halls that participated in the representative sample for the program.

1.26 Some 50 cities in different parts of the country and with different economic and demographic characteristics were visited by teams from the Bank and the Ministry of Finance to obtain data for preparing the different analyses.

1.27 The diagnosis identified a series of common problems in the municipalities which, broadly speaking, have been the causes of inefficiency in municipal administration and, consequently, of the shortcomings in management of revenue and public spending and, often, of the low levels of own revenue collection.

1.28 In the area of administration and management, there has been a complete absence of planning systems and urban development plans, too many agencies with duplicate functions, lack of human resource management systems and of control over the numbers of employees, lack of control over municipal goods and property, and a glaring absence of structures for delivering services to citizens in different areas. Furthermore, the public is not informed about investment plans, financial management or municipal budget performance.

1.29 The lack of qualified municipal staff, particularly in the area of public finances, is a consequence of the absence of training for municipal employees and the lack of modernization policies and new municipal management techniques.

1.30 The analysis of the management of public finances has found major shortcomings in the areas of tax and financial administration. In the field of taxation, the municipalities do not have tax codes or up-to-date property and taxpayer rolls. There is also a complete absence of controls over tax collection and inspection activities. On the public spending side, the lack of methodology and techniques for budget preparation and financial management controls have been the main reasons for the financial deficits, difficulties in cash flow and, often, for inefficient public spending.

1.31 In short, most of the municipalities lack the technical capacity and resources to manage their incomes and spending efficiently and transparently, promote compliance by citizens with their tax obligations, and provide good-quality public services.

1.32 Last, the analysis indicated that in municipalities where there is greater public input into budget preparation and management and greater transparency in the management of public finances, levels of own income are higher since people pay

their taxes voluntarily. These municipalities have also achieved greater efficiency in public spending and a better balance in their public accounts.

1.33 The 1988 Constitution called for intensive decentralization of the public sector and transferred powers and responsibilities to the municipalities in strategic fields such as the delivery of health care and education. However, the municipalities lack the institutional capacity to exercise their constitutional autonomy and therefore are unable to manage these transferred powers.

C. The fiscal balance and country strategy

1.34 Achieving fiscal balance has been a prime objective of macroeconomic policy ever since the *Plano Real* was introduced in July 1994. However, the country has only been partially successful. The main obstacle, initially, was limited progress in passing the priority amendments to the 1988 Constitution which were necessary to restructure and modernize the public sector. Later, with the eruption of the Asian crisis in the final quarter of 1997 and the need to pay very high interest rates to prevent the flight of capital, the country's fiscal situation deteriorated sharply. This situation is mirrored in public sector financing requirements which, after falling to 5.9% of GDP in 1996, rose to 6.1% in 1997 and 8.1% in 1998. Although it is difficult to quantify the magnitude of this deterioration on each level of government, it is clear that they have all been negatively affected by the rise in debt service (owing to the high interest rates) and by the difficulties in reducing the payroll costs for both working and retired employees.

1.35 This difficult situation forced the authorities to prepare a series of new measures to cope with the crisis. The first of these efforts became apparent on November 13, 1998, when the authorities signed a Stand-by Agreement with the IMF for SDR13 billion (US$18.1 billion). In the area of public finances, the main goal was to increase the primary surplus (nominal deficit excluding interest payments) from 0.1% of GDP in 1998 to 3% of GDP by 2000. It is worth underlining that without the measures included in the agreement, Brazil would have posted a primary deficit of more than 2% of GDP in 2000.

1.36 However, these initiatives were insufficient to restore confidence, since the country continued to lose reserves. Owing to this situation, the authorities allowed the exchange rate to float on January 15, 1999. At the same time, congress quickly passed major fiscal measures which, in turn, facilitated the rapid conclusion of a Modified Agreement with the IMF. The agreement, which was reached on March 8, took account of the impact on the exchange system and set a new goal for the primary surplus, which was increased to 3.1% of GDP for 1999 and 3.5% in 2001.

1.37 The events in early 1999 constituted a *fundamental change* in Brazil's macroeconomic policies. Broadly speaking, the main objective of the authorities is to make a macroeconomic adjustment that will reduce the external and internal imbalances that have affected the country. In the short term, this adjustment means

recession, increased unemployment, higher inflation and, in particular, the *need to mount a sustained frontal attack on the underlying causes of the fiscal deficit on all levels of government.*

1.38 To sum up, there are two main lines of action in this struggle to achieve fiscal balance. First, a short-term adjustment in finances is urgently required as described above. Second, it is necessary to push forward with the structural reforms that the authorities have been introducing, some of which include the Stand-by Agreement with the IMF. The main initiatives in this second category are summarized below.

1.39 The **federal government** is carrying out a broad program for the privatization and concession of public services and another for reform of the State, with Bank support. It has also established a modern financial administration system (SIAFI) and seeks to modernize its tax administration structure with support from a Bank technical cooperation project (program to modernize the Federal Income Department 999/OC-BR).

1.40 The **states** participate in a fiscal adjustment program based on two main actions: renegotiation of their debt with the federal government and modernization of their tax and financial administration instruments, which is being financed by the Bank (national tax administration support program for Brazilian states or PNAFE, 980/OC-BR).

1.41 To complete this integrated set of actions, the federal government in search of the self-sustained fiscal balance that is needed in its three spheres of power, asked the Bank for technical and financial support to promote sweeping modernization of municipal administrative and fiscal management country-wide. The federal government is studying a proposal to renegotiate the municipal debt that will not compromise the fiscal adjustment policy which is the basis for the country's macroeconomic stability plan.

1.42 Ever since congress passed new legislation on social security, the federal government have been developing studies and instruments to support the state and municipal levels of government in defining strategies to solve their own social security problems.

1.43 Brazil's senate has passed Resolution 78/98 which establishes new restrictions on contracting debt on the subnational level and has placed legislation before congress (Fiscal Responsibility Act) that establishes new sanctions for public resource managers who fail to comply with the legislation and reduces income linked to specific public sector areas. With passage of the administrative reform, the municipalities have major tools for reducing their staffing levels.

D. Bank experience in the sector and lessons learned

1.44 The Bank has gained extensive experience in the fiscal area through its financing for programs to modernize public financial management in more than 20 countries

in the region. In the specific case of Brazil, the Bank has experience in the fiscal area from two operations: (i) the program to modernize the Federal Income Department, loan 888/OC-BR for US$78 million; and (ii) the national tax administration support program for the Brazilian states, loan 980/OC-BR for US$500 million.

1.45 The Bank also has experience in the field of municipal administrative and tax management in Brazil under the municipal development program for Porto Alegre, loan 1095/OC-BR for US$77 million, and in the field of modernization of the State under the program to modernize the Brazilian executive branch, loan BR-0288 for US$54 million.

1.46 In preparing the above programs, which are currently being implemented, the Bank has developed methodologies and documents on best practices in aspects related to the preparation, execution and evaluation of programs to modernize public sector management.

1.47 These methodologies and documents consolidate the different experiences and lessons learned from the programs financed by the Bank. They have also been relied on as the basis for preparing the program presented below.

1.48 The guiding framework for defining this program was taken mainly from the national program on tax administration for the Brazilian states, since the two programs are similar. The programs allow for participation by many executing agencies in different stages of development, they are targeted to modernizing public management on the subnational level, contain strict conditionalities and establish guidelines for strategic areas of government.

1.49 In short, the success of a program such as the one proposed here is based on the following lessons learned.

1. For the program preparation stage

a. Availability of methodologies and automated systems to support the different executing agencies in project analysis and preparation. These tools have proven to be the keys to identifying problems and preparing projects with high levels of quality and uniformity within the guidelines defined for the program. They also guide executing agencies in adopting Bank policies.

b. Preparation of a representative sample of projects using methodologies and automated systems. The experience acquired in preparing the sample of projects is a key input for evaluating the scale originally established for the program and for all the definitions of components in the different projects. It also serves as the basis for evaluating aspects relating to program execution, pinpointing the public management areas in the different levels of government

needing the most work, and identifying the technical documents necessary to support and guide the executing agencies.

c. Preparation of detailed technical specifications for the different products to be tendered under the program and the establishment of mechanisms for information and dialogue with the private sector. The comments submitted by the private sector will make it possible to review the consistency of the technical specifications. This will also allow the private sector more time to get organized to meet the demands generated during the program, thus improving the competitiveness of the bids.

2. For the program execution stage

a. Use of a financial agent to administer Bank and counterpart funds, which will also make all payments directly to suppliers. This mechanism for managing program funds optimizes disbursements, streamlines the flow of funds needed by the executing agencies and minimizes the volume of funds disbursed but not used. It also facilitates ex post review of disbursements and reduces program auditing costs.

b. Use by the executing agency and the financial agent of an integrated financial administration system (standard) to manage program funds. The system optimizes control of financial management and program accounts, while simultaneously reducing program supervision costs.

c. Establishment of model bid documents and contracts to guide executing agencies in procurement and contracting. They serve as a frame of reference for the executing agencies and the private sector, minimizing protests regarding bids and contract deficiencies and reducing the Bank's volume of work when it comes to revising procurement-related documents.

