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Country Program Evaluation

Brazil

2015-2018

IDB | IDB Invest

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CONTENTS

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PREFACE

This country program evaluation (CPE) with Brazil is the fifth evaluation by the Office of Evaluation and Oversight (OVE) of the Bank's country program with Brazil. The previous two evaluations covered the periods 2007-2010 (document RE-398) and 2011-2014 (document RE-482). This CPE covers the period 2015-2018, and its starting point is December 2014, the end of the prior CPE evaluation period. Thus, the period under review spans two IDB country strategies: the 2012-2014 country strategy (in force until March 2016) and the 2016-2018 country strategy, each originally designed to cover a three-year period in response to the preparation cycle of the Multiyear Government Plan.

The CPE is divided into four chapters plus annexes. Chapter I analyzes the overall country context. Chapter II examines the IDB program during the 2015-2018 period from a strategic standpoint, particularly focusing on the relevance of the country strategy and the implemented program. Chapter III assesses the degree of progress made toward achieving the strategic objectives set by the Bank under the 2015-2018 country strategy. Chapter IV lays out conclusions and recommendations. In addition, the CPE analyzes the implementation of the prior CPE's recommendations by IDB Group Management (Annex VI).

According to the Protocol for Country Program Evaluations (document RE-348-3), the main goal of the CPE is to "provide information on Bank performance at the country level that is credible and useful, and that enables the incorporation of lessons and recommendations that can be used to improve the development effectiveness of the Bank's overall strategy and program of country assistance." This CPE serves as input for the IDB Group's new country strategy with Brazil that is currently in preparation.

ABBREVIATIONS

BNDES	Banco Nacional de Desenvolvimento Econômico e Social [National Bank for Economic and Social Development]
CAESB	Companhia de Saneamento Ambiental do Distrito Federal [Environmental Sanitation Company of the Federal District]
CBR	IDB Country Office in Brazil
CCLIP	Conditional credit line for investment projects
CEDLAS	Centro de Estudios Distributivos, Laborales y Sociales [Center for Distributive, Labor, and Social Studies]
COGEF	Comissão de Gestão Fazendária [Fiscal Management Commission]
CPE	Country program evaluation
FINEP	Financiadora de Estudos e Projetos [Funding Authority for Studies and Projects]
IBGE	Instituto Brasileiro de Geografia e Estatísticas [Brazilian Institute of Geography and Statistics]
LRF	Lei de Responsibildade Fiscal [Fiscal Responsibility Act]
NSG	Non-sovereign guaranteed [operations]
OECD	Organization for Economic Cooperation and Development
OVE	Office of Evaluation and Oversight
PNAFM	Programa Nacional de Apoio à Gestão Administrativa e Fiscal dos Municípios Brasileiros [National Program to Support the Administrative and Fiscal Management of Brazilian Municipios]
PPP	Public-private partnership
PRODETUR	Programs Regionais de Desenvolvimento do Turismo [Regional Programs for Tourism Development]
PROFISCO	Programa de Apoio à Gestão e Integração dos Fiscos no Brasil [Program to Support the Management and Integration of Fiscal Administrations in Brazil
SABESP	Companhia de Saneamento Básico do Estado de São Paulo S.A [Basic Sanitation Company of the State of São Paulo]
SEDLAC	Socioeconomic Database for Latin America and the Caribbean
SMEs	Small and medium-sized enterprises
TFFP	Trade Finance Facilitation Program
WDI	World Development Indicators

EXECUTIVE SUMMARY

The 2015-2018 evaluation period was marked by the difficult economic and political context in which the country found itself. During this period, Brazil experienced one of the most severe recessions in its history. Between 2015 and 2017, average annual growth was -2%, well below the 2.4% rate over the 2011-2014 period. The economic crisis was triggered by both domestic and external factors, exacerbating preexisting macroeconomic vulnerabilities. In line with the economic performance at the national level, the financial position of subnational governments has deteriorated considerably since 2014. The recession also reversed the significant progress made in reducing poverty and extreme poverty that had been achieved since the early 2000s. Add to this the unexpected removal of the president in the middle of her term. In response, the government initiated a series of reforms, which included changes to the Fiscal Responsibility Act (LRF), the proposed pension system reforms, and the labor reform and corporate governance bills. The economy began staging a slow recovery, growing 1% in 2017 and 2018.

The Bank's country strategy with Brazil 2016-2018 included very broad yet relevant strategic objectives, and sought to give continuity to the business model with subnational entities. The business model, which was largely based on the work with subnational entities, had been the Bank's response since the mid-2000s to the Brazilian government's strategy of channeling external financing to the states and municípios. The country strategy sought to contribute to the country's "medium- and long-term inclusive and sustainable growth" through three pillars or strategic areas: (i) increase productivity and competitiveness; (ii) reduce inequity and improve public services; and (iii) strengthen institutions at the three levels of government. A fourth pillar was added, related to the strengthening and use of the country financial and procurement systems. From these pillars 16 relevant strategic objectives were identified, since they were aligned with the priorities in the government's 2016-2018 Multiyear Plan, but were expanded given the number of possible areas of cooperation considered. In view of the economic outlook, the estimated lending envelope remained high (between US$5 billion and US$5.5 billion, compared to US$7 billion in the previous country strategy) and the intention to continue to deploy a business model focused on lending to subnational entities was also maintained.

In addition to strategic objectives, the 2016-2018 country strategy included "comprehensive implementation approaches" for the first time, which proved difficult to implement in practice. The country strategy developed a system of comprehensive implementation approaches that included the strengthening of public-private partnerships (PPPs), the sustainable economic development of metropolitan areas, and reducing regional socioeconomic inequalities. What was not developed, however, was *how* the approaches should be implemented in practice. The implementation approach through public-private partnerships (PPPs) was much less active than envisaged, limited to some specific instances of support, primarily through technical cooperation operations. The metropolitan areas approach was limited due to the difficulties of working directly with subnational entities and the lack of clarity on how to tackle the work with several municipalities under the metropolitan area concept, with the exception of health. Lastly, as a result of the intensification of work in regions with the greater inequalities (North and Northeast), 30% of approved loans to subnational entities in the 2015-2018 period were concentrated in the Northeast region, which is the same as in the preceding evaluation period. However, approvals in the North region declined significantly (from 13% to 2%). In contrast, In contrast, the South region went from concentrating 16% of the amounts approved for subnational entities in 2011-2014 to accounting for 28% in 2015-2018.

The 2015-2018 implemented program was generally aligned with the country strategy priorities. It included a total level of sovereign-guaranteed approvals that was lower than previous periods, but in line with the country strategy's estimated lending envelope, and a significant increase in non-sovereign guaranteed (NSG) approvals. The broad definition of the potential areas of support allowed the implemented program to easily fit into the areas of the country strategy, although the approvals were in large part in dialogue areas for which the IDB Group had not identified strategic objectives (e.g. energy, science and technology, urban development, tourism, and agriculture). Approvals during the period totaled US$6.771 billion, distributed among 29 sovereign-guaranteed loans (US$5.139 billion), 27 non-sovereign-guaranteed (NSG) operations (US$1.573 billion), 54 technical cooperation operations (US$27.5 million), and an investment grant (US$32 million). The sovereign-guaranteed amounts approved were lower than in previous periods, but in line with the country strategy's estimated lending envelope. As a result, the NSG amounts approved were twice the amounts for the 2011-2014 period. The implemented program included US$8,852,300.00 in undisbursed balances on 123 sovereign-guaranteed loans (US$8.428 billion) and nine NSG legacy operations (US$424.3 billion) from earlier periods. As of early 2015, the Bank had approved 26 loans that were awaiting signature of their loan contracts.

Sovereign-guaranteed approvals were concentrated in the final year of the period. When the crisis erupted in 2015, the government sought to minimize the fiscal impact of new loans at the three levels of government. Consequently, the Bank approved only one sovereign-guaranteed loan to a subnational entity, for US$50 million. This explains why practically half of the sovereign-guaranteed approvals in the country strategy period occurred in 2018, the last year of the period evaluated. Sovereign-guaranteed approvals for 2015-2018 targeted 11 sectors and, in terms of amounts, were concentrated in energy (20%), transportation (17%), financial markets (15%), science and technology (12%), and water and sanitation (9%).

The fiscal restrictions that characterized the period prevented the Bank from continuing the intensive model of directly financing subnational governments that it had been deploying since the previous period. Between 2015 and 2018, there was a significant reduction in demand for financing in general, but especially among subnational entities. During that period, the Bank approved 13 direct loans to states (US$1.509 billion) and 11 loans to municípios (US$735 million), for significantly lower amounts than approved during the previous evaluation period (US$9.160 billion). The continuity of the PROFISCO program was especially important, in that its loans accounted for more than half (54%) of loans to subnational entities over the 2015-2018 period. Moreover, in response to the federal government's decision to take a more strict approach to the fiscal capacity of subnational entities, the Bank adjusted its approach to lend only to entities that, in addition to having a guarantee from the federal government, also had a payment capacity rated A or B by the National Treasury.

The Bank adjusted its financing model, reactivating its work with public financial intermediaries through operations that enabled it to achieve the level of approvals set forth in the country strategy. The Bank reactivated its work with public financial intermediaries, and between late 2016 and 2018 approved four loans for US$2.7 billion with three entities (BNDES, FINEP, and Banco do Brasil). These loans amounted to 53% of total sovereign-guaranteed approvals for the evaluation period. The approved CCLIP with BNDES was important for reestablishing a long-term partnership between the two institutions. However, there has been limited financial and nonfinancial additionality for the first operations under the CCLIP. Both operations support large and consolidated lines of financing to BNDES (renewable energy and SMEs). Under the first operation, IDB resources were primarily used retroactively to finance wind energy. New operations currently being explored focus on more incipient lines of credit where both institutions intend to expand their support (e.g. citizen security and health). Regarding the operation with Banco do Brasil, approved in late 2018, elements of additionality are clearly identified. In that case, the Bank's financing is aimed at expanding a small line of credit offered by Banco do Brasil to municípios, considering that Banco do Brasil's subnational lending business had in the past focused almost exclusively on states. The IDB is helping Banco do Brasil to strengthen its institutional capacities for program design and supervision. In the operation with FINEP, the Bank's participation has also been important, particularly from a financial standpoint, in expanding the agency's lines of credit in priority sectors and supporting its strategy of diversification of financing sources, including financing in local currency. The Bank is providing technical support to FINEP on specific issues.

At the federal level, the Bank worked to create opportunities for dialogue on sector and operational issues, especially since 2016; nevertheless, it still has room to strengthen its position. Aimed at addressing subnational demand, the Bank's program included only one loan at the federal level, approved in late 2018. Technical cooperation operations were also approved at the federal level in a number of sectors in which the Bank had been working. The dialogue between the Bank and the country also served to adjust the work program (e.g. reorientation of sovereign-guaranteed operations to State-owned financial intermediaries, reorientation of NSG operations, creation of a fund for structuring PPP projects). Nonetheless, there is still room for further support for policy reforms (e.g. energy), for greater coordination of work at the subnational level with the federal level (e.g. tourism), and for developing new opportunities to support the government in emerging policy areas with long-term implications for the country through the use of instruments such as technical cooperation operations, knowledge products, and fee for service arrangements.