3. For the program supervision and evaluation stage

a. Establishment of a supervision and evaluation methodology based on three tools: (i) a questionnaire; (ii) public opinion polls; and (iii) evaluation meetings. Use of this broad data-collection methodology improves the quality of the data captured, promotes public participation in program evaluation and allows for self-evaluation by the executing agencies. Also, execution and management indicators clearly define the yardsticks for measuring and evaluating program results.

b. Establishment of public management evaluation indicators. Use of a management model based on indicators of results allows for greater

clarity in establishing institutional objectives and goals and in measuring citizen satisfaction with the services delivered.

1.50 Last, the quest for fiscal balance and better quality public services is based on achieving higher levels of efficiency in public administrative and financial management. Therefore, the sustainability of the process of achieving greater efficiency is based on introducing mechanisms to permit effective control over public sector actions by society. These mechanisms are based on transparency in public management and participation by society in defining investment priorities and monitoring public spending.

E. Bank strategy in the sector

1.51 The country paper identifies four main areas for Brazil's socioeconomic development: (i) price stabilization; (ii) public sector reform; (iii) modernization of the productive sectors; and (iv) attention to social problems.

1.52 The national program to support the administrative and fiscal management of Brazilian municipalities is fully compatible with the Bank's operating strategy. First, it is consistent with public sector reform, which is one of the four priorities. The relative priority of this area has increased since the country paper was prepared, largely because of the need to reverse the deterioration in public finances since the last quarter of 1997 when the international financial crisis made very sharp increases in interest rates necessary. Second, successful implementation of the national program for municipalities will facilitate faster progress in the other areas in the Bank's strategy. For example, higher levels of current savings by the municipalities (which are expected to be one result of the project) will lead to higher investments, which are essential for programs to modernize the productive apparatus and cushion the serious social and environmental problems in Brazil.

1.53 The program proposed below is not simply the result of a request by the federal government based on an analysis of problems, it has also been demanded directly and insistently by the municipalities. To date, more than 1,000 municipalities have signed the terms of adhesion to the program, more than 100 already have projects prepared and 71 have had their projects reviewed by the Bank and the Ministry of Finance.

1.54 Last, with this program, the Bank will be supporting institutional strengthening in the Brazilian fiscal area on its three levels (federal, state and municipal), thereby consolidating its support for the country in its quest for a self-sustaining fiscal balance.

II. THE PROGRAM

A. Program objectives

2.1 The main objective of the program is to support the Brazilian government in achieving macroeconomic stability through a self-sustaining fiscal balance supported by an efficient and transparent public policy for managing municipal income and spending.

2.2 The specific objectives to be achieved during the program are:

a. With respect to efficient municipal management:

(i) increase in municipal financing of public spending using own revenues;

(ii) economy in municipal public administration; and

(iii) improved quality and availability of municipal public services.

b. With respect to transparency in municipal management

(i) regular information made available to the public on budget performance, public accounts and municipal management;

(ii) effective citizen participation in budget planning and definition and in the municipal investment plan; and

(iii) evaluation and review of the actions of municipal governments, taking public opinion into account.

B. Program results

2.3 To evaluate the scope of the objectives and results expected from the municipal projects, the Bank and the Ministry of Finance defined a series of goals and indicators as shown in the logical framework (annex I-1) and in the program supervision and evaluation methodology (annex I-2).

2.4 Since all municipalities that comply with the eligibility requirements can join the program, it is expected that by the time it concludes, direct support (financial resources and technical assistance) will have been provided to at least 70% of Brazilian municipalities and indirect support (national seminars and dissemination of technical documents) will have been received by all of them.

C. Program description

2.5 The program has been designed to place municipal governments in a position to:

a. Perform integrated management of the different municipal government activities; and

b. Provide the public with the information and tools needed for effective control by society over all municipal management activities.

2.6 The program plans to support institutional strengthening projects intended to perfect the legal, administrative and technical mechanisms used by the areas responsible for municipal administrative and fiscal management. Specifically, the program is designed to:

a. Perfect the management model, functional structure, policy and administration of human resources and the strategy and procedures for concessions and privatization of municipal public services;

b. Introduce methods and tools for planning and preparing budgets, in a context of transparency and citizen participation;

c. Integrate financial administration and introduce automated controls for budget performance and the consolidation of municipal auditing and internal controls;

d. Perfect control over compliance with taxpayer obligations through the introduction of new collection techniques and methods and administrative and judicial inspection and collection of taxes owing; and

e. Enable city halls to better carry out the functions of tax education and taxpayer assistance and the delivery of community services.

2.7 The program is expected to minimize the technical and operational disparities that currently exist in the different municipal tax administrations. The solutions developed will have a multiplier effect and the groundwork will be laid for integration of the different systems, thereby providing greater support for the less developed municipal administrations. It will also help to make the fiscal activities of the federal public administration more homogeneous, leading to greater equity in the structure and functioning of Brazilian federalism.

2.8 To achieve the expected objectives and results, the program will carry out activities on the federal and municipal levels, structured into two components.

1. Component I. Coordination and technical assistance (US$5 million in stage 1)

2.9 The purpose of this component is to strength the Executive Secretariat of the Ministry of Finance to enable it to perform its functions of supervision, integration and coordination of the national fiscal area more efficiently.

2.10 The Executive Secretariat will carry out a technical assistance program for municipalities in the fiscal field, which includes preparation of specific modernization projects, and studies, conferences and courses financed by the program on the national level in areas related to municipal management.

2.11 The component will also finance the Information Technology Solutions Laboratory (LSTI) that has been created to examine and prequalify computerized solutions for municipal management during this program. The laboratory has been provided with the capacity to analyze the array of products that will be presented for study by different world suppliers, which will help the municipalities to reach decisions on procurement.

2.12 The Secretariat will also support the strengthening of different associations, federations and other non-profit agencies that provide technical assistance for municipalities.

2. Component II: Municipal institutional strengthening (US$295 million in stage 1)

2.13 This component is intended to finance projects to modernize municipal government in the administrative, fiscal and public service areas.

2.14 The program will support the individual initiatives of each municipality under a common reference framework which will provide the basic structure for specific projects while making it possible to attend to the requirements arising from each case study.

2.15 The component will finance projects to modernize municipal management in the following fields:

a. Fiscal (public income and spending):

- Tax legislation and regulations
- Tax administration: taxpayer roll, collections, inspection, recovery of taxes past due

- Financial administration: budget preparation and execution, control over spending and the public debt
- Auditing and internal control

b. Planning and administration:

- Administrative legislation and regulations
- Planning and management
- Assets and procurement
- Human resources
- Service to the public
- Information technology

c. Land use administration

- Geographic information systems (GIS)
- Referential databases

2.16 Owing to the disparities in the development levels and management capacity of the municipalities taking part in the program and the differences in demand for municipal government services depending on population, two types of projects (simplified and expanded) were defined and 18 groups of municipalities were established on the basis of population.

a. Simplified projects

2.17 These projects are intended to provide effective short-term solutions to the basic problems faced by most medium-sized and small municipalities. They also form part of the program's strategy to optimize execution through the flexible and structured system to be used on the large scale, making it possible to assist as many municipalities as possible as quickly as possible.

2.18 A series of products have been defined – information systems (tax, financial, administrative and citizen assistance), training programs, management models, administrative procedures and basic infrastructure (computer networks, hardware and software) – to form what has been called an integrated solution for municipal management.

2.19 This solution (kit solution) has been defined in detail in every aspect and has been disseminated to the entire international private sector, with a view to identifying the various options available in the market of suppliers of the solution.

2.20 The information technology solutions laboratory (LSTI) which has been created in the Financial Administration School of the Ministry of Finance to prequalify suppliers of this kit solution began to publicize its technical specifications in January 1999 (see the program's home page on the Internet – www.confaz.fazenda.gov.br/pnafm) and will begin to evaluate the products available on the international market when the Bank approves the program.

2.21 The simplified projects will chiefly finance the procurement and introduction of the kit solution, based on the technical guidelines defined under the program and publicized by the LSTI and, as a supplement, will contract training in specific areas of municipal management.

b. Expanded projects

2.22 They are for municipalities with the capacity to carry out complete modernization and institutional strengthening projects, in other words, projects that include activities that cover the fiscal, planning and administrative areas as a whole. They are also intended for municipalities that are planning to use or are currently using geoprocessing techniques.

2.23 The expanded projects are also intended to develop specific modernization proposals for each municipality, based on a set of guidelines drawn up by the Bank to be followed during project preparation.

2.24 Only municipalities with populations over 150,000 may present projects of this kind.

2.25 Table II-1 defines the different groups of municipalities and the types of projects for each of the groups.

Table II-1

GROUP	POPULATION	TYPE OF PROJECT	REFERENCE VALUE OF PROJECTS (US$)
1	Up to 5.000	Simplified	180,000
2	5,001 to 10,000	Simplified	196,000
3	10,001 to 20,000	Simplified	226,000
4	20,001 to 30,000	Simplified	286,000
5	30,001 to 50,000	Simplified	360,000
6	50,001 to 70,000	Optional – S or E	436,000 / 1,800,000
7	70,001 to 90,000	Optional – S or E	500,000 / 2,200,000
8	90,001 to 120,000	Optional – S or E	624,000 / 3,700,000
9	120,001 to 150,000	Optional – S or E	738,000 / 5,100,000
10	150,001 to 200,000	Expanded	6,200,000
11	200,001 to 250,000	Expanded	7,600,000
12	250,001 to 350,000	Expanded	9,000,000
13	350,001 to 450,000	Expanded	11,000,000
14	450,001 to 700,000	Expanded	13,000,000
15	700,001 to 950,000	Expanded	16,000,000
16	950,001 to 1,950,000	Expanded	25,000,000
17	1,950,001 to 2,950,000	Expanded	37,000,000
18	Over 2,950,001	Expanded	50,000,000

S = Simplified / E = Expanded

D. Program scale

1. Scale of component I

2.26 Component I has been scaled on the basis of consulting and travel costs, training programs and the equipment necessary for the activities to be carried out by the Executive Secretariat, so that it can offer effective support for the municipalities in the fiscal field and technical assistance linked to program execution over an estimated period of 12 years.

2.27 The need for consulting services in different fields has been included, such as taxation, inspection, , budgeting, government accounting, municipal management, information systems, organizational development and training, human resources, social security, travel for technical assistance and municipal evaluation purposes, and actions related to training programs on the national level. As for the LSTI laboratory, the costs have been scaled to cover its start-up and operation during the entire program.

2.28 Half of these costs, which amount to US$25 million, will be financed with proceeds from the Bank loan and the other half will come from the federal government counterpart.

2. Scale of component II

2.29 Component II has been scaled on the basis of diagnoses and studies prepared by the Bank and the Ministry of Finance using questionnaires, identification missions, and reviews of projects already presented to the Bank by the municipalities.

2.30 The scale of the simplified projects has been designed based on the two main shortcomings observed in small and medium-sized municipalities:

a. General absence of automation in operational processes with shortcomings in control systems and in the generation of information for city governments and the public; and

b. Low levels of training for municipal managers and technical experts in all areas and very scant use of management instruments and techniques for dealing with the public.

2.31 It was in this context that the target areas for basic investments in specific projects were defined: (a) information technology, and (b) human resources. On that basis, specifications were developed for the different products to be included in the kit solution and training programs were defined for the different groups of municipalities. Based on these specifications and on the results of a survey of market costs (prepared by the Ministry of Finance), the costs for the different products have been scaled and values have been established for projects for the different groups of municipalities.

2.32 The scale of the expanded projects has been determined on the basis of the Bank's experience in preparing projects in the fiscal area and the experience acquired by the project team and the Ministry of Finance in preparing the 18 expanded projects in the representative sample.

2.33 The different needs detected when the sample was being prepared made it possible to define the components of the expanded projects and to consolidate a basic investment cost based on municipal size.

3. Overall scale of the program

2.34 Initially, the operation was scaled using the values necessary to enable all the municipalities to carry out complete administrative modernization programs. It was estimated that the funds required to execute a comprehensive municipal modernization program would be in the order of from US$2.8 billion to US$3.6 billion. It was determined that 70% of municipalities (3,854) would participate in the program and that demand would always be higher for the simplified projects, leading to a total estimated value for the program of US$2.2 billion.

2.35 In function of program size and the time necessary to carry it out and with the objective of adjusting and prioritizing existing needs by linking them to the funds available and to Bank and country programming for 1999, the project team made an adjustment so that the program could be carried out in three stages, as described below.

2.36 Table II-2 summarizes the scope of the stages planned. The coverage goals are based on population, location and level of municipal development, to ensure equitable distribution among the different sizes and types of municipalities.

Table II-2

Group	Number of municipalities	Stage 1		Stage 2		Stage 3		Total
		#	Value	#	Value	#	Value	
1	990	198	35,632,800	406	73,047,240	386	69,483,960	178,164,000
2	909	182	35,644,560	373	73,071,348	355	69,506,892	178,222,800
3	963	193	43,505,000	395	89,185,250	375	84,834,750	217,525,000
4	384	77	21,941,920	157	44,980,936	150	42,786,744	109,709,600
5	265	53	19,101,600	109	39,158,280	103	37,248,120	95,508,000
6	110	22	9,583,280	45	19,645,724	43	18,687,396	47,916,400
7	66	13	6,580,000	27	13,489,000	26	12,831,000	32,900,000
8	48	10	6,027,840	20	12,357,072	19	11,754,288	30,139,200
9	20	4	2,892,960	8	5,930,568	8	5,641,272	14,464,800
10	29	6	36,456,000	12	74,734,800	11	71,089,200	182,280,000
11	18	4	27,664,000	7	56,711,200	7	53,944,800	138,320,000
12	20	4	36,540,000	8	74,907,000	8	71,253,000	182,700,000
13	8	2	20,020,000	3	41,041,000	3	36,036,000	92,400,000
14	10	2	25,480,000	4	52,234,000	4	49,686,000	127,400,000
15	5	1	15,680,000	2	32,144,000	2	30,576,000	78,400,000
16	6	1	28,000,000	2	57,400,000	2	54,600,000	140,000,000
17	2	1	37,000,000	1	37,000,000	-	-	50,000,000
18	2	1	50,000,000	-	-	-	-	50,000,000
Subtotal	**3,854**	**772**	**457,749,960**	**1,580**	**797,037,418**	**1,502**	**722962,422**	**1,977,749,800**

2.37 The needs for stage 1 of component I were scaled and progressive values were estimated based on the economies of scale that would be obtained once stages 2 and 3 were operating and integrated with the other subnational modernization programs. The estimated cost of component I is US$10 million in stages 1 and 2 and US$5 million in stage 3 (see Table II-3).

Table II–3
Scale of component I – stage 1

Investment category	IDB	Local	Total
1. Consulting services in the following areas: taxation, finance, information technology, organizational development, municipal management, human resources, social security and auditing	3,200,000	-	3,200,000
2. Travel for missions, technical assistance and supervision	400,000	1,100,000	1,500,000
3. Training programs on the national level, average of one program a month	400,000	1,900,000	2,300,000
4. Computer equipment and information systems, LSTI laboratory, financial administration systems	900,000	100,000	1,000,000
5. General support. Installations, publications, transport and communications	100,000	1,900,000	2,000,000
TOTAL	**5,000,000**	**5,000,000**	**10,000,000**

E. Cost and financing

2.38 The program will cost an estimated US$2.2 billion for the three stages. The Bank will contribute US$1.1 billion and the local counterpart will also be US$1.1 billion, to be financed jointly by the federal government and the beneficiary municipalities.

2.39 Initially, the Bank will approve financing for stage 1, which will cost an estimated US$600 million, with the Bank financing 50% (US$300 million). The other stages will be approved in accordance with the rules that have been established (see paragraph 2.48 and Tables II-4 and II-5).

Table II-4

BUDGET* CATEGORIES	TOTAL PROGRAM IDB	TOTAL PROGRAM LOCAL	TOTAL PROGRAM TOTAL	STAGES 1	STAGES 2	STAGES 3
1. Administration		**175**	**175**	**50**	**70**	**55**
1.1 PCU (federal)		7	7	2	3	2
1.2 MEU (municipal)		168	168	48	67	53
2. Component I	**12.5**	**12.5**	**25**	**10**	**10**	**5**
2.1 Consulting/training	10	6	16	7	7	3.5
2.2 General support and equipment	2.5	6.5	9	3	3	1.5
3. Component II	**1,000**	**775**	**1,775**	**483**	**722**	**570**
3.1 Simplified projects	400	310	710	193	289	228
3.2 Expanded projects	600	465	1,065	290	433	342
4. Unallocated costs	**76.5**	**8**	**85.5**	**22**	**38**	**25.5**
4.1 Contingencies (Comp. I)	2.5	2.5	5	3	5	4.0
4.2 Contingencies (Comp. II)	74.0	5.5	79.5	19	33	21.5
5. Financial costs	**11**	**129**	**140**	**35**	**60**	**45**
5.1 Inspection and supervision	11	-	11	3	5	3
5.2 Bank interest	-	120	120	27	46	36
5.3 Credit fee	-	9	9	5	9	6
TOTAL	**1,100**	**1,100**	**2,200**	**600**	**900**	**700**

(*) US$ millions

Table II-5
BUDGET FOR STAGE 1

Category	IDB (*)	Local (*)	Total (*)	(%) total
1. Administration		**50**	**50**	**8.3**
1.1 PCU (federal)		2	2	
1.2 MEU (municipal)		48	48	
2. Component I	**5**	**5**	**10**	**1.7**
2.1 Consulting/training	4	3	7	
2.2 General support and equipment	1	2	3	
3. Component II	**275**	**208**	**483**	**80.5**
3.1 Simplified projects	110	83	193	
3.2 Expanded projects	165	125	290	
4. Unallocated costs	**17.0**	**5.0**	**22**	**3.7**
4.1 Contingencies (Comp. I)	1.5	1.5	3	
4.2 Contingencies (Comp. II)	15.5	3.5	19	
5. Financial costs	**3**	**32**	**35**	**5.8**
5.1 Inspection and supervision	3	-	3	
5.2 Bank interest	-	27	27	
5.3 Credit fee	-	5	5	
TOTAL	**300**	**300**	**600**	**100**

(in US$ millions)

F. Financing bases

2.40 Financing for component II was calculated so that the local counterpart to be contributed by each municipality would be variable, thus reflecting the Bank's intention of providing greater support for less-developed municipalities.