NSG financing, in turn, was redirected toward new sectors with some additionality. In a departure from the preceding period, in which NSG operations focused on foreign trade finance (through the Trade Finance Facilitation Program (TFFP)), the reorganization of the IDB Group's private sector windows in 2016 led NSG approvals to be concentrated, in terms of amounts, mainly in energy (42%), financial markets (23%), agriculture (12%), and water and sanitation (11%). IDB Invest found room to participate, primarily in renewable energy (although a relatively developed market already existed), acting together with BNDES through a combination of innovative financial products. In the case of support for small and medium-sized enterprises (SMEs), IDB Invest endeavored to work with a more diversified group of intermediary clients than in the previous period in promoting SME access to financing in various sectors.

Coordination between the IDB and IDB Invest remains incipient. There is no significant evidence of coordination between the two institutions in the areas in which they both worked during the period, or in the application of criteria defining the cases justifying use of sovereign-guaranteed and NSG financing for the same purposes. The greater presence of IDB Invest staff in the country and the opening of the new IDB Group office in São Paulo in 2017 contributed to increasing IDB Invest activity.

The use of instruments has been limited during the evaluation period. Due to the preference of the federal government, investment loans have been the main instrument used by the Bank to support subnational entities. During 2015-2018, all direct financing to subnational entities was channeled through specific investment loans and multiple works loans. At the end of the period under evaluation (December 2018), the only loan based on results was approved, which was also the only loan at the federal level. The Bank has also been exploring the possible use of guarantees. These experiences, as well as the use of programmatic approaches in certain sectors (e.g. the PROFISCO CCLIP) can serve as the basis for promoting a broader use of the available loan instruments, differentiating by project type and the executing agencies' level of sophistication and work experience with the Bank. The technical cooperation portfolio, executed for the most part (80%) by the Bank, has been used primarily to support sector agendas, and to a lesser extent, to support program management.

Portfolio performance improved during the period. The average preparation time and costs decreased. Since the second half of the evaluation period, the Bank's Country Office in Brazil (CBR) has made significant efforts to manage the portfolio's size and improve its execution. One of its main tasks was to cancel 15 loan contracts (US$791.8 million) that had not been signed, 13 of which had been approved before 2015. In addition, nearly US$200 million in uncommitted and unutilized resources for loans in execution were canceled. Other initiatives adopted by CBR to boost the efficiency and reduce the transactional costs of managing the portfolio included reorganizing and training the operations team, standardizing CBR processes (especially those related to interaction with execution units), and implementing semiannual comprehensive portfolio reviews with the participation of the three levels of government. Between January 2015 and December 2018, the number of active loans dropped from 123 to 97, a figure that CBR continues to consider high. Moreover, the percentage of projects classified as satisfactory in the Banks progress monitoring reports (PMRs) increased from 45% in 2015 to 88% in 2018.

Despite this progress, at the end of 2018, a significant portion of the active portfolio had extensions. In late 2018, there were 17 loans approved between 2017 and 2018 pending signature, and of the 80 signed loans, 43% had extensions of their disbursement periods averaging 28.9 months. Against this backdrop and as part of its strategy to reduce the size of the portfolio, CBR has made headway in establishing criteria for limiting project extensions. According to the executing agencies interviewed, there were a number of factors that delayed project implementation. The most commonly mentioned included difficulties in using the Bank's procurement rules, particularly in cases of limited institutional capacity or executing agencies that were working with the Bank for the first time, the complexity of executing projects involving numerous actors and requiring a high degree of coordination, the lack of final designs in infrastructure projects, and the use of the multiple works modality. Executing agencies reported that turnover of officials and political authorities, and the fiscal deterioration of the subnational governments has also adversely impacted the appropriation, prioritization, and pace of project execution.

More progress was made toward achieving the strategic objectives of the country strategy with respect to infrastructure projects, in line with the emphasis promoted by the government. OVE analyzed the entire active loan portfolio in all areas of IDB Group work: 165 operations in total. At the program level, it found that the greatest progress was made in interventions related to infrastructure construction or rehabilitation, especially when designed to expand health, education, care for at-risk young people, water and sanitation coverage, or to expand the installed capacity for renewable energy or to rehabilitate and pave state roads. In the case of interventions related to enhancing the quality of existing services, improving their management, or strengthening the capacity of the responsible entities, progress was generally more limited. In the case of management of public resources, the greatest advances were achieved at the state level with PROFISCO, where the Bank helped to boost state revenue, although there are no clear indicators showing advances on the expenditure side.

Based on the findings of this evaluation, OVE recommends the following:

1. **Develop individual business models for working with each type of borrower (federal government, states, municípios, private sector, or public financial institutions), establishing critical considerations for working with each,** such as: (i) objectives that the IDB Group intends to achieve; (ii) engagement conditions; (iii) potential use of instruments; (iv) areas requiring particular attention or support; (iv) replicable factors of success in working with each borrower; and (v) the way in which activities requiring other borrowers to participate will be coordinated.

   By way of example, the objectives at the federal level could include (i) positioning the Bank as a strategic partner on emerging key issues with long-term implications for the country and on which the Bank has experience and knowledge. To this end, the Bank should use instruments such as technical cooperation operations, fee for services, and even loans if they can make it possible to leverage resources, knowledge, or good practices; and (ii) delineating policy guidelines to guide interventions at the subnational level and facilitating greater coordination between the federal level and subnational entities.

2. **Consolidate the efforts to manage the size of the portfolio and explore new mechanisms for assisting executing agencies, considering their institutional capacity, with a view to improving the execution of projects.**

3. **In the context of new approvals, promote a greater use of available loan instruments, considering the type of project and the executing agencies' experience and capacity.**

4. **Strengthen coordination between the Bank and IDB Invest, and reach consensus on cases that justify the use of sovereign-guaranteed and NSG financing for the same purposes.**

5. **Emphasize expenditure control and quality considerations in the Bank's sector work at the subnational level in view of the fiscally restrictive context that will frame the next country strategy.**

I. CONTEXT

A. Situation analysis, 2015-2018

1.1 **If anything defines the period under review in Brazil, it is the convergence of a severe recession and political instability.** Brazil is the world's seventh largest economy and the largest in Latin America. With a population of 208 million, it is the world's fifth most populous country. Per capita gross domestic product (GDP) in purchasing power parity was US$15,484 in 2017. During the evaluation period, Brazil experienced one of the most severe recessions in its history. Average annual growth between 2015 and 2017 was -2%, well below the 2.4% rate over the 2011-2014 period, with cumulative growth of -7% in 2015-2016. The economy then began a slow recovery, growing by 1% in 2017 and 2018.[1]

1.2 **The economic crisis was triggered by both domestic and external factors that aggravated preexisting macroeconomic vulnerabilities.** A decline in competitiveness, coupled with more restrictive credit conditions and various corruption cases, undermined the confidence of the population and of international investors, adversely affecting consumption and investment. These factors added to preexisting weaknesses: growing inflation and an increase in primary expenditure had eroded the credibility of macroeconomic policy in the period preceding the crisis. In addition, external factors such as low commodity prices and slower growth in China led investors to reevaluate the outlook for Brazil's medium-term economic growth, putting an end to the boom in domestic consumption.

1.3 **While total federal government resources declined in the 2015-2017 period, total expenditure continued to trend upward, expanding the fiscal deficit and public debt.** Tax revenue averaged 17.5% of GDP between 2015 and 2017, one percentage point below the average for the 2011-2-014 period.[2] At the same time, the average primary expenditure between 2015 and 2017 was 19.6% of GDP, rising by 2.1% of GDP with respect to the 2011-2014 period (primarily due to an increase in social security expenditure).[3] Given this context, the primary balance went from an average surplus of 1.6% of GDP between 2011 and 2014 to an average deficit of 2% of GDP between 2015 and 2017. The total deficit rose from 3.4% of GDP in 2011-2014 to 9% of GDP in 2015-2017. In line with the higher deficit and lower economic growth, the gross public debt increased from 56% to 74% of GDP.[4] As a result of Brazil's weak fiscal and debt position, Standard & Poor's and Fitch downgraded the country's credit rating in September 2015. Searching for fiscal

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[1] Macroeconomic Report, Annex II.

[2] Refers to the net proceeds of transfers to subnational entities. Social security contributions and income tax are the largest sources of government revenue in Brazil (5.7% and 5.2% of GDP, respectively). Taxes on imports, industrial products, and on loan, insurance, and foreign-exchange transactions account for 0.5%, 0.7%, and 0.5% of GDP, respectively.

[3] Close to 90% of the primary expenditure is considered mandatory and consists of transfers (established by rules) to other levels of government, public employee wages, pensions, and social programs. Thus, a large proportion of the public expenditure is perennially on an upward trend.

[4] Net debt rose from 34% to 55% of GDP. A large percentage of Brazil's public debt portfolio is denominated in local currency, was issued at a fixed rate, and has an average maturity that has lengthened over time. As a result of this composition, the balance sheet is less exposed to refinancing, foreign exchange, and financing cost risks.

sustainability, the authorities introduced a ceiling on the federal government's real primary expenditure in late 2016 and are working on a reform of the pension system.

1.4 **In line with the economic performance at the national level, the financial position of subnational governments has deteriorated considerably since 2014.** Brazil has 26 states, one federal district, and some 5,700 municípios, which together account for more than 40% of the total budgeted resources collected in the country (net of transfers). During the evaluation period, mandatory expenditures such as wages and pensions, coupled with tax cuts designed to stimulate economic activity (in the form of incentives and exemptions to attract private investment to the states), put pressure on subnational government finances. As a result, states took on debt to cover the fiscal gap while reducing public investment spending.

1.5 **Thus, state debt levels rose in recent years, with the largest states exceeding the limits established under the Fiscal Responsibility Act (LRF).** In 2015, 15 of the 27 states exceeded the limit on payroll expenditure in relation to current net revenue under the LRF (which establishes debt limits for subnational entities). The remainder of the states came close to the limit, and two states (Rio de Janeiro and Minas Gerais) exceeded the limit alert.[5] Other than the Treasury, federal financial institutions (Caixa Econômica Federal and the National Bank for Economic and Social Development (BNDES)) are the largest source of funds for the states. States may also incur external debt (commercial, bilateral, and multilateral) but require a central government guarantee. The disparities among states are reflected in their widely differing finance costs.

1.6 **The 2015-2016 recession marked a turning point in the labor market: since that time, informal employment has been on the rise.** The Brazilian job market has made significant gains over the last 15 years. These were reflected in a growing formal employment rate,[6] an increase in wage earners' income, and a 90% rise in the minimum wage in real terms. The drop in economic activity in the last three years shrank employment in all sectors. The unemployment rate therefore doubled from 7% in 2014 to 12.1% in August 2018,[7] after having remained stable between 2011 and 2014.

1.7 **At the same time, the 2015-2016 recession reversed the significant progress in poverty and extreme poverty reduction achieved since the early 2000s.** The global rise in commodity prices in the first decade of the millennium, the strong performance of the labor market,[8] and expansive social policies[9] helped bring about a decline in poverty[10] from 23.5% in 2003 to 6.9% in 2014, and a decline in extreme poverty[11] from 11.6% to 2.8% over the same period. This trend began to reverse

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5 See "Selected Issues Paper. Stretching the limits: the evolution of subnational public finances in Brazil" (November 2016) (International Monetary Fund Country Report 16/349).