2.41 The administration costs cover the salaries of the public employees assigned to the PCU. The municipalities will establish municipal executing units (MEUs) to be financed with counterpart funds.

2.42 The amounts allocated to contingencies (component II) will be used to support municipalities with good project performance that need additional funds to complete the modernization processes introduced.

1. Financing criteria

2.43 The criteria shown in Table II-1 were used to define the ceiling on Bank financing for projects in each municipality. For municipalities carrying out simplified projects, the values defined for groups 1 to 9 are the caps. For municipalities carrying out expanded projects, the values for groups 6 to 18 are benchmarks to be used by the PCU in evaluating each individual case.

2.44 With regard to the classification adopted for the program, minimum percentages were assigned for the local financial counterpart for each of the groups, using the following guidelines:

a. As a whole, the program should present a global financing matrix of 50:50; and

b. The municipalities with the greatest technical and financial needs will be favored in financing, without overloading the matrix for the more developed municipalities.

2.45 So that the poorer municipalities do not have to contribute funding that outstrips their capacity, the program was adjusted to enable the Bank to recognize local counterpart items up to a predetermined amount, related to activities linked to the final results of the program.

2.46 The Bank may recognize counterpart costs for the less developed municipalities based on the following criteria:

a. Costs of employees working in the inspection and property/taxpayer roll areas who are carrying out activities linked to the new programs to revise the rolls and inspection and collection programs introduced under the program;

b. Costs of setting up new units to provide service for taxpayers and citizens;

c. Additional data processing costs in function of the new systems introduced under the program and the costs of maintaining the application systems (kit solution) financed by the program;

d. Costs of new technical experts in the fiscal area contracted for program activities; and

e. Other costs relating to the modernization process and staff reduction programs.

2.47 The program Operating Regulations describe the matrix for caps on financing and the rules for counterpart contributions by each type of municipality.

2. Execution period and term for the commitment of funds

2.48 The program will be carried out in three stages, each lasting four years each, with three years to commit the funds, both counting from the date on which the loan contract becomes effective.

a. For approval of stage 2:

(i) At least 75% of the funds for the first stage of the program have been committed through subloans;

(ii) At least 50% of the funds for the first stage have been disbursed by the Bank;

(iii) The Bank has verified, using the indicators established in the supervision and evaluation methodology (annex I-2), achievement of program results and benefits such as:

- at least 70% of the municipalities that joined the program in years 1 and 2 have introduced integrated management systems for public finances and municipal property and tax rolls;

- at least 70% of the municipalities that joined the program in years 1 and 2 have informed the public about their budget performance, including administrative costs and public investments;

- at least 70% of the municipalities that joined the program in years 1 and 2 have obtained increases in the numerical value of their management indicators (annex I-2), particularly indicators for the deficit and public debt, tax revenues, and control and auditing;

(iv) At least 800 municipalities that did not participate in stage 1 have signed commitments to join the program, indicating the existence of demand that would justify approval by the Bank of the funds for stage 2.

b. For approval of stage 3:

(i) One hundred percent of the funds for stage 1 and at least 75% of those for stage 2 have been committed through subloans;

(ii) One hundred percent of the funds for stage 1 and at least 50% of those for stage 2 have been disbursed by the Bank;

(iii) The Bank has verified, using the indicators established in the supervision and evaluation methodology (annex I-2), achievement of program results and benefits such as:

- at least 70% of the municipalities that joined the program in years 3 and 4 have introduced integrated management systems for public finances and municipal property and tax rolls;

- at least 70% of the municipalities that joined the program in years 3 and 4 have informed the public about their budget performance, including administrative costs and public investments;

- at least 70% of the municipalities that joined the program in years 3 and 4 have obtained increases in the numerical value of their management indicators (annex I-2), particularly indicators for the deficit and public debt, tax revenues, and control and auditing;

- at least 70% of the municipalities that joined in the previous two stages have achieved better results in the indicators for transparency and quality in the delivery of municipal public services based on public opinion polls;

(iv) At least 700 municipalities that did not participate in the previous stages have signed commitments to join the program, indicating the existence of demand that would justify approval by the Bank of the funds for stage 3.

2.49 Once the conditions stipulated in paragraph 2.48 have been complied with, a supervision and evaluation mission will be conducted by the Bank. The memorandum of this mission will be submitted to the Board of Executive Directors for approval of the following stage.

G. Loan conditions

2.50 The Bank will finance the program with funds from its ordinary capital. The terms and conditions of the loan will be:

Currency:	Currency pool
Interest rate:	Variable
Credit fee:	0.75%
Inspection & supervision:	1%
Amortization period:	20 years
Disbursement period per stage:	4 years
Grace period per stage:	4 years
Commitment period per stage:	3 years

III. PROGRAM EXECUTION

A. Program Operating Regulations

3.1 The Operating Regulations will serve as the common frame of reference that establishes rules relating to program execution. The Ministry of Finance will officially publish and disseminate these regulations to program participants. The entry into force of the Operating Regulations will be a condition precedent to the first disbursement.

B. Borrower and executing agencies

3.2 The federal government will be the borrower.

3.3 The Ministry of Finance will be in charge of program execution through its Executive Secretariat, which will be responsible for coordinating program activities with the municipal governments (subborrowers) and the Caixa Econômica Federal (Caixa), which will act as the financial agent and coexecuting agency.

3.4 The program will be executed through a program coordination unit (PCU) which has already been officially established and will have the following responsibilities:

a. To disseminate information about the program and publish the Operating Regulations and all related technical and operational documents;

b. To certify that the projects presented by the municipalities comply with the eligibility requirements established in the Operating Regulations;

c. To authorize and coordinate signature of contracts for subloans between the municipalities and the Caixa;

d. To supervise execution of the subloans;

e. To coordinate with the Caixa and approve the programming for disbursements of program funds;

f. To coordinate procedures for the approval and execution of projects in each municipality with the Bank;

g. To supervise and evaluate project execution; and

h. To coordinate disbursements and program accounting with the Bank.

3.5 The PCU will be staffed with specialists in the program's technical areas and support staff and will be headed by a coordinator who will report directly to the Executive Secretary of the Ministry of Finance.

3.6 The PCU will be responsible for coordinating the proposed program and the national tax administration support program for the Brazilian States, which is currently under way.

3.7 As a condition precedent to the first disbursement of the loan, evidence must be presented that the financial administration systems specific to program management of the Caixa and the PCU are compatible.

3.8 The Caixa will support the PCU in executing the program and will act as its financial agent.

3.9 As financial agent, the Caixa will transfer program funds in the form of subloans to the participating municipalities and will be responsible for management of the subloans (both from the Bank loan and the local counterpart) and will make direct payments to the suppliers of goods, works and services.

3.10 As coexecuting agency, the Caixa will publicize the program throughout the country and will provide technical support and guidance in preparing the technical documents for the simplified and expanded projects presented by the municipalities.

3.11 The Caixa will also be responsible for determining the eligibility of simplified projects for funding under the program. The PCU will be do the same for the expanded projects.

3.12 The Caixa will also be responsible for coordinating activities related to the programming of disbursements, presentation of accounts and auditing with the PCU.

3.13 The Caixa will sign a contract (approved in advance by the Bank) with the borrower, establishing the system for transferring funds, the conditions under which financing will be granted to the municipalities, and the Caixa's obligations under the program. Presentation to the Bank of the signed agreement will be a condition precedent to the first disbursement.

3.14 The municipalities will be the subborrowers under the program. They will establish municipal executing units (MEUs) with adequate staff, in accordance with the program Operating Regulations.

C. Subloans

1. Financial conditions

3.15 The conditions for granting financing to the municipalities will be the same, as far as possible, as those established in the loan contract between the Bank and the Brazilian government, plus the cost of the services provided by the Caixa, which will be an estimated 0.2% a year on the outstanding balance of the subloan.

3.16 Repayments by the municipalities to the federal government will be in local currency (reais) in values equivalent to the currency in which the IDB/government loan contract is denominated, based on the market selling rate of the United States dollar on the date of payment. Interest will be calculated as of the dates on which the disbursements are made to the municipalities, based on the same interest rates that the Bank will charge the federal government for the principal loan. A breakdown of the financial flows for disbursements and repayments by the subborrowers is given in the Operating Regulations.