6 From 2004 to 2015, the formal employment rate in Brazil grew by 16.4%. Source: IBGE, National Household Sample Survey. Rate measurement based on legally registered jobs ("carteira de trabalho assinada").

7 World Bank, based on official data and data from the International Labor Organization (ILO).

8 An analysis of poverty reduction between 2004 and 2013 shows that 60% of the decline in moderate poverty is associated with improvements in job earnings. Source: World Bank (2016).

9 World Bank Group, 2016. Retaking the Path to Inclusion, Growth and Sustainability.

10 Measured as the population living on less than US$3.2 a day.

11 Measured as the population living on less than US$1.9 a day.

following the 2015 crisis, with increases in poverty (9.1%) and extreme poverty (4.1%) in 2016 to levels resembling those of 2012.[12] In addition, after adding more than 44 million people to its ranks between 2003 and 2013,[13] the middle class stopped expanding.

1.8 **In response, the government initiated a series of reforms to stabilize the economic situation.** These included changes to the LRF, the proposed pension system reforms, and the labor reform and corporate governance bills.[14]

1.9 **In the political sphere, charges of violating the Constitution and the LRF led to the impeachment and removal from office of the President in 2016.** In 2014, Dilma Rousseff was reelected as President of Brazil with 51% of the votes. The first impeachment proceedings against the President, who was accused of violating the Constitution and the LRF, got under way one year later. A formal impeachment petition was presented in April 2016. In May, President Rouseff was suspended from her duties by the Senate and in August she was removed from office. Michel Temer, Rouseff's Vice President, assumed the presidency for two years until the election of Jair Bolsonaro (Social Liberal Party), who took office in January 2019.

B. Structural challenges

1.10 **As in most of the countries in the region, productivity in Brazil declined in recent decades and only marginally contributed to the country's growth.** While the Brazilian economy grew at an average annual rate of 7.4% between 1950 and 1980 ("the golden age"), average annual growth in the 1980s was 2.6%. This slowdown was primarily attributable to the poor performance of total factor productivity, largely due to low labor productivity (Annex II).

1.11 **Multiple factors impede a recovery in productivity and impair the country's growth.** Brazil needs to increase the amount and quality of its infrastructure to reduce operational shortcomings and resource allocation deficiencies.[15] Brazil also has higher trade barriers than most countries, with high tariffs and local requirements that reduce competition and limit access to inputs and technologies. The cost of doing business in Brazil is extremely high,[16] largely the result of its complex tax and bureaucratic system. At the same time, the financial system is inefficient and costly, and small and medium-sized enterprises (SMEs) face credit restrictions due to limited and expensive long-term financing. Lastly, despite the progress made on combatting corruption, between 2011 and 2017, Brazil was one of the countries with the largest declines in control of corruption, one of the Worldwide Governance Indicators*,* partly due to the "Lava Jato" investigation.[17]

1.12 **Despite significant strides, social challenges persist in key areas of social development, with pronounced regional disparities.** Although income inequality,

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12 WDI, SEDLAC, and Povcalnet.

13 Neri, M., 2014. Brazil's Middle Classes. Economics Working Papers, EPGE, No. 759.

14 For more details, see Annex II.

15 The high cost of connectivity between regions reduces market opportunities for the more isolated regions, exacerbating the adverse impact of external competition in certain industries and sectors. World Bank (2018).

16 According to *Doing Business* (World Bank), Brazil ranks 125th out of 190 countries.

17 In the Lava Jato case, Petrobras executives were charged with receiving bribes from construction companies (primarily Odebrecht) in exchange for awarding contracts at higher-than-market prices and using a portion of these funds for election campaigns.

measured by the Gini coefficient, decreased between 2001 and 2015,[18] Brazil has one of the highest rates of inequality in the region,[19] creating challenges in terms of translating economic growth into improvements in income distribution among the various population groups. Income distribution across the country's regions also shows significant disparities; thus, the rate of poverty in the North region is five times higher than in the South region[20] (Figure 1.1). In education, despite advances in enrollment rates,[21] challenges persist in terms of education quality and socioeconomic and regional disparities.[22] Scholastic achievement tests show that economically disadvantaged students are less likely to be academically successful than their more advantaged peers and that the North and Northeast regions lag the furthest behind in education.[23] In health, while indicators for infant mortality and life expectancy at birth improved from 2003 to 2016, exceeding the average change in Latin America and the OECD countries, gaps by region and population group persist across all key indicators.[24] Lastly, Brazil has one of the highest homicide rates in the world,[25] and the rate is higher among young people (ages 15-24) and particularly among Afrodescendants, who are 23.5% more likely to be murder victims than non-Afro-Brazilians. The more rural North and Northeast regions have witnessed a rise in violence in recent years.[26]

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18 It went from 58.4 to 51.3 (last figure available) (World Bank. World Development Indicators (WDI)).

19 Together with Colombia (51.1, 2015 and 50.8, 2016), Panama (50.4, 2016), and Honduras (50, 2016) (idem).

20 Based on the international poverty line of US$3.2/day using 2016 data (CEDLAS and World Bank).

21 Preschool coverage went from 78.1% in 2012 to 91.7% in 2017, and secondary school coverage went from 60.2% to 68.17% over the same period. Source: Fundação Getúlio Vargas - Clear estimates using IBGE (National Household Sample Survey) data. According to OECD-PISA (2015), close to 71% (2015) of 15-year-olds are enrolled in grade 7 or above, 15% more than in 2003.

22 The Program for International Student Assessment (PISA) test (2015) shows that Brazil falls below the average for the OECD and other countries in the region, such as Chile, Mexico, and Colombia, in the three subjects tested.

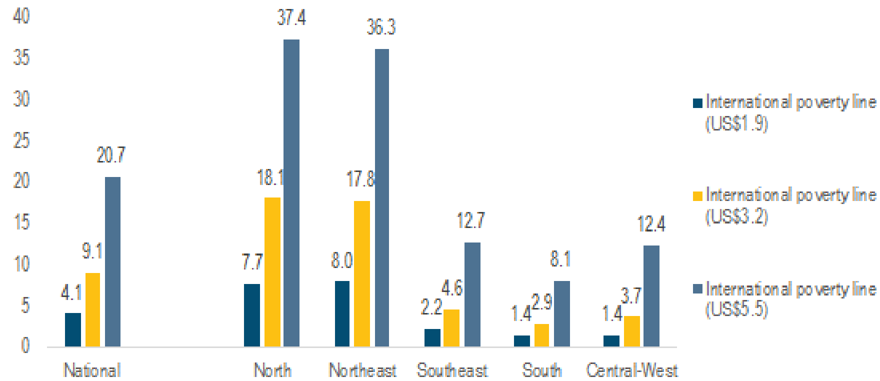
23 OECD-PISA (2015). The trend is confirmed by data from the Índice de Desenvolvimento da Educação Básica [Basic Education Development Index] (INDEB), Avaliação Nacional da Alfabetização [National Literacy Evaluation], and Exame Nacional do Ensino Médio [National High School Examination].

24 World Bank, WDI and Brazilian Ministry of Health Basic Data Indicators.

25 UNODC (www.unodc.org). According to the IDB publication The Costs of Crime and Violence: New Evidence and Insights in Latin America and the Caribbean (2017), the national homicide rate went from 22 per 100,000 population in 2004 to 25.7 per 100,000 pop. in 2016.

26 In São Paulo, the number of murders dropped by 44.3% between 2005 and 2015, while in Rio Grande do Norte it rose by 232% (www.insightcrime.org, IPEA (2018 a) "Atlas da violência 2018" and (2018 b) "Atlas da violência: políticas públicas e retratos dos municípios brasileiros").

Figure 1.1 Poverty rate (%) by region of Brazil, 2016



Source: Socioeconomic Database for Latin America and the Caribbean (Center for Distributive, Labor, and Social Studies (CEDLAS) and World Bank).

C. Outlook and future challenges

1.13 **In view of the demanding global financial conditions for developing countries, Brazil needs political and macroeconomic stability.** In the short term, reducing the fiscal deficit and the public debt is a priority in order to clear up any doubt concerning the sustainability of the debt. In this regard, strides have been made by introducing strict fiscal rules for primary expenditure to try to stabilize (and reduce) the public debt. However, fiscal consolidation should be hastened in order to create a "fiscal cushion" in the event of domestic or external shocks. In the medium term, Brazil's efforts to participate in the OECD as a full member could serve to expand the agenda of tax, pension, and financial reforms, which will probably have to be introduced in an adverse international context.

II. IDB Group Program in Brazil 2015-2018

A. Relevance of the country strategy

2.1 **The Bank's country strategy with Brazil for 2016-2018 sought to give continuity to the subnational business model that the Bank had been implementing since the mid-2000s.** The business model, which was largely based on work with subnational entities, had been the Bank's response since the 2000s to the Brazilian government's strategy of channeling external financing from the multilateral development banks to the subnational entities, taking into account the limited financial additionality of these resources at the federal level. In this context, the design of the country strategy coincided with the start of the country's economic and political difficulties, which complicated coordination with the country's authorities. Thus, while the country strategy set a lower level of approvals than the previous strategy (US$7 billion) in view of the difficult economic outlook, the estimated lending envelope remained high (between US$5 billion and US$5.5 billion) and the intention to continue to deploy a business model focused on lending to subnational entities was also maintained.[27]

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[27] Under the country strategy, approvals for the 2016-2018 period were primarily to be absorbed by subnational borrowers and were expected to be concentrated in the last two years of the strategy period, owing to an expected improvement in the economy and the country's fiscal position.

2.2 **The IDB Group objectives for the 2016-2018 period were relevant and aligned with the government's priorities, but were also expanded given the number of possible areas of cooperation considered.** The Country Development Challenges offered a more comprehensive and less sector-driven vision of the country's main development challenges. In response to these challenges, the country strategy sought to contribute to Brazil's "medium- and long-term inclusive and sustainable growth" through three pillars or strategic areas: (i) increase productivity and competitiveness; (ii) reduce inequity and improve public services; and (iii) strengthen institutions at the three levels of government. A fourth pillar was added, related to the strengthening and use of the country financial and procurement systems. The pillars sought to address critical problems in the country and reflected the strategic principles laid out by the government in its 2016-2018 Multiyear Plan (Table 2.1). Although the 16 strategic objectives drawn from them were relevant, they resulted in a large number of areas of action.

2.3 **Recognizing its financing limitations in relation to the size of Brazil's economy and funding needs, the country strategy aimed to maximize the nonfinancial impact of the IDB Group and, to that end, developed "implementation approaches" for the first time.** Aware of its limitations in terms of financial significance, the IDB Group sought to boost the nonfinancial significance of its program, in order to derive "the greatest possible impact" from its contribution. Accordingly, the country strategy developed a system of comprehensive implementation approaches that included the strengthening of PPPs, the sustainable economic development of metropolitan areas, and reducing socioeconomic disparities at the regional level. Additionally, this comprehensive approach called for the complementarity of interventions in order to "transcend the barriers between sector divisions." The country strategy also identified crosscutting themes, dialogue areas, and a knowledge agenda (Table 2.1), which were also meant to maximize the Group's nonfinancial impact.

Table 2.1. Multiyear Government Plan and IDB Group strategic objectives 2016-2018

<table>
<tr><th>Government of Brazil Multiyear Plan 2016-2019</th><th>Pillar 1:
Increase productivity and competitiveness</th><th>Pillar 2:
Reduce inequity and improve public services</th><th>Pillar 3:
Strengthen institutions (federal, state, and municipal)</th><th>Country fiduciary systems</th></tr>
<tr><td>Strategic principles:
• Quality education
• Social inclusion and inequality reduction
• Expansion of productivity and competitiveness
• Strengthening of public institutions</td><td>Strategic objectives:
• Improve the business climate
• Expand and reform the transportation and logistics infrastructure
• Support the development of SMEs</td><td>Strategic objectives:
• Support to achieve the country's health targets
• Improvement in education quality
• Support in preparing young people for the job market through vocational education
• Expand and improve the primary health care network
• Help reduce violence and crime among 15-24-year-olds
• Expand and improve water and basic sanitation service</td><td>Strategic objectives:
• Enhance efficiency in the management of public resources</td><td>Strategic objectives:
• Strengthen systems
• Use country fiduciary systems</td></tr>
<tr><td></td><td colspan="4">Comprehensive implementation approaches:
• Strengthening of public-private partnerships
• Sustainable economic development in the metropolitan areas
• Reduction in regional socioeconomic inequalities -regional approach</td></tr>
<tr><td></td><td colspan="4">Crosscutting themes: gender, diversity, integration, and climate change</td></tr>
<tr><td></td><td colspan="4">Dialogue areas: innovation, regional integration, agriculture, food security, energy sector, pensions</td></tr>
</table>

Source: OVE

2.4 **The combination of strategic objectives, implementation approaches, crosscutting themes, and dialogue areas, without coordination, made the country strategy highly complex**. This was compounded by the failure to determine how this structure was expected to be put in practice. Thus, despite the effort to create a more targeted country strategy than the previous one, the 2015-2018 country strategy ended up including the vast majority of objectives and priority sectors from the previous strategy. At the same time, there was no analysis of issues of importance for the Banco do Brasil program, such as the difficulties of overseeing the large loan portfolio existing at the start of the period—which started to be addressed in 2016—or the implications of establishing a country strategy with the federal government when demand was expected to come from the states and municípios, or the complexity of implementing a program that was highly fragmented both geographically and across sectors, with clients with differing levels of capacity and experience working with the Bank.

B. Relevance of the implemented program

2.5 **At the start of the evaluation period, the Bank was facing an enormous legacy portfolio of operations with subnational entities that posed major execution-related challenges.** Between 2011 and 2014, the Bank had approved 79 loans to states and municípios for a total of US$9.634 billion in a context of economic growth and in line with the federal government's emphasis on expanding subnational financing. Support to subnational entities had been channeled through individual operations and umbrella programs (e.g. PROFISCO, PROCIDADES, and PRODETUR). At the start of 2015, the Bank portfolio consisted of 123 loans distributed in 13 sectors and in all 27 states. Of this total, 26 loan contracts had yet to be signed and almost 30% of the signed loan contracts had been subject to requests for extensions averaging 27 months.

2.6 **The implemented program included a lower level of sovereign-guaranteed approvals than in previous periods and a significant increase in NSG approvals.** Between 2015 and 2018, the IDB Group approved a total of US$6.771 billion. Of this total, 76% (US$5.139 billion) was allocated to 29 sovereign-guaranteed loans, 23% (US$1.573 billion)[28] to 27 NSG operations, and the balance to 54 technical cooperation operations (US$27.5 million) and an investment grant (US$32 million). While the sovereign-guaranteed amounts approved were lower than in previous periods (Figure 2.1), they were in line country strategy's estimated lending envelope. In contrast, the NSG amounts approved were twice the amounts for the 2011-2014 period. The implemented program also included US$8.428 billion in undisbursed balances on 123 sovereign-guaranteed loans and US$424.3 million in undisbursed balances on nine NSG operations that were active as of early 2015.[29]

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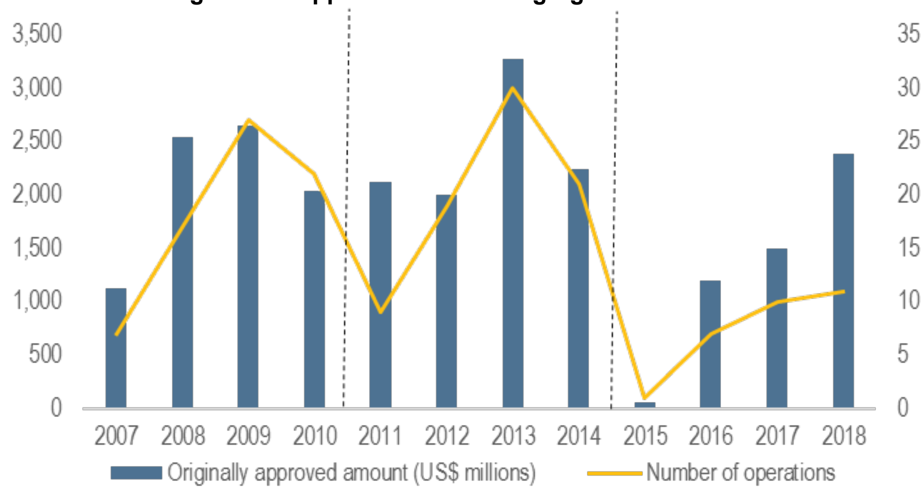
[28] The former private windows of the IDB Group—Structured and Corporate Financing Department and Opportunities for the Majority—approved six operations for US$329 million. Meanwhile, IDB Invest approved 21 operations for US$1,243,300,000. The latter consist of Inter-American Investment Corporation operations (loan, guarantees, and equity) and, more recently, IDB Invest operations. The amount includes resources from the IDB Group and other sources of funds managed by the Group. B-loans are not included.

[29] The CPE only includes technical cooperation operations approved in the period. Legacy operations included 54 technical cooperation projects and two investment grants that were active as of January 2015, with US$111 million in undisbursed balances.

Figure 2.1. Approvals of sovereign-guaranteed loans



Source: OVEDA, using the Bank's data warehouse.

2.7 **The implemented IDB Group program was aligned with the strategic areas and objectives of the country strategy, given how broadly they were defined, although it differed from what was originally envisaged.** The broad definition of the potential areas of support allowed the implemented program to easily fit into the areas of the country strategy, although the approvals were in large part in dialogue areas for which the IDB Group had not identified strategic objectives (e.g. energy, science and technology, urban development, tourism, and agriculture).

2.8 **Sovereign-guaranteed approvals were concentrated in the final year of the period and, unlike in the prior period, were focused on loans to public financial intermediaries.** When the crisis erupted in 2015, the government sought to minimize the fiscal impact of new loans at the three levels of government. Consequently, the Bank approved only one sovereign-guaranteed loan to a subnational entity, for US$50 million (Figure 2.1). This explains why practically half of the sovereign-guaranteed approvals in the country strategy period occurred in 2018. In a departure from the preceding period and from the business model envisaged in the country strategy, the approved sovereign-guaranteed amounts were concentrated in loans to public financial intermediaries (making it possible to achieve the baseline financing scenario under the country strategy), followed by subnational entities and the federal government (Table 2.2). Approvals in the 2015-2018 period targeted 11 sectors and, in terms of amounts, were concentrated in the energy (20%), transportation (17%), financial markets (15%), science and technology (12%), and water and sanitation (9%) sectors.[30]

[30] In terms of number of operations, approvals were concentrated in state reform and modernization (24%), health (14%), transportation (14%), and urban development and housing (14%).

Table 2.2. Sovereign-guaranteed loan approvals by type of borrower (months)

	2011-2014				2015-2018			
	Number	Number (%)	Amount (US$ millions)	Amount (%)	Number	Number (%)	Amount (US$ millions)	Amount (%)
Federal	9	11%	474.6	5%	1	3%	195.0	4%
States	51	65%	8,269.6	86%	13	45%	1,509.3	29%
Municípios	19	24%	890.8	9%	11	38%	735.1	14%
Intermediaries	-	-	-	-	4	14%	2,700.0	53%
Total	**79**	**100%**	**9,634.9**	**100%**	**29**	**100%**	**5,139.3**	**100%**

Source: OVEDA, using the Bank's data warehouse.

2.9 **The fiscal restrictions that characterized the period prevented the Bank from continuing with the intensive model of directly financing subnational governments that it had been deploying since the previous period.** The fiscal position of the subnational governments led to the establishment of debt ceilings and adjustments in the criteria for granting sovereign guarantees (Box 2.1). For the Bank, this translated into a significant reduction in demand for financing in general and in demand from subnational entities in particular. Between 2015 and 2018, the Bank approved 13 direct loans to states (US$1.509 billion) and 11 loans to municípios (US$735 million), far smaller amounts than those approved during the previous evaluation period (totaling US$9.160 billion). In response to the federal government's decision to take a more strict approach to the fiscal capacity of subnational entities, the Bank adjusted its approach to lend only to entities that, in addition to having a guarantee from the federal government, also had a payment capacity rated A or B by the National Treasury (Box 2.1),[31] and started to conduct its own monitoring of the fiscal position of future subnational borrowers. Until 2015, loans had been approved with states that did not have the A or B rating (e.g. BR-L1417 with Minas Gerais and BR-L1343 with Rio Grande do Sul) without an analysis of the possible implications for the beneficiary entity.

[31] Between 2016 and 2017, several Bank-approved operations pending signature were cancelled upon receiving word from the government that it would not provide federal guarantees to subnational entities that lacked the requisite repayment capacity.

Box 2.1. Criteria for incurring debt for subnational entities

Under the Federal Constitution of 1988, the various levels of government in Brazil are able to incur debt. The National Treasury Secretariat of the Ministry of Finance is the central agency responsible for financial planning and control and for the federal government's Integrated Financial Administration System (SIAF). The National Treasury assesses compliance with the fiscal rules established in the LRF and assigns subnational entities an A, B, C, or D rating according to their "*capacidade de pagamento*" (repayment capacity), based on three indicators: indebtedness, current savings, and liquidity. Only entities with a repayment capacity rating of A or B are eligible for a federal government loan guarantee, including projects financed by multilaterals. The sole exception to the repayment capacity rule is in the case of fiscal management-related operations (aimed at debt restructuring or rescheduling or improvements in tax, financial, or asset administration), such as PROFISCO. There have been periods in which the federal government has waived this requirement and given federal loan guarantees to subnational entities with a C or D repayment capacity rating.

Resolution 1 issued by the Ministry of Planning in 2017 adjusted the criteria for approving external credit operations for entities that require a federal guarantee. The repayment capacity analysis was expanded to include four other criteria: (i) track record and level of indebtedness; (ii) project analysis; (iii) sector priority; and (iv) human development index. The government discouraged projects funded through credit instruments for budgetary support aimed at financing current expenditure. In view of the worsening subnational fiscal position, these criteria have been enforced more strictly in recent years.

With regard to loans from multilateral development banks (MDB), the federal government reviews the payment capacity of subnational entities at three different moments: before initiating the operation's design; once the design is completed; and once the loan has been approved by the MDB and is ready to sign the loan contract. In view of the time that passes between reviews, the payment capacity of the state or município may change after having prepared the project.