2. Eligibility conditions

3.17 The Operating Regulations establish the conditions to be complied with by the municipalities and the projects they present to be eligible for financing with loan proceeds. The main conditions are:

a. To formally establish, through appropriate legal means, a municipal executing unit (MEU) and staff it adequately as defined in the Operating Regulations in order to perform effective accounting and financial controls and project execution;

b. To obtain legislative approval to contract the subloan with the Caixa and to put up the necessary guarantees;

c. To keep the counterpart funds needed for supplementary project financing, based on the formula established in the Operating Regulations, in a separate municipal account or to present evidence that the funds have been committed to ensure project execution during year 1;

d. To present within three months after the program adhesion commitment has been signed, at least one project that is eligible for financing under the program, prepared according to the rules established in the Operating Regulations; and

e. To sign a subloan contract with the Caixa.

3.18 The above conditions will be conditions precedent to the first disbursement of the Bank contribution to the subborrowers.

3. Strategy and methodology for analyzing and preparing municipal projects

3.19 To support the municipalities in preparing their analyses and specific projects, the project team, in cooperation with the Ministry of Finance, will develop a methodology and a series of support systems known as the "automated program to support preparation of questionnaires and projects – PEP", which will be available on the program's home page. Only projects that have been validated by the PEP will be approved.

3.20 The PEP includes a complete methodology for project development defined by the Bank (including financial and counterpart aspects), basic information on the 5,507 Brazilian municipalities, and the eligibility rules and conditions for simplified and expanded projects.

3.21 The PEP also provides supporting tools to enable the municipalities to carry out an analysis of their current situation, prepare a modernization plan and define all project components, including goals, resources and activities, and indicators for evaluating municipal management.

3.22 A representative sample of 71 projects (53 simplified and 18 expanded) was developed during program preparation. The methodology and support systems (PEP) were tested during that exercise, which made it possible to establish estimated times for project preparation and program execution.

4. Procedures for contracting the subloans

3.23 The municipalities will be served in the order in which they sign the program adhesion commitment. They will have a maximum of three years after they have signed it to present eligible projects to the PCU/Caixa. If they do not present eligible projects within that period, they will go to the end of the list.

3.24 Once the PCU/Caixa has certified that the municipality complies with the eligibility requirements set forth in the adhesion commitment, the municipality can sign a subloan contract with the Caixa, based on a model approved in advance by the Bank. Approval by the Bank of the final version of the model subloan contract is a condition precedent to the first disbursement of its loan.

D. Disbursement procedures

3.25 In view of the nature of the operation and the large volume of transactions entailed in the procurement of goods and services, an efficient mechanism is required for disbursements of program funds.

3.26 The ex post method of reviewing documentation in support of disbursements will be used. A revolving fund will be established and replenished in accordance with Bank rules. The executing agency will present disbursement requests to the Country Office together with breakdowns of payments on magnetic supports.

3.27 The original documents on the costs for component I will be retained by the PCU and the original documents on the costs for component II will be retained by the subborrowers (municipalities) with copies to the financial agent.

3.28 The executing agency will satisfy itself that the information contained in the breakdowns of payments is duly backed by documentation. The Caixa and the municipalities will be required to keep the supporting documents (contracts, orders, invoices, receipts, suppliers' certificates, certificates of origin and other documents

backing the information provided in the breakdowns of payments) duly identified and properly filed and available for review by authorized staff of the IDB and the Secretaria Federal de Controle (SFC) [Federal Auditing Department] and external auditors.

3.29 During its technical inspection and/or financial visits, the Country Office will carry out sampling to ensure that the supporting documents for disbursements are available in the files of the executing agency and that the funds have been used as established in the loan contract. The Country Office will also use the weekly reports prepared by the SFC as the basis for reviewing the supporting documentation for disbursement requests.

E. Auditing

3.30 The Federal Auditing Department (SFC) will audit the program's financial statements in accordance with Bank policies and will issue a report for each calendar year during program execution, within 120 days after the end of the year.

3.31 The SFC will sample the supporting documentation for the disbursement requests presented to the Bank during each six-month period, issuing a separate report within 90 days after the period ends.

3.32 The loan proceeds may be used to hire individual auditors or auditing firms under the 'consultants' category to assist in program-related audits.

3.33 Whenever the Bank or the Ministry of Finance deems it necessary to conduct an audit of a specific project, an independent auditor will be hired under PCU coordination, and paid for with resources from the municipality's counterpart.

F. Procurement and contracting of goods and services

3.34 The municipalities carrying out simplified or expanded projects will call for bids based on models defined by the Bank and the Ministry of Finance (documents and contracts) and on Bank procurement policies.

3.35 Only companies with products that comply with the program's technical specifications and have been evaluated by the LSTI laboratory may participate in the bidding for the kit solutions.

3.36 Once the bidding has been concluded, the municipalities should inform the Caixa and forward all the documentation to it. When a service or good has been accepted by a municipality, the Caixa will pay the supplier directly.

3.37 Procurements of goods and contracts for works and consulting services will be carried out in accordance with the procedures set forth in annexes B and C of the loan contract, within the following limits. International competitive bidding will be

required for works costing US$5 million and over, goods costing US$350,000 and over and services costing US$200,000 and over.

3.38 The Bank's Country Office will perform ex post reviews of the tendering processes through sampling, for works costing less than US$5 million and goods worth less than US$350,000. Contracts for consulting services under US$200,000 for firms and US$100,000 for individual experts will also be reviewed based on ex post samples. However, the Bank will perform an ex ante review of each of the stages in the first contracting process.

3.39 The executing agency and the subborrowers may use the services of specialized agencies. The agencies must follow Bank procedures for the contracting of consulting services and procurement of goods and the cost of hiring them may be financed only from the local counterpart.

3.40 Based on the analysis of the projects in the representative sample, a tentative schedule for international and local bidding is presented below. This tentative program takes account of the nature of the projects in the sample and the number of simplified and expanded projects to be carried out in stage 1.

3.41 It is expected that a total of 740 simplified and 32 extended projects will be financed in stage 1. The number of bids is simply indicative of the types of procurements to be made during the program. The total estimated value of procurements in stage 1 is about 70% of the value of component II (US$458 million).

Table III-1

Main procurements, Stage 1	Amount (US$ millions)	Nr. of lots	Method	Estimated dates of publication of the SPN
1. Simplified projects (740)	**128**			
1.1 Kit solution	102	74	(70) ICB (4) LCB	20 bids per semester starting in 10/1999 4 bids per semester starting in 2000
1.2 Training	26	148	LCB	20 bids per quarter starting in 10/1999
2. Expanded projects (32)	**192**			
2.1 Consulting services	50	96	(32) ICB (64) LCB	15 bids per semester starting in 01/2000 20 bids per semester starting in 01/2000
2.2 Training	47	64	(32) ICB (32) LCB	5 bids per quarter starting in 01/2000 10 bids per semester starting in 01/2000
2.3 Computer equipment and programs	67	64	ICB	15 bids per semester starting in 01/2000
2.4 Equipment to support inspections	9	64	(32) ICB (32) LCB	10 bids per semester starting in 01/2001 10 bids per semester starting in 01/2001
2.5 Infrastructure	19	64	LCB	10 bids per quarter starting in 01/2000
TOTAL	**320**			

LCB = local competitive bidding not contingent upon international participation
ICB = international competitive bidding

G. Cost recognition

3.42 Based on the work done on the projects in the representative sample, the Bank will recognize spending of up to US$30 million under the program from April 30, 1998, up to the date on which the operation is approved by the Board of Executive Directors, as part of the counterpart contribution, provided it complies with requirements that are substantially similar to those established in the loan contract.

H. Revolving fund

3.43 Because of the large number of subborrowers and the large differences in project size, it is recommended that a revolving fund be established for up to 20% of the Bank loan in order to ensure that funds will be available to all the municipalities (large and small) in a timely fashion.

I. Disbursement schedule

3.44 Based on the timetable for financial execution of the representative sample and the program for implementing projects whose preparation is advanced, the following disbursement schedule has been estimated for the operation.

Table III-2
ANNUAL DISBURSEMENT SCHEDULE, STAGE 1
(US$ millions)

Source	Year 1	Year 2	Year 3	Year 4	TOTAL	%
Bank	45	98	120	37	300	50
Counterpart	45	94	109	52	300	50
Total	90	192	229	89	600	100
% total	15	32	38.2	14.8		100

J. Reports, program supervision and evaluation

1. Reports

3.45 The borrower will prepare and submit the following reports to the Bank:

a. **Work plan**, 60 days after the loan contract become effective, containing the following: (i) a general work timetable indicating the main goals and objectives to be achieved in the first 12 months of the program; (ii) a plan for contracting consulting services; (iii) a list of all the staff assigned permanently and exclusively to the program; (iv) a national training program for the first year of the program; (v) the program for technical assistance missions to the municipalities by the PCU's and the Caixa's

team of technical experts and consultants; and (vi) the program of studies to be conducted in year one of program execution.

b. **Progress reports**, 60 days after the end of every six-month period during the program, providing the information necessary to enable the Bank to perform effective monitoring of developments. The progress reports should contain the following as a minimum: (i) the general work timetable for the program, containing the main goals and objectives for the next six months; (ii) the main problems detected by the PCU that are hampering program development; and (iii) the degree of compliance with the outcomes and goals established for the specific municipal projects and for the program as a whole;

c. **Final report**, 120 days after the three stages of the operation are completed. The executing agency will present the report which should contain the following as a minimum: (i) analysis of the results of the program; (ii) the main obstacles encountered during execution; and (iii) conclusions and recommendations for the preparation of future operations of a similar nature; and

d. **Financial reports**, 120 days after the end of each calendar year. The executing agency will present these reports on the use of Bank and counterpart funds. Also, within 90 days after the end of each six-month period, the executing agency will present a report prepared by the SFC on the ex post reviews of supporting documentation for disbursement requests, as established in the section on auditing in this loan proposal.