2.10 **Nevertheless, the Bank found opportunities for lending to subnational governments.** For example, in 2016 the Bank approved seven direct loans to subnational entities (US$446.7 million) for operations that had begun to be prepared between 2013 and 2015. In addition, the continuity of the PROFISCO program to support the modernization of state fiscal management was particularly important. In June 2017, the Bank approved a new conditional credit line for investment projects (CCLIP) for up to US$900 million (BR-X1039) for the second phase of the program. Of this total, US$356.8 million was approved in 2017-2018 through seven loans. Thus, the PROFISCO loans accounted for more than half (54%) of the number of loans to subnational entities over the 2015-2018 period. The other operations with states were primarily for new phases of projects that the Bank had already been supporting. With respect to other umbrella programs, a PRODETUR (operation BR-L1412) operation and four urban development operations were approved, but the latter were not on the order of the PROCIDADES program.

2.11 **The Bank adjusted its financing model accordingly, reactivating its work with public financial intermediaries.** The Bank's difficulties in working at the subnational level were compounded by the trend toward lower demand for financing from the federal government, which had begun years earlier. Against this backdrop, the Bank reactivated its work with public financial intermediaries,[32] and between late 2016 and 2018 approved four loans for US$2.7 billion with three entities (BNDES, FINEP, and Banco do Brasil). These loans amounted to 53% of total sovereign-guaranteed approvals for the evaluation period. Aside from the importance of these operations in achieving the level of approvals envisaged under the country strategy,

[32] In the 2011-2014 period, the Bank had discontinued its work with public financial intermediaries, primarily to make more financing room for subnational entities.

the Bank has, through these operations, sought to expand client diversity and coverage while at the same time reducing the transaction costs of working in the country. The Bank plans to continue to solidify this work model.[33]

Box 2.2. Operations with public financial intermediaries (2015-2018)

BNDES (operations BR-L1442, BR-L1521). In December 2016, the Bank approved a CCLIP for up to US$2.4 billion with BNDES to foster productivity by promoting greater private-sector participation in infrastructure financing for sustainable energy and production projects for SMEs. The first such operation (BR-L1442, US$750 million) was aimed at supporting investments in renewable energy and energy efficiency, and has been fully disbursed. A second operation (BR-L1521, US$750 million) was approved in late 2018 and is aimed at supporting long-term financing of micro, small, and medium-sized enterprises (MSMEs). The loan contract for this operation has not yet been signed.

FINEP (operation BR-L1490). In November 2017, the Bank approved a CCLIP (BR-O004) for up to US$1.5 billion with the Funding Authority for Studies and Projects (FINEP). The CCLIP is intended to boost the productivity of enterprises by increasing investment in innovation and energizing the National Innovation System. Simultaneously with the approval of the CCLIP, the Bank approved the first operation (BR-L1490, US$600 million) to: increase investment in innovation by businesses in priority sectors under the National Science, Technology, and Innovation Strategy; expand the adoption of technologies at MSMEs; facilitate the growth of dynamic start-ups; and strengthen the institutional capacities of FINEP to design, monitor, and evaluate strategic projects. The first disbursement under this operation (US$298.6 million) was made in December 2018.

Banco do Brasil (operation BR-L1503). The US$600 million Public Infrastructure Management Investment Program for Municipal Efficiency was approved by the Bank in November 2018. The program supports a line of credit from Banco do Brasil and is designed to contribute to the improvement and efficiency of municipal infrastructure and public services through investments in public lighting and energy efficiency, basic sanitation, and municipal transport systems for municípios with fewer than 500,000 inhabitants. The loan contract for this operation has not yet been signed.

2.12 **To date, the Bank's additionality in these operations has been mixed.** The approved CCLIP with BNDES was important for reestablishing a long-term partnership between the two institutions. However, there has been limited financial and nonfinancial additionality under the CCLIP. While BNDES has been subject to more financing restrictions during the evaluation period, both operations support large and consolidated lines of financing to BNDES (renewable energy and SMEs), and the additionality of Bank financing has not been significant. The Bank's nonfinancial additionality has also been minor, as shown by the first operation, in which the Bank's resources were primarily used retroactively to finance wind energy projects (see Chapter III). New operations currently being explored focus on more incipient lines of credit where both institutions intend to expand their support (e.g. citizen security) and where the Bank is more actively providing technical assistance in structuring them. Regarding the operation with Banco do Brasil, approved in late 2018, elements of additionality are clearly identified. In that case, the Bank's financing is aimed at expanding a small line of credit offered by Banco do Brasil to municípios, considering that Banco do Brasil's subnational lending business had in the past focused almost exclusively on states. Recognizing both Banco do Brasil's comparative advantages in terms of presence at the national level and the greater technical challenges involved in working with municípios, the Bank is actively helping this bank to strengthen its institutional capacities for program design and supervision, including the development of model contracts, standard

[33] The 2019 pipeline includes a CCLIP with Caixa Econômica Federal for an estimated US$500 million for investments in infrastructure and production projects for SMEs.

designs for off-the-shelf projects, and a project monitoring platform. In the operation with FINEP, the Bank's participation has also been important, particularly from a financial standpoint, in expanding the agency's lines of credit in priority sectors and supporting its strategy of diversification of financing sources, including financing in local currency. The Bank is providing technical support to FINEP on specific issues, such as the establishment of an environmental and social management system and the implementation of impact assessments for its lines of credit.

2.13 **At the federal level, the Bank is creating opportunities for dialogue on sector and operational issues, especially since 2016; nevertheless, it still has room to strengthen its position.** Aimed at addressing subnational demand, the Bank's program included only one loan at the federal level, approved in late 2018 (Program to Modernize and Strengthen Agricultural Health and Food Safety Services, BR-L1496, US$195 million). Technical cooperation operations were also approved at the federal level in a number of sectors in which the Bank had been working.[34] The dialogue between the Bank and the country also served to adjust the work program (e.g. reorientation of sovereign-guaranteed operations to State-owned financial intermediaries, reorientation of NSG operations, creation of a fund for structuring PPP projects). Nonetheless, there is still room for further support for policy reforms (e.g. energy), for greater coordination of work at the subnational level with the federal level (e.g. tourism), and for developing new opportunities to support the government in emerging policy areas with long-term implications for the country through the use of instruments such as technical cooperation operations, knowledge products, and fee for service arrangements.

2.14 **NSG financing was redirected toward new sectors with some additionality; however, coordination with the Bank is still in the early stages.** In a departure from the preceding period, in which the NSG operations focused on foreign trade finance (through the TFFP), the reorganization of the IDB Group's private sector windows in 2016 led NSG approvals to be concentrated, in terms of amount, primarily in energy (42%), followed by financial markets (23%), agriculture (12%), and water and sanitation (11%). IDB Invest identified opportunities to participate, primarily in renewable energy (although a relatively developed market already existed), acting in tandem with BNDES and through a combination of innovative financial products, including local-currency loans, guarantees, and issuance of debentures for the full loan guarantee amount.[35] With regard to support for SMEs, IDB Invest has endeavored to work with a more diversified group of intermediary clients than in the previous period (e.g. banks of various sizes, cooperatives, and private equity funds) to promote SME access to financing in a variety of sectors. Other forms of support have been more specific and opportunistic (e.g. agribusiness). The increased presence of IDB Invest staff in the country, facilitated by the 2017 opening of a new IDB Group office in São Paulo, has also been an important factor in the expansion of this activity. However, there is no major evidence of coordination between the Bank and IDB Invest in areas such as energy

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34 In the area of citizen security, all technical cooperation operations at the federal level were initiated in the previous country strategy period, and supported the formulation and approval of the Unified Public Safety System (SUSP) in 2018.

35 In this context, IDB Invest, in coordination with BNDES, is currently structuring an infrastructure credit (B2 Infra) for up to US$1.5 billion aimed at investing in debt instruments in the energy, transportation, water and sanitation, and social infrastructure sectors.

and SME support, in which both institutions worked during the period,[36] or in the application of criteria defining the cases justifying use of sovereign-guaranteed and NSG financing for the same purposes.

C. Financial importance of the program

2.15 **While the smaller size of the sovereign-guaranteed program reduced its financial exposure to Brazil, the Bank remained the country's main multilateral development bank over the period.** From a financial standpoint, the program with Brazil has historically been of major importance for the Bank, accounting for 22% of all sovereign-guaranteed approvals between 2011 and 2014 (Figure 2.2). However, from 2015 to 2018, sovereign-guaranteed approvals averaged only 12% of the total, significantly reducing the Bank's exposure to the country. Since 2013, when Brazil made repayments on its debt with the Bank, the country's public debt with the IDB has remained relatively constant, ranging from 16.4% to 18% of the total debt of borrowing countries with the Bank. Also, between 2015 and 2018, the Bank increased its share in the stock of Brazil's external debt from 4.6% to 5%, and in the stock of the country's multilateral debt from 33.9% to 36.8%, retaining its position as the main multilateral development bank in the country despite the limited extent of its financing in relation to the size of the Brazilian economy.[37] Like the Bank, few loans from other multilateral development banks were approved during the period (Box 2.3), and no joint operations were coordinated.

Figure 2.2. Sovereign-guaranteed loan approvals (% Bank approvals)

Source: OVEDA, using the Bank's data warehouse.

[36] For example, in the context of the dialogue initiative with public and private institutions promoted by the IDB (Lab) to develop long-term financing solutions and regulatory changes in various areas, including green energy, inclusive, and SME finance, there is no evidence of IDB Invest participation.

[37] Sovereign-guaranteed approvals in the 2015-2018 period were equivalent to less than 1% of Brazil's GDP.

Box 2.3. Approvals by other multilateral development banks 2015-2018

The World Bank approved US$1.45 billion in loans during the 2015-2018 period, significantly less than the amount approved during the 2011-2014 period (US$9.518 billion). The 2015-2018 amount was channeled through two development policy loans, seven investment loans, and one results-based loan at the federal level. Subnational governments accounted for most of the total approval amount (states: 39%, municípios: 30%), while federal entities and intermediaries (CAIXA), respectively, accounted for 17% and 14% of total approvals. Direct approvals with subnational entities were entirely circumscribed to the North (17%) and Northeast (83%) regions. During the 2015-2018 period, the Andean Development Corporation approved 15 sovereign-guaranteed loans for US$1.039 billion, in all cases with subnational entities, primarily at the municipal level (93%) and in the Southeast (31%) and North (28%) regions.

2.16 **In contrast to the previous period, net sovereign-guaranteed lending flows to the country in the 2015-2018 period were positive, primarily driven by a significant increase in disbursements under operations with financial intermediaries.** In 2015 and 2016, against a difficult economic and fiscal backdrop, net lending flows to the country were negative (Figure 2.3). This situation was reversed in 2017 and 2018, when the flows turned positive due to a significant increase in disbursements, mostly under operations with BNDES and FINEP (Figure 2.4). As a result, net lending flows to the country during the evaluation period were positive (approximately US$120 million).