2. Program supervision and evaluation

3.46 A methodology has been developed for program supervision and evaluation (annex I-2) which includes a set of indicators (results, execution and management) based on the following instruments: (a) a questionnaire to be answered by each municipality participating in the program; (b) the project progress reports presented by the municipalities; and (c) the project supervision reports presented by the Caixa.

3.47 Evidence regarding the modernization process will be collected by the missions conducted by the PCU during the program. It will be included in the semiannual progress reports submitted to the Bank.

3.48 To permit the Bank to monitor the operation, the PCU will use the Internet to post a database, available to the Bank, containing all the projects and the questionnaires answered by the municipalities participating in the program. The questionnaires should be answered by the municipalities for the first time when they present their projects and then annually during execution.

3.49 In view of the nature of the operation and the importance for the Bank of being able to evaluate specific projects in greater detail, a Bank supervisory mission will be carried out each year during the program. Apart from evaluating progress, the missions will present an annual technical report that will be used as the basis for the evaluation and approval of the second and third stages of the program.

3.50 For these missions, the PCU will organize a meeting/seminar lasting at least three days to be attended by the coordinators of a set of municipalities chosen by the Bank in order to review the progress made and the problems that have cropped up in different projects. This will permit the Bank to effectively monitor the projects and will provide data to evaluate the application of funds not yet committed through subloans as of that date.

3.51 During the supervisory missions, the Bank will consider the possibility of reallocating the uncommitted funds to municipalities with the best performance that need additional resources to complete their administrative and fiscal modernization programs.

3.52 This evaluation will be based on indicators defined by the Bank to measure the effectiveness and efficiency of the different municipal administrations, based on an evaluation of the data supplied in the municipal questionnaires and the government's report. The program supervision methodology describes the main evaluation indicators prepared by the Bank.

K. Program preparation status

1. Representative sample of projects

3.53 In conjunction with the Ministry of Finance, the Bank has performed a diagnosis of the status of the projects presented by the municipalities, based on an analysis of more than 90 questionnaires and missions to over 50 municipalities. The diagnosis permitted the Bank to establish a representative sample of 71 projects costing some US$171 million, composed of 18 expanded projects and 53 simplified projects. More than 100 additional projects in an advanced stage of preparation have been identified.

Table III-4
Representative sample

Group	Total municipalities	70% of municipalities	Estimate for the stage	Projects in the representative sample	Cost
1	1,414	990	198	4	720,000
2	1,299	909	182	11	2,156,000
3	1,375	963	193	19	4,294,000
4	548	384	77	12	3,432,000
5	379	265	53	6	2,160,000
6	157	110	22	2	1,962,185
7	94	66	13	2	2,232,416
8	69	48	10	-	-
9	28	20	4	2	10,382,614
10	42	29	6	2	10,205,827
11	26	18	4	-	10,063,804
12	29	20	4	4	-
13	12	8	2	2	56,120,902
14	14	10	2	2	21,873,976
15	7	5	1	-	26,923,110
16	8	6	1	1	-
17	3	2	1	-	16,090,710
18	2	1	1	71	-
	5,507	3,854	772	71	169,287,991

3.54 The sample is representative in terms of scale, since it represents 25% of investments in stage 1 of the program and approximately 10% of all the municipalities expected to participate in that stage. It is also representative with respect to the groups identified by population and the different regions, since it is comprised of municipalities located in 14 different states in the five regions: south, southeast, north, northwest and center-west.

2. Projects in an advanced stage of preparation

3.55 To date, more than 1,000 municipalities have signed the adhesion commitment. Over 100 projects are well advanced in their preparation, totaling more than US$200 million or 30% of the funds for stage 1 of the program. To be included in this category, the project team considered the following to be necessary:

a. There had been at least one meeting between the PCU/Caixa and the municipality;

b. The municipality had received the basic documentation on the program; and

c. The municipality had submitted at least one technical consultation on the project to the PCU/Caixa.

3.56 It is expected that these projects could be reviewed and approved for financing within six months of the date of program approval. These projects, together with the representative sample, would use 50% of the funds available for stage 1 of the program.

IV. Feasibility, benefits and risks

A. Program justification

4.1 The program is an important part of the efforts being made by the Brazilian government to modernize its public sector and, in particular, to strengthen fiscal federalism as defined in the constitution. The program responds to explicit demand by the federal government and the municipalities which seek to achieve complementary goals under it: in the first case, the integration and conceptual coherency of subnational fiscal reforms and in the second, the strengthening of tax administrations to enable them to collect and use funds in a manner that is consistent with their development objectives.

4.2 The Bank's participation in this effort forms part of a strategy to support Brazilian fiscal institutions that began with the program to modernize federal revenues (BR-0193) approved by the Bank in September 1995 and continued with the national tax administration support program for the Brazilian states (PNAFE) approved by the Bank in December 1996. These programs seek many of the same organizational, methodological and information technology objectives as the program proposed here.

4.3 Both the volume of demand by the municipalities and the operational and technical role played by the federal government justify the decision to carry out a national program, rather than independent projects with the municipalities. The organization of the program, with a national coordination unit, a financial agent/coexecuting agency (Caixa) and operating regulations that channel the loan proceeds to the municipalities is an efficient and transparent plan of execution that can be adequately supervised by the Bank.

B. Institutional feasibility

4.4 The institutional feasibility of this program has been analyzed for the federal government, the municipalities in the representative sample and the Caixa.

4.5 The regular mechanisms for coordination between the federal government and the lower levels of government in fiscal affairs are fluid, as has been apparent on various occasions when aspects connected to the national fiscal area have been redefined, such as during the process of consultations on amendments to the Public Budget Preparation and Audit Act (Law 4320), during reforms of legislation relating to taxation on foreign trade and in renegotiation of the subnational public debt.

4.6 As for the municipal governments, the analysis of the representative sample used to prepare this program demonstrated that the municipalities have made strides in creating adequate execution mechanisms. Municipal executing units (MEUs) have

been established and staffed with qualified full-time staff and provided with logistical support and adequate physical installations. The creation of the MEUs, by municipal government decree, is an eligibility criterion for municipal projects.

4.7 The Caixa is linked to the organizational structure of the Ministry of Finance and is represented in every state through more than 2,000 agencies. In addition, it has been increasing its involvement in different federal social and financial projects. In 1999, it became the federal government's principal financial agent for municipal programs.

4.8 The Caixa will be the only agent paying out program funds. It has legal authorization to do so and has physical facilities (agencies) throughout the country. The Caixa has established a central unit to work exclusively on coordinating all program activities. The unit, which was initially set up to support the Bank and the Ministry of Finance during the stage involving preparation of the representative sample of projects, will also be responsible for coordinating a training program for its employees who will participate directly in the program throughout the country.

C. Technical feasibility

4.9 The project preparation manual and the PEP program contain specific technical guidelines for the analysis, identification, design, review, approval and execution of municipal projects. The guidelines are based on the experience built up by the Bank in designing programs to strengthen tax administrations and will ensure that: (i) projects are formulated based on a predetermined menu of components; (ii) indispensable technical guidelines will be observed; (iii) adequate technical supervision will be provided by the PCU; and (iv) the Bank will supervise compliance with the guidelines in all project stages.

4.10 The PEP program has been designed to support the preparation of questionnaires and projects, and provides the controls necessary to ensure high-quality project documents.

D. Economic feasibility

4.11 The program is a cornerstone for the sustainability of the country's macroeconomic balance owing to its direct impact on municipal public finances. The efforts by governments to adjust their spending and reduce their debt are hampered by the lack of financial administration systems that permit the efficient allocation of funds and proper application of legal and policy guidelines in public budgets.

4.12 On the income side, high tax evasion, which is often above 80%, suggests that administrative efforts in the areas of inspection and information will lead to significant increases in tax revenues. As a whole, the tax, financial and publicity measures proposed for the program will help lay the groundwork for sustainable reform of municipal public finances.

E. Social equity and poverty reduction classification

4.13 The project does not include explicit performance indicators for measuring poverty reduction or improvements in social equity. Its nature makes it impossible to quantify its impact on poverty reduction with precision. The effort to increase tax revenues is expected to have an impact on the additional mobilization of private sector resources to the public sector, which will affect all income levels to different degrees in each municipality. However, greater efficiency in public spending plus higher tax revenues will facilitate the implementation of social programs and poverty reduction actions.