Figure 2.3. Disbursements and net financial flows (2011-2018)

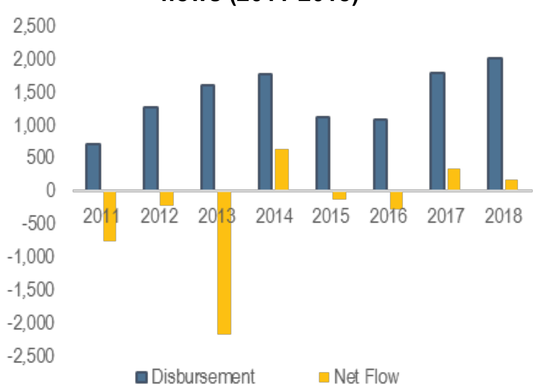
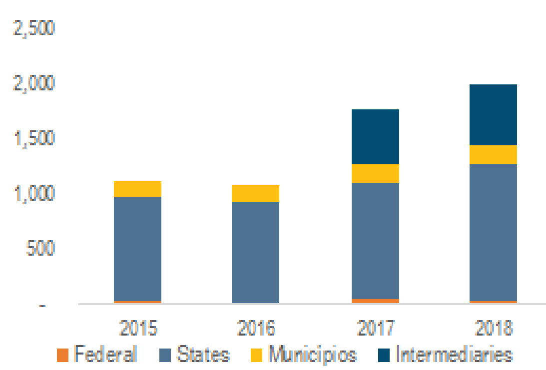


Figure 2.4. Disbursements by type of borrower (2015-2018)



Note: The net financial flows to the country include disbursements to the country minus principal and interest payments and lending charges on the country's debt with the Bank.
Source: OVE, using the Bank's data warehouse.

D. Use of instruments

2.17 **Sovereign-guaranteed approvals were channeled through investment loans.** Between 2011 and 2014, policy-based loans were actively used (19% of sovereign-guaranteed lending), which were channeled to support fiscal consolidation in six states. In contrast, not one policy-based loan was approved during the 2015-2018 period, due to the federal government's preference for using other mechanisms to encourage and address fiscal consolidation in subnational governments.[38] All direct lending to subnational entities was channeled through specific investment loans and

[38] In fact, the federal government discouraged the use of credit instruments for budgetary support to finance the current expenditure of subnational governments (Resolution 1, 2017).

multiple works loans. A results-based loan was approved in December 2018, the only federal-level loan approved during the period. The Bank has been exploring the use of guarantees. Lastly, the first conversion to local currency was carried out in December 2018 (US$298.6 million for the first disbursement under the loan to FINEP (BR-L1490) approved in 2017).

Table 2.3. Sovereign-guaranteed loan approvals by type of instrument

		2011-2014				2015-2018			
		Number	Number (%)	Amount (US$ millions)	Amount (%)	Number	Number (%)	Amount (US$ millions)	Amount (%)
Investment	Specific	46	58%	4,375	45%	19	66%	1,877	37%
	Multiple works	17	22%	3,081	32%	3	10%	968	19%
	Global credit	8	10%	185	2%	6	21%	2,100	41%
	Results-based*	-	-	-	-	1	3%	195	4%
	Multiphase	2	3%	160	2%	-	-	-	-
Policy	Policy-based loans	6	8%	1,834	19%	-	-	-	-
	Total	79	100%	9,635	100%	29	100%	5,139	100%

Source: OVEDA, using the Bank's data warehouse.

2.18 **The technical cooperation operations, most of which were Bank-executed, have been used to support sector priorities, and to a lesser extent, to support program management.** Despite the large loan portfolio and execution-related difficulties, only five of the 54 technical cooperation operations approved were for "operational support," the vast majority of which (46) were for "client support." With regard to financing, the main sectors supported were the environment (24%), water and sanitation (17%), transportation (11.3%), and social investments (9.7%). Since technical cooperation operations do not provide budgetary additionality, the Bank has increasingly assumed responsibility for their execution and the associated transaction costs. The percentage of Bank-executed technical cooperation projects went from 63% in 2011-2014 to 80% in 2015-2018. As a result, the intrinsic implementation difficulties were compounded by the complexity of managing certain large-scale technical cooperation operations involving multiple stakeholders and beneficiaries.[39]

E. Operational performance of the loan portfolio

2.19 **Average preparation times and costs decreased.** The average time from inclusion in the pipeline to approval was reduced by slightly more than eight months (Table 2.4) with respect to the previous evaluation period, yet remains above the Bank average. While the average times to approval decreased by almost half in the case of states, they remained mostly unchanged for municípios. This was largely due to the federal government's review process for granting sovereign guarantees and to several operations programmed for 2015 and 2016 but then postponed and approved subsequently. The improvements at the state level are determined by the second PROFISCO CCLIP approved in 2017. The operations under this line accounted for slightly more than half of the approvals with subnational entities for the 2015-2018 period and took an average of 8.6 months to be approved. The average time between approval and signing of the loan contract increased with

[39] This was the case in a technical cooperation project for low-carbon agriculture and deforestation avoidance to reduce poverty (BR-X1028), approved in 2013 for US$39.2 million (until recently, the largest technical cooperation operation directly executed by the Bank), and consisting of cash transfers to a large number of beneficiaries in 70 municípios in exchange for adopting low-carbon agricultural technologies and deforestation projects. After five years of execution, the operation has disbursed 77% of its proceeds.

respect to the previous evaluation period (Table 2.4) due to an intensification of the federal government's review process for granting sovereign guarantees, affecting loans to state and municipal entities. In contrast, the average times from contract signing to eligibility and from eligibility to first disbursement decreased significantly. On average, the interval between loan approval and first disbursement was approximately 1.5 years. The preparation costs per U.S. million approved fell by 40%, from US$2,303 in 2011-2014 to US$1,453 in 2015-2018, coming in below the Bank average (US$2,822), due to the reactivation of loans to public financial intermediaries.[40]

Table 2.4. Preparation times for sovereign-guaranteed loans by type of borrower

	Brazil by type of borrower (in months)					
	Municipal	State	Federal	Intermediary	Brazil	IDB
2015-2018						
Pipeline to approval	24.7	14.8	12.9	10.5	**17.9**	**14.9**
Approval to contract signing	16.5	10.7	-	10.1	**13.2**	**5.2**
Contract signing to eligibility	3.5	2.6	-	1.8	**2.9**	**5.9**
Eligibility to first disbursement	1.9	1.3	-	1.1	**1.5**	**2.1**
2011-2014						
Pipeline to approval	25.9	26.5	25.8	-	**26.2**	**20.2**
Approval to contract signing	14.9	10.2	11.5	-	**11.8**	**5.8**
Contract signing to eligibility	5.0	4.6	3.8	-	**4.7**	**6.5**
Eligibility to first disbursement	3.9	2.8	7.5	-	**3.6**	**2.7**

Source: OVEDA, using the Bank's data warehouse.

2.20 **Since the second half of the evaluation period, the Bank's Country Office in Brazil (CBR) has made significant efforts to manage the portfolio's size and improve its execution.** From 2016 to 2018, the new CBR management team implemented a strategy to streamline the size of the portfolio. One of its main tasks was to cancel 15 loan contracts (US$791.8 million) that had not been signed. Most of these (13 of 15) concerned loans that had been approved prior to 2015, in some cases with subnational entities that did not have a repayment capacity rating of A or B. This means that approximately one of six prepared between 2011 and 2014 were ultimately canceled. In addition, nearly US$200 million in uncommitted and unutilized resources for loans in execution were canceled. Other initiatives adopted by CBR to boost the efficiency and reduce the transactional costs of managing the portfolio included reorganizing and training the operations team, standardizing CBR processes (especially those related to interaction with execution units), and implementing semiannual comprehensive portfolio reviews with the participation of the three levels of government. Between January 2015 and December 2018, the number of active loans dropped from 123 to 97, a figure that CBR continues to consider high. Moreover, the percentage of projects classified as satisfactory in the Banks progress monitoring reports (PMRs) increased from 45% in 2015 to 88% in 2018.

[40] This calculation does not factor in the costs incurred in preparing loans that were never approved.

2.21 **As of year-end 2018, a significant portion of the active portfolio had disbursement period extensions.** The Bank's operational work in the country has focused on ensuring the implementation of the legacy portfolio (loans that were active in early 2015), given the delays in starting the execution of the new projects.[41] In late 2018, there were 17 loans approved between 2017 and 2018 pending signature, and of the 80 signed loans, 43% had extensions of their disbursement periods averaging 28.9 months. The sectors with the most extensions are: environment (100% of loans; 39.6 months), housing and urban development (69% of loans; 27.6 months), tourism (60% of loans; 35.8 months), transportation (50% of loans; 35.9 months), and water and sanitation (45% of loans; 25 months). Against this backdrop and as part of its strategy to reduce the size of the portfolio, CBR has made headway in establishing criteria for limiting project extensions.[42]

2.22 **A variety of factors can delay project execution.** The most common factors reported by the executing agencies in interviews with OVE include difficulties associated with implementing the Banks procurement policies (especially for those with limited institutional capacity or little work experience with the Bank), the complexity of implementing multisector projects that involve a number of different actors, and hence require -a high level of coordination that at times is difficult to achieve (e.g. tourism and citizen security), the absence of detailed designs for infrastructure projects, and the use of the multiple works modality. The Bank has made active use of management firms in some sectors (e.g. transportation, water and sanitation, health, and education) to attack these problems, but their added value in terms of improving execution is unclear. The turnover of officials and political authorities has also adversely affected the appropriation, prioritization, and pace of project execution. Lastly, the fiscal deterioration of subnational governments has also had significant impacts on portfolio execution, primarily due to the limited budgetary headroom for execution of the local counterpart (e.g. transportation, education, and health).

F. Implementation approaches

2.23 **In general, it was hard to put in practice the country strategy's intention to maximize the nonfinancial contribution of the IDB Group through *implementation approaches*.** While the Bank made strides in applying a comprehensive approach by double-booking[43] several loans,[44] coordination between the IDB and IDB Invest continues to be a challenge. This approach also sought to achieve coordinated action at the three levels of government, clearly laid out in some umbrella programs such as PROFISCO and PNAFM (where there is full coordination among federal, state, and municipal priorities). The *metropolitan areas* approach was limited due to the difficulties of working directly with subnational entities and the lack of clarity on how to tackle the work with several municipalities under the metropolitan area concept, with the exception of health. The implementation approach through public-private partnerships (PPPs) was much less active than envisaged, limited to some specific instances of support, primarily

[41] Of the 29 projects approved in the period, 11 have achieved eligibility, and only 3 operations (2 of them with public financial intermediaries) have disbursed more than 25% of their proceeds.

[42] Maximum extension of 50% for projects rated "satisfactory" in progress monitoring reports.

[43] Double-booking refers to the accounting of operations under various divisions of the Vice Presidency for Sectors and Knowledge (VPS).

[44] In the 2015-2018 period, one third of the sovereign-guaranteed approvals were cross-booked loans, compared to 11% in the 2011-2014 period.

through technical cooperation operations. In other approaches, such as *gender and diversity*, most of the loans addressing this issue during the period did so indirectly (through a disaggregation of indicators), although some more recent operations include specific objectives (PRODETUR Salvador, BR-L1412).