F. Environmental impact

4.14 The program was considered by CESI at its meeting on October 9, 1998. Its recommendations were to: (i) include considerations in the fiscal planning exercises for the participating municipalities to help identify resources to finance new and existing mandates in the field of environmental control; (ii) explore opportunities to promote rational land use; (iii) promote transparency in the financial administration of municipalities, particularly with respect to spending on social services and the environment. These recommendations were taken into account in designing the program.

G. Benefits

4.15 The main benefits expected from the program are:

a. Better prospects for controlling public spending and achieving a sustainable fiscal balance in the municipalities thanks to an increase in municipal tax revenues in the order of 2% of GDP. This, in turn, translates into a more solid foundation for fiscal solvency on the national level.

b. Increase in the capacity of municipal government to carry out economic and social development programs since they will have more funds to spend and instruments to make for their more efficient and effective management.

c. Substantial savings for the municipal governments as a result of the integration of national tax systems, and a reduction in the operating costs of monitoring compliance as a result of the introduction of integrated taxpayer and property rolls.

d. Reduction or elimination of tax distortions that affect domestic trade through a reduction in the sharp differences in efforts to monitor compliance in the different municipalities, which will lead to a reduction in inequities in the national tax system.

e. Strengthening of the mechanisms for dialogue on taxation between the federal and municipal governments.

f. Greater participation and control by society over municipal management with the introduction of measures to promote transparency recommended by the program.

H. Risks

4.16 The following are the main risks identified in the program:

a. The possibility of inadequate project formulation by the participating municipalities during the program. During preparation of the representative sample, the Bank supported formulation of projects in various parts of the country, but the responsibility of assisting the municipalities will rest with the PCU and the Caixa. To mitigate this risk, the Bank has developed an automated support system for preparing analyses and projects (PEP) and is effectively transferring its know-how to the technical experts of the PCU and the Caixa. Funds will be included in the PCU's budget to contract consultants to assist the municipal governments in preparing their specific projects. Strict criteria and technical recommendations are included in the project preparation manual that forms part of the program's Operating Regulations.

b. The possibility of unsatisfactory execution of specific projects owing to the lack of institutional capacity in the municipalities. Although some of the municipalities analyzed by the Bank and included in the representative sample have demonstrated their institutional soundness, a large number of municipalities encounter difficulties in executing projects. This risk will be reduced by the criteria and rules established mainly for the simplified projects, which provide detailed definitions of all projects stages, the support provided by Cain, and the fact that each municipality must issue a resolution creating an MEU.

4.17 The possibility that technical yardsticks for measuring financial needs will not be used in distributing program funds to the municipalities. This risk is minimized by including explicit quantitative parameters in the program that have been defined by designing and reviewing the projects in the sample, which will be used as the basis for distributing funds to the municipalities.

Logical framework
National program to support the administrative and fiscal management of Brazilian municipalities

Objective	Indicators	Means of verification	Assumptions
ribute to greater macroeconomic through a self-sustained fiscal on the municipal level.	– Higher own income on the municipal level. – Greater efficiency in municipal public spending. – Greater transparency and more control by society over municipal public management.	– Agreements reached under the federal government's fiscal adjustment program. – Publication by the Central Bank and the Treasury Department of fiscal data and financial statistics. – Information published by the municipalities on municipal management.	– Maintenance of the country's macroeconomic stabilization proce – Continuity in structural reforms, particularly administrative, social security and fiscal reforms. – Commitment by the federal and municipal governments to reduce tl public deficit.
e: e municipal administrative and nanagement (income and public g) more efficient and transparent.	**1. Efficiency** a. Level of own collections increases by: 10% for municipalities founded since 1988 and 15% for the rest with populations under 50,000; 20% for municipalities between 50,000 and 200,000 in the first 24 months; and 35% for municipalities over 200,000 in the first 36 months. b. The administrative costs of the municipalities are curtailed or reduced to the levels established in federal and municipal legislation 12 months after an integrated financial administrative system is introduced. c. Municipal income available to finance investment programs increases by 10% in the first 36 months. d. The quality and coverage of municipal services for citizens improves in the first 36 months.	– Annual reports by the Central Bank, the Treasury Department and the municipal finance departments. – Municipal budgets. – Municipal investment plans. – Municipal government programs.	– High degree of commitment by municipal governments to the goal achieving fiscal balance. – Maintenance of the country's decentralization.

Objective	Indicators	Means of verification	Assumptions
	2. Transparency a. List of taxpayers in irregular situations is published semi-annually in all the municipalities served starting six months after the integrated tax system is introduced. b. List of taxpayers owing municipal taxes is available for public consultation in all the municipalities served starting six months after the integrated tax system is introduced. c. Citizen participation thanks to the information available on budget performance, administrative events and management of the public investment plan, three months after the start of the project. d. All the municipalities served inform the community semiannually of the results of the evaluations, six months after the start of the project.		
nents: jects to modernize municipal nagement prepared by the nicipalities. cal management modernization jects financed and executed. ministrative modernization jects financed and executed. egrated administration projects ked to special controls financed l executed.	1. 200 projects prepared by the end of year 1. 2. 200 projects financed and executed by the end of year 2. 3. 200 projects financed and executed by the end of year 3. 4. 172 projects financed and executed by the end of year 4.	– Program progress reports. – Access to information systems developed by the program. – Contracts and commitments between the Ministry of Finance, Caixa and the municipalities.	– Little resistance to change by municipal finance departments. – Projects prepared using the models and methodologies defined in the project preparation manual. – Projects executed on schedule. – Capacity of the municipalities to comply with project requirements – Effective coordination and technica assistance from the Ministry of Finance and Caixa. – Availability in the country of consulting services with the necess qualifications. – Private sector interested in providin technical solutions

National Program to Support the Administrative and Fiscal Management of Brazilian Municipalities (BR-0286)

Methodology for Program Supervision and Evaluation

Objective

pervise and evaluate the objectives, results and goals established for the program, the execution strategy of the projects finance ie sustainability of the modernization process.

Basic structure

rogram supervision and evaluation system is based on the actions of the following agencies that will provide coordination, vision and support for the program: the IDB, the Executive Secretariat and the Federal Audit Department of the Ministry of ce, the program financial agent and associations of municipalities.

asic structure of the supervision and evaluation system is composed of indicators for results and performance evaluation and s and technical meetings held for the executing agencies (municipalities), supervised by the PCU and with participation by the cial agent and associations of municipalities. Apart from serving as opportunities for the exchange of information and ience, these events will facilitate discussion and analysis of the results of the performance indicators.

dition to the indicators and analysis events, the basic program supervision and evaluation structure will be complemented by visory missions by the IDB and the PCU.

Indicators of results

upervision and evaluation system will monitor compliance with program objectives, the financial goals of the subloans set for of the stages and the following expected results for each of the municipalities participating in the program:

Regarding efficiency in municipal public management

a. Own revenue collection levels of at least:

(i) 10% of total income for municipalities founded since 1988 and 15% for the rest of municipalities with populatio under 50,000, 12 months after the project begins.

(ii) 20% for municipalities over 50,000 and under 200,000, 24 months after the project begins; and

(iii) 35% for municipalities over 200,000, 36 months after the project begins.

b. Curtailment and eventual reduction of municipal administrative costs to the levels established in federal and municipal legislation, 12 months after the integrated financial administration system is introduced.

c. At least 10% of total municipal income is used to finance investment programs, 36 months after the project begins.

d. Introduction and availability of the different services for citizens in accordance with program guidelines, 36 months aft the project begins.

Regarding the transparency of municipal public management

a. 100% of information on irregularities in the property and taxpayer rolls available for public consultation, six months after the integrated tax system is established.

b. Introduction of mechanisms to integrate the different taxpayer rolls on the national level to consolidate the federal government's strategy of integrating the different tax systems on the three levels of government (federal, state and municipal), six months after the integrated tax system is established.

c. 100% of information on budget performance, administrative events and management of the public investment plan is made available regularly to the community (monthly by the end of the project), three months after the project begins.

d. The methodology for evaluating municipal management established for the program is implemented and all the results the evaluations are made public semiannually, six months after the project begins.

vement of result 2 (d) is linked to the design and systematic use of a set of municipal performance indicators that will lement and facilitate monitoring of the progress they make until they obtain all the expected objectives and results of the am.

PERFORMANCE INDICATORS

erformance evaluation indicators cover three different levels of action that are linked to operational execution of the program, cation of compliance by the projects financed, and control and evaluation of management of the modernization process by the cipal administrations. As a complement to these indicators, opinion polls will be conducted among internal and external clients tax administration, which should be coordinated by the municipality with the support of associations of municipalities, under pervision of the PCU and the financial agent.