2.24 **The intensification of work in regions with greater inequalities (North and Northeast) under a *territorial approach* was limited.** As in the preceding evaluation period, 30% of the approved loans to subnational entities in the 2015-2018 period were geographically concentrated in the Northeast region. However, approvals in the North region declined significantly (from 13% to 2%). Thus, a single PROFISCO loan was approved in late 2017 (operation BR-L1499) for the state of Pará, and the corresponding loan contract has yet to be signed. In total, 10 sovereign-guaranteed loans to subnational entities were approved in the North and Northeast regions, primarily corresponding to five PROFISCO operations and two operations in the health sector. In contrast, the South region went from concentrating 16% of the amounts approved for subnational entities in 2011-2014 to accounting for 28% in 2015-2018 (Table 2.5). São Paulo (Southeast region) and Ceará (Northeast region) continued to be the states with the greatest concentration of approval amounts at 24% and 14%, respectively, followed by Santa Catarina (13%) and Paraná (11%) in the South region.[45]

Table 2.5. Approvals of direct sovereign-guaranteed loans to subnational entities by region

	2011-2014				2015-2018			
	Number	Number (%)	Amount (US$ millions)	Amount (%)	Number	Number (%)	Amount (US$ millions)	Amount (%)
North	14	19%	1,228.5	13%	1	4%	35.1	2%
Northeast	20	27%	2,799.9	30%	10	43%	627.2	30%
Central-West	8	11%	467.2	5%	3	13%	203.7	10%
South	17	23%	1,483.5	16%	3	13%	591.9	28%
Southeast	15	20%	3,384.0	36%	6	26%	668.1	31%
Total	**74**	**100%**	**9,363.2**	**100%**	**23**	**100%**	**2,126.0**	**100%**

Source: OVEDA, using the Bank's data warehouse.

III. IMPLEMENTATION AND OUTCOMES

3.1 **This chapter examines the progress made on implementing the IDB Group program in Brazil and the outcomes achieved in the 2015-2018 period.** The effectiveness of the program was analyzed on the basis of the strategic objectives of the 2016-2018 country strategy. OVE examined a portfolio comprised of all operations approved between 2015 and 2018 (loans and technical cooperation operations) as well as previously approved loans with undisbursed proceeds as of January 2015.[46] Given the magnitude of the program analyzed, this chapter only provides a summary of the strategic areas that accounted for the most activity during the period (whether in terms of amount or number of projects) and were part of the objectives of the country strategy, namely: transportation, SMEs, health, water and sanitation, and public financial management. Education was added because of its importance (three strategic objectives) under the country strategy. Lastly, energy

[45] In the 2011-2014 period, approval amounts for loans to subnational entities were primarily concentrated in São Paulo (28%), Bahia (10%), Ceará (8%), and Amazonas (8%).

[46] OVE carried out a documentary review of a portfolio of 165 loan operations (loans approved in 2015-2018 and loans active as of January 2015 and disbursed during the evaluation period) and conducted field visits to 66 of these. A detailed description of the methodology applied is found in Annex I.

was added since, although a dialogue area in the country strategy, it was important in terms of sovereign-guaranteed and NSG financing. The annexes contain the analysis of the other strategic objectives (business climate, citizen security, and country systems), areas of dialogue, and other areas (Annex V), as well as a more detailed analysis of financial and tax management (Annex III) and drinking water and sanitation (Annex IV).

A. Expand and reform the transportation and logistics infrastructure

3.2 **To make headway on this objective, the Bank was to support investments in infrastructure, specifically in the areas of urban mobility, road transport, and logistics. The implemented program was consistent with this objective and the envisaged areas of support.** In addition, given the fiscal limitations, and whenever viable, the Bank was to support the implementation of PPPs in the sector. The program consisted primarily of sovereign-guaranteed loans at the subnational level[47] and was geographically highly concentrated in three states: São Paulo, Ceará, and Santa Catarina. Four sovereign-guaranteed loans amounting to US$891 million were approved in the 2015-2018 period, adding to a portfolio of 14 loans that at the start of 2015 had US$3.067 billion in undisbursed balances.[48] While the country strategy entertained the possibility of approving NSG operations, only one such operation (R$150 million) was approved, in late 2018, to expand a port terminal in Santa Catarina. In terms of PPPs, the Bank's support primarily took the form of technical assistance, including support for institutional and process considerations, regulatory frameworks in certain states, methodological tools, and for the identification and preparation of projects (See Annex V).[49]

3.3 **In the area of urban mobility, the Bank continued to work primarily with municípios through programs to support integrated urban transportation systems and road infrastructure.** The portfolio consists of a series of loans to the Federal District and the municípios of Fortaleza (Phase I and II), São Bernardo do Campo (Phase II), and Blumenau, all of them active as of January 2015, and two new programs approved in 2015-2018 with the municípios of Maracanaú and Santo André. The programs primarily comprise investments in bus corridors and associated infrastructure, integration terminals and stations, urban space improvements (e.g. bicycle paths), road infrastructure, institutional strengthening, and actions in road security, planning, and transportation system planning and management. In addition, the loan to extend Line 5 of the São Paulo Metro continued to be executed.

3.4 **The implementation of these programs has involved significant challenges.** With the exception of the second loan to Fortaleza, all loans have had their disbursement periods extended, notably including the loan to the Federal District (72 months). The most recurrent problem has been institutional in nature. In the project with the Federal District, the weaknesses in execution capacity were compounded by institutional changes, including the creation of a mobility secretariat

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47 At the federal level, a loan approved in 2011 for the National Ground Transportation Agency and aimed at expanding the share of railway transportation was never signed and was canceled in 2017.

48 In addition, some operations in other sectors such as tourism and urban development (e.g. operations BR-L1204 and BR-L1442) include some interventions in transportation. These operations were reviewed by OVE as part of the analyses of those sectors (Annex V).

49 During 2015-2018, the Bank approved six technical cooperation operations (US$2.5 million), primarily in the area of PPPs, most of which are still in execution. Regional technical-cooperation operations also supported other PPP-related issues, including federal airport concessions (Annex V).

and seven government changes that affected the priority status of the project. Regarding the loan to São Bernardo do Campo (24 months of extensions), initially there was a long period with no disbursements because the município failed to prioritize the loan proceeds, which led to a restructuring of the loan and limited the scope of its works. In Blumenau (24 months of extensions), the lack of work experience with the Bank was coupled with a change of municipal government and technical teams at the start, affecting the selection of certain works to be financed and creating delays in preparing the final designs. Another crosscutting problem affecting execution has to do with difficulties in the expropriation processes, which in cases such as Blumenau have become one of the main project costs. Several problems are financial in nature. The variation in the exchange rate between the dates of preparation and start of the loans to the Federal District and Fortaleza I, combined with adjustments in the cost of the works and rising inflation, have adversely affected the scope of the projects, significantly limiting the originally planned works. The fiscal situation has also hindered the execution of local counterpart resources (e.g. São Bernardo do Campo and Fortaleza); accordingly, the possibility of expensing investments already made by the municipalities is being explored. At the state level, the loan for the São Paulo Metro was subject to significant extensions and a redirection of resources (Box 3.1).

Box 3.1. São Paulo Metro Line 5 Expansion Project (BR-L1227)

Approved in 2010, the loan to support extending Line 5 of the São Paulo Metro (US$480.9 million) had a 90% undisbursed balance in early 2015. The total cost of the project was US$2,485,200,000; in addition, the Bank had financing from other sources. The state government and BNDES were to finance the works, the World Bank was to finance the procurement and retrofitting of trains, and the IDB was to finance the procurement of electrical, telecommunications, and control systems and equipment for operating the line. As a result of significant delays in the civil works, the IDB loan disbursements had to be extended several times (due to the sequence of the interventions) for an aggregate total of 4.7 years. In addition, the loan has been reformulated in terms of the use of its proceeds. The savings of approximately US$120 million in bids due to overestimates led to the available loan proceeds being redirected to supplement the financing of civil works (stations and associated works, including an overpass) in three of the eight lots of works. An important implication of this was the Bank's reclassification of the environmental and social impacts of the project, which went from medium (category "B") to high (category "A"). Furthermore, in 2018 the government of São Paulo decided to change the execution arrangements by placing the operation of the line under concession. In light of this change, it was recently decided that a remaining US$43.5 million set aside to operate the system could be used to reimburse expenses that have already been incurred related to expropriations for the project and the procurement of goods.

3.5 **With most of the projects in execution, the main advances are in works components, while the activities for institutional strengthening and for improvement in the management and planning of the transportation systems are those lagging furthest behind.** The Bank's support has played a leading role in the significant improvements achieved in the transportation system of Fortaleza through investments in the system's infrastructure and actions to support its management. Noteworthy under the first loan is the financing of an express bus corridor that has led to increases in the number of passengers transported and average bus speed. The second loan has disbursed 82% of its proceeds, with progress in the civil works and road safety activities, and with delays occurring primarily in training activities. Regarding the loan to the Federal District, while the Bank supported some important investments and outputs, the outcomes have been more limited due to significant execution problems and reduction of planned works.

The physical progress on works in Blumenau stands at 80%, and a road safety plan is in development along with bidding processes for traffic control and operational centers. After a slow start, the program in São Bernardo do Campo has shown improvements in execution (69% disbursed). The first works for construction of a corridor and a terminal were recently completed; at the same time, the institutional strengthening component lags furthest behind. The loan for the São Paulo Metro has disbursed 90% of its proceeds, and the 11.5-kilometer extension of the line was completed in October 2018. An average of 423,000 passengers are being transported per day, and this figure is expected to double once the line becomes fully operational.

3.6 **In road and logistics infrastructure, the Bank continued to work through a programmatic approach with state counterparts that have extensive experience working with the Bank; more recently, new mechanisms are being sought out to support road investments in small municípios.** The portfolio is comprised of a series of loans, active at the start of 2015, for new phases of road programs in Santa Catarina (Phase VI), Ceará (Phase IV), Espíritu Santo (Phase III), and São Paulo. In addition, a new program in Paraná was approved in 2017. Supplementing traditional investments in highways (e.g. construction, rehabilitation, paving, and lane widening) and institutional strengthening, issues such as road safety, logistics, and other innovations have progressively been introduced (e.g. results-based maintenance pilot in Ceará). The loan for construction of the north section of the Mário Covas beltway (the final segment of the beltway in the São Paulo Metropolitan Region), remains in execution. At the municipal level, a loan to Banco do Brasil to finance municipal projects was approved in late 2018. Half of the loan's proceeds will be used for road infrastructure, including rehabilitation and paving of existing roads and procurement of maintenance machinery and equipment.[50]

3.7 **The execution of the road infrastructure programs has improved, with significant progress in road rehabilitation and paving.** However, these programs have not been problem-free, particularly in executing the local counterpart in view of the fiscal context (e.g. Santa Catarina and São Paulo). Disbursement of the loan to Espíritu Santo was recently completed, achieving the targets related to newly paved roads (15.1 km) and rehabilitated roads (259 km), although the achievements in terms of lane widening and some outputs of the road safety component were less than expected. The program in Santa Catarina (90% disbursed) has already exceeded the road rehabilitation target (226 km) and shows significant progress in road construction (33 km) and paving (93 km). Also noteworthy are a new state plan for roads and a road investment planning system. The program in São Paulo has disbursed 63% of its proceeds and has similarly made progress in road rehabilitation (987 km), although there are lags in formalizing supervision contracts and in preparing a master plan for freight mobility and other strategic studies. The program with Ceará has disbursed 79% of its proceeds, which have served to pave 586 kilometers of roads and rehabilitate another 809 kilometers. The program has also supported a state logistics plan and a road safety action plan. The project for Mário Covas beltway (the Bank's largest financing project in Brazil) has encountered

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[50] Strengthening of the institutional capacities of Banco do Brasil, including for the design, monitoring, and evaluation of the program, is being supported through two technical cooperation operations approved in 2017.

some of the greatest challenges, including a recent temporary halt in some of the works (Box 3.2).