1 FOLLOW-UP ON PROGRAM OPERATIONS: PERFORMANCE INDICATORS

urpose of these indicators is to monitor compliance with the program's operating rules and execution procedures as they apply lministrative practices used by the different program agents. The financial agent and the PCU are responsible for the final tion of the indicators and periodic reporting on them. As a minimum, the performance indicators will include: (1) number of cipalities that have joined the program; (2) amount of funds committed; (3) amount of disbursements; (4) number and breakdow tax administration systems installed and in operation.

2 FOLLOW-UP ON THE MUNICIPAL MODERNIZATION PROCESS: MANAGEMENT INDICATORS

upervision and evaluation system also seeks to obtain information on the capacity of the municipal management model to ensur stainability and durability of the results obtained. A series of indicators has been defined to measure execution of the program' rnization components and the impact of the modernization of municipal tax administrations on municipal management. The gement indicators, which are described in the table at the end of this annex, should be calculated for the municipalities and

ted to the PCU periodically. The reports will be submitted semiannually and will be accompanied by the respective onnaires.

3 OPINION POLLS

on polls of the external and internal clients of municipal tax administrations will flesh out the picture provided by the gement indicators and facilitate measurements of the results of the modernization process supported by the projects financed. CU may use associations of municipalities as agents to support or coordinate the opinion polls, which should be conducted eve ears. The results should be taken into account in preparing specific plans to correct any deviant results identified.

SUPERVISORY MISSIONS

DB and the PCU will send supervisory missions to track the modernization process and identify actions to reduce the risks d to execution of the program and the projects financed. The results of the missions on the modernization process will also be rted by the activities of the financial agent and may receive support from associations of municipalities as well, for which se opinion polls will also be used.

1 IDB SUPERVISORY MISSIONS

year, the IDB will send a program supervision mission. It will follow an agenda proposed by the Bank and agreed upon with t utive Secretariat of the Ministry of Finance and will cover the PCU, municipalities in the program selected by the Bank and the cial agent.

2 PCU SUPERVISORY MISSIONS

CU should promote selected supervisory missions based on an analysis of the program supervision indicators or on specific that have been identified. The purpose of these missions could also include supervision of the financial agent or the entities rting the program such as associations of municipalities.

3 TECHNICAL EVENTS

ay of federal government support for the municipalities, regional technical events will be held to promote the exchange of ideas n analysis of the results of the projects, with a view to ensuring risk reduction, greater economies and closer integration of the am's actions. These events will be held and coordinated by the PCU and may include support from the financial agent and the iations of municipalities.

ROLE OF THE FINANCIAL AGENT

inancial agent will provide supervision for the simplified projects and certify that solutions have been implemented. It will also nt consolidated information to the PCU for fiscal and financial project supervision. The financial agent will also provide nce for the municipalities, particularly in aspects related to project administrative and financial management.

ROLE OF THE ASSOCIATIONS OF MUNICIPALITIES

ssociations of municipalities and their federations can act as agents to support events to determine the potential for integration echnical-cooperation activities and to analyze and discuss the results of projects whose purpose was to reduce risks and achieve omy and savings. The associations may also coordinate the administration of opinion polls to their internal and external clients e results of the actions of municipal tax administrations.

INPUTS FOR THE SUPERVISION AND EVALUATION METHODOLOGY

Approved project document prepared by the PEP program
Questionnaires used by the PEP program
Program Operating Regulations
Loan contract between the Brazilian government and the IDB
Subloan contracts between the municipalities and the financial agent
Report on program execution by the financial agent
Financial and progress reports

Reports by the IDB supervisory missions
Reports by the PCU supervisory and evaluation missions
Reports containing the recommendations of the technical meetings
Performance indicators
Results of the opinion polls

INDICATORS

NDICATORS	CALCULATION FORMULA	CONCEPTS
d income estimates and btained	Total income obtained / Total budgeted income	**Total income obtained**: total income (current + capital) in real terms in the balance shee **Total budgeted income**: total income (current + capital) established in the initial budget
pending estimates and spent	Total spending committed / Total spending budgeted	**Total spending committed**: total committed but not yet paid out. **Total budgeted spending**: total spending (current + capital) established in the initial bu
non-discretionary g	Total non-discretionary spending / Total spending	**Total non-discretionary spending**: total spending on non-discretionary payments (non-discretionary income). **Total spending**: total actual spending (current + capital) in the balance sheet.
budget balance	Current income / Current spending	**Current income**: total current income in real terms in the balance sheet. **Current spending**: total current spending in real terms in the balance sheet.
al debt service	Municipal debt service / Total current income	**Debt service**: flow of funds to pay the municipal debt (capital and interest) **Current income**: total current income in real terms in the balance sheet.
inancial administration	Cost of financial administration / Current spending	**Cost of financial administration**: total spending (current + capital) by the municipal fin department, except for pensions. **Current spending**: see indicator 4.
el costs	Personnel costs (working and pensioners) / Current spending	**Personnel costs**: labor costs including retired personnel. **Current spending**: total current spending in real terms in the balance sheet.
management units that use rated financial ration system	Management units on line with the integrated system / Total budget management units	**Management units on line with the integrated system**: number of budget managemen on line with an integrated financial administration system. **Total budget management units**: total number of budget management units, including that manage funds.
reported on line in the ed financial management	Amounts committed reported on line / Total spending committed	**Amounts committed reported on line**: costs committed but not spent reported on line in integrated financial management system. **Total spending committed**: see indicator 2.
ta share of tax revenues	Tax revenue collected / Population	**Tax revenue collected**: total tax revenue, including legal increases. **Population**: total municipal population.
ration of revenues	Number of taxpayers accounting for 50% / Total registered in the active ISS taxroll	**Number of taxpayers who contribute 50%**: total number of taxpayers who contribute ISS revenues. **Total number registered in the active taxroll**: total number of active registrants in the taxroll as of December 31.
ISS paid by active ts	Total registrants in the ISS / Total registrants in the active ISS taxroll	**Total registrants in the ISS**: actual number of companies/producers who submit some k return for the ICMS (monthly, annual or covering any period). **Total registrations in the active ISS taxroll**: see indicator 9.

NDICATORS	CALCULATION FORMULA	CONCEPTS
IPTU paid by active its	Total registrants in the IPTU Total registrants in the active IPTU taxroll	**Total registrants in the IPTU**: **Total registrants in the active IPTU taxroll**:
filed using electronic	Electronic returns Total returns filed	**Returns filed on electronic means**: total ISS returns filed on diskette/e-mail (monthly, a or other period). **Total returns received**: total number of ISS returns filed in a year using any means (mo annually or other period).
validated on line	Revenue validated on line Tax revenue collected	**Revenue validated on line**: total value of tax revenue validated in the banking system, v electronic data transmission to the state treasury. **Tax revenue collected**: see indicator 8
of actions for collection	Total number of actions for collection Total number of tax debts due	**Total number of actions for collection**: total number of actions to collect taxes due exc those in court collection. **Total number of debts due**: total number of debts due as of December 31.
enue recovered through nal action	Debt due paid Stock of debt due	**Debt due paid**: total value of tax debt due paid during the year. **Stock of debt due**: total value of the stock of tax debt due as of December 31 in the prec year, plus new debt due during the year under consideration.
ue in arrears	Stock of debt due Tax revenues collected	**Stock of debt due**: see indicator 13. **Tax revenue collected**: see indicator 8.
revenues	Total stock of tax debt Total tax revenues	**Total stock of revenues**: total value of the tax debt stock, excepting that in court collecti December 31. **Total tax revenue**: see indicator 8.
enue under administrative	Stock of taxes under appeal Tax revenue collected	**Stock of taxes under appeal**: total value of tax debt in first and second appeal as of Dec 31. **Tax revenue collected**: see indicator 8.
enue in court collection	Stock of debt in collection Tax revenue collected	**Stock of debt in court collection**: total value of active tax debt in the process of court co as of December 31. **Tax revenue collected**: see indicator 8.
f training activities	Number of employees trained Total number of employees	**Number of employees trained**: number of employees who will receive some kind of tra during the year. **Total number of employees**: total number of employees in the financial area (tax and fi
of municipal employees	Number of municipal employees Population	**Number of municipal employees**: total employees working for the municipal governme (includes teachers, physicians, other professionals and technical and support staff). **Population**: total population in the municipality.
nity assistance services	Number of means of assistance available to the community	**Number of means of assistance available to the community**: includes telephone assist electronic, printed and direct channels.

PROPOSED RESOLUTION

LOAN BRAZIL /OC-BR. REPUBLICA FEDERATIVA DE BRASIL.
Program for the Support of the Fiscal and Administrative Mangement of Brazilian Municipalities

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 the Federative Republic of Brazil, as Borrower, for the purpose of granting it a financing to cooperate in the execution of the first phase of a program for the support of the fiscal and administrative management of Brazilian municipalities. Such financing will be for the amount of up to three hundred million dollars of the United States of America (300,000,000), or its equivalent in other currencies, except that of the República Federativa de Brasil, which are part of the Ordinary Capital resources of the Bank and will be subject to the "Financial Terms and Conditions" and the "Special Contractual Conditions" of the Executive Summary of the Loan Proposal.