Box 3.2. Rodoanel Mário Covas Project – Northern Section (BR-L1296)

In December 2011, the Bank approved a US$1.148 billion loan for construction of the northern section of the beltway for the São Paulo Metropolitan Region (RMSP). The estimated cost of the project was US$3.015 billion and it consisted of a series of complex works traversing densely populated urban areas and environmental preserves. In early 2015, 53% of the loan was still undisbursed, and the disbursement period has been extended by two years. In addition to delays due to the complex geotechnical conditions of the area, the process of resettling the approximately 5,000 affected households has posed a major challenge and has been further prolonged by judicial action in several cases. The progress made in resettling households stands at 55%. More recently, the project has been affected by the financial difficulties of some construction companies involved in the Lava Jato case, causing a halt in construction work in three of the eight segments included in the bidding process. In December 2018, the contracts for these three segments were terminated and a new bidding process is under way. The loan is now 95% disbursed and, in view of the constraints on the local counterpart resources, the Bank is evaluating the possibility of redirecting loan proceeds toward state roads (operation BR-L1041) to support the completion of works.

3.8 **In general, progress toward the objective of expanding and reforming transport and logistics infrastructure has been mixed.** In road and logistics infrastructure, significant progress was made in rehabilitating and paving state roads with executing agencies that have extensive experience working with the Bank. Nevertheless, challenges persist in terms of road maintenance and, principally, in terms of the need to explore new financing arrangements. Progress was observed in urban mobility, primarily in works related to the municipal transportation system. However, increased difficulties in execution have translated into greater delays, and the planned scope of the projects has in some cases been scaled back. In general, strengthening institutional capacities continues to be a major challenge.

B. Support the development of SMEs

3.9 **In a context of economic recession and greater constraints on financing liquidity, the IDB Group found opportunities to expand its support of SMEs by working through a more diversified base of financial intermediaries, primarily through NSG operations.** The expected result of the country strategy was to expand SME access to financing. As part of the knowledge agenda to be implemented, the country strategy also proposed developing long-term financing models for SMEs. The implemented program includes 12 operations approved during the 2015-2018 period, 8 of which (7 sovereign-guaranteed and 1 NSG) are fully focused on SMEs, while 4 (3 NSG and 1 sovereign-guaranteed) are partially focused on SMEs since they also finance other types of enterprises and/or have broader objectives than expanding SME access to financing.[51] Since the private-sector windows of the IDB Group were reorganized in 2016, IDB Invest has worked with a more diversified group of financial intermediaries than in the previous evaluation period (e.g. banks of various sizes, cooperatives, equity funds), supporting SMEs on a broader spectrum of sectors and issues. Most of the operations support traditional loans to SMEs in multiple sectors with general capital constraints, but there are specific operations providing for more targeted lines and

[51] In addition, the portfolio includes seven other operations that were approved prior to 2015 but had undisbursed balances, four of which were fully focused on SMEs.

solutions (e.g. women-owned SMEs, SMEs with high potential for growth, rural SMEs, purchase of receivables, and leasing solutions). In late 2018, a sovereign-guaranteed loan focused on SMEs was approved under the CCLIP to BNDES specifically to support BNDES product lines for SMEs through digital channels. In terms of financing, this US$750 million operation is the largest one approved in the 2015-2018 period to support of SMEs.[52]

3.10 **In general, given the advances in implementing a large part of the operations, it is still too soon to determine the level of progress made on the strategic objective of the country strategy. More coordination between the public and private windows of the IDB Group will be needed to achieve a greater impact in this area.** Until 2016, the outcomes of most operations were measured by attempting to trace the Bank's resources by linking them to individual loans to financial intermediaries. Given the fungible nature of the transferred funds, this limited the discussion on the achievement of outcomes. Since then, IDB Invest has sought to engage in a more strategic monitoring of outcomes, approving projects that are aimed at measuring the impact of its support on the relevant portfolios of the financial intermediaries, in line with OVE's recommendations in its evaluation of the IDB Group's work through financial intermediaries.[53] However, since most of the operations approved under this new approach are only starting to disburse, the evidence of results from this support is still limited. Significant efforts have been made to expand financing to SMEs, primarily through operations with a more diversified group of financial intermediaries and sectors, in a context in which several financial intermediaries have reduced their loan exposure to this market segment. Meanwhile, progress on creating long-term financing models for SMEs, as proposed under the knowledge agenda laid out in the country strategy, has been far less than anticipated. Initiatives such as the financial innovation laboratory (Lab) are important and point in this direction, but, in general, greater coordination will be required in the work of the public and private windows of the IDB Group in order to achieve a greater impact in this area.

C. Expand and improve the primary health care network

3.11 **The Bank addressed the problems of coverage and quality of primary and specialized health care services through interventions at the subnational level, with an emphasis on the North and Northeast regions.** Between 2015 and 2018, the Bank approved four loans for US$279 million. More than half of the financing approved in the period was allocated to activities in the state of Ceará, in the form of a loan to the municipality of Fortaleza (BR-L1414) and another to the state itself (BR-L1408). The other two approvals were for loans to the municipality of Belo Horizonte in Minas Gerais (operation BR-L1519) and to the município of São Paulo (operation BR-L1429). These approvals were in addition to five other loans which, as of January 2015, had US$530.5 million in undisbursed balances. Three of these were for the state of São Paulo (operation BR-L1376 with the state, and operations BR-L1044 and BR-L1415 with the município of São Bernardo do Campo). Lastly, a loan approved in 2014 for the state of Sergipe (operation

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[52] Another sovereign-guaranteed operation approved in 2015-2018 with a partial focus on SMEs is a loan to FINEP aimed at fostering investments in innovation by businesses. One of its four components is focused on financing technological innovation projects for SMEs. For more details on this operation, see the Science, Technology, and Innovation section in Annex V.

[53] Evaluation of IDB Group's Work through Financial Intermediaries. OVE, 2016. (document RE-486-2, CII/RE-18)

BR-L1378) was canceled in 2017 (the loan contract was never signed owing to the state's fiscal position). In addition, the Bank approved three technical cooperation operations for a total of US$950,000, only one of which (Improvement in Health Services in Ceará (BR-T1353)) was completed, supporting the loan to the state.

3.12 **The regional concentration of the loan portfolio enabled the Bank to offer long-term support and intensify its interventions.** The period included two interventions with the state of Ceará (Proexmaes I (operation BR-L1177) and Proexmaes II (operation BR-L1408) and two others to the município of São Bernardo do Campo (operations BR-L1044 and BR-L1415). In both cases, there was coherence and progression in the Bank's support in line with local needs, as well as recognition by the executing agencies that the long-term relationship with the Bank is being consolidated. The Bank's support to the state of Ceará dates from 2009, with the Program for the Expansion and Improvement of Specialized Health Care in the State of Ceará (Proexmaes I), which focused on closing health care gaps in medium- and high-complexity services. Proexmaes II seeks to promote management and quality components in the health care network as a whole. In the município of São Bernardo do Campo, the first project was aimed at strengthening basic health care services, while the second focuses on supporting medium- and high-complexity services and consolidating the lines of care.

3.13 **As in other sectors, the health portfolio incurred delays in execution.** The three active operations with the highest disbursement percentage were all approved prior to the evaluation period and none of them has been completed. Approved in 2013, the Program to Strengthen Health Care Management in the State of São Paulo (operation BR-L1376) is 75% disbursed to date. Some progress has been made under this program in terms of building basic health care units, psychosocial care centers, and a hospital unit, and deploying a network management model and a health education plan. The second operation with the município of São Bernardo do Campo (operation BR-L1415), approved in 2014 and 60% disbursed, has made progress in building the emergency hospital, although construction has not yet been completed. This operation has also financed three psychosocial care centers and a dental specialties center. The PROSUS program with the Salvador Metropolitan Region, Bahia (operation BR-L1389), approved in 2014 and 51% disbursed, has made progress in building comprehensive health care centers, although several basic health care units are in the bidding process or construction stages. The main factors affecting execution, in addition to government delays in the approval processes, include the executing units' lack of experience in health care system management and quality, which has meant a significant learning curve; election cycles at the federal and local level, which have led to changes in approach and, in some cases, changes in executing teams; and challenges in implementing the Bank's procurement policies.

3.14 **Two loans completed during the period were the main contributors to the objective of expanding coverage.** In the two completed loans, the Program for the Expansion and Improvement of Specialized Health Care in the State of Ceará (Proexmaes I) (operation BR-L1177) and the Health Modernization and Humanization Program (operation BR-L1044) for the município of São Bernardo do Campo, priority was given to the components aimed at expanding coverage. The construction and rehabilitation of medium- and high-complexity specialized health care services (in Ceará) and the construction, renovation, and equipping of basic health care units (in São Bernardo do Campo) helped to raise the health care access indicators. However, progress in terms of quality and management was limited. For example, of 37 health care units planned for Ceará,[54] eight were accredited, and the financing meant for strengthening the management capacity of the Health Secretariat was reduced from 24% to approximately 5%. Similarly, while the program in São Bernardo do Campo made some headway on the issue of quality, its main accomplishments concerned coverage.

3.15 **Progress toward achieving the strategic objectives of the country strategy has been mixed, and coverage considerations have taken precedence over considerations of quality.** This is partly due to the loan structure, which, of the three types of intervention typically included (coverage, quality, management), tends to prioritize coverage interventions, which involve infrastructure construction and/or renovation (more than 80% of the financing in six of the nine active loans and more than 70% in two others was allocated to infrastructure and equipment). This structure is exacerbated by the difficulties of implementing innovative management and quality approaches, as was the case in the Ceará and São Bernardo do Campo projects. The self-evaluations in the project completion reports for these projects have highlighted the importance of strengthening quality and management so as to improve the operation of the health care networks and thereby ensure that the infrastructure is fully functional. Coverage components are also prioritized in the other active loans, although they include some quality-driven actions (plans for completing the accreditation of the health care network in Ceará and organizing the São Bernardo do Campo, Fortaleza, and São Paulo networks by lines of care).

D. School coverage, quality of education, and technical education

3.16 **The implemented program partially addressed the strategic objectives.** The Bank set three objectives: (i) support the country to help it achieve its school coverage goals; (ii) improve the quality of education; and (iii) prepare young people for the job market by developing technical and vocational training. The implemented program addressed problems of basic education coverage and quality,[55] but did not include loans with specific actions to "expan[d] [the] proportion of students enrolled in technical schools focused on vocational skills" as envisaged.[56]

3.17 **The implemented program was focused on a legacy loan portfolio, since the two loans approved during the period were canceled.** The sovereign-guaranteed loan to the município of Porto Alegre (operation BR-L1393, US$80.8 million), approved in 2016 to improve the quality, management, and monitoring of the school network, was canceled in 2017 without the contract having been signed, as the municipality's repayment capacity rating prevented it from qualifying for a federal government guarantee. Meanwhile, an NSG loan approved in 2015 to expand

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[54] Although the physical targets were ambitious, experience enabled the creation of the largest accredited network in the country's health system.

[55] In general, interventions to expand coverage and improve quality follow the same structure, divided into three components: (i) construction and rehabilitation of educational centers (all sovereign-guaranteed loans) and implementation of distance learning programs (Pará and Amazonas); (ii) accelerated learning programs, educational reinforcement, teacher training, and/or systematic use of scholastic achievement tests (sovereign-guaranteed and NSG loans); and (iii) actions to improve the management and monitoring capacity of the education secretariats, also focused on access and quality (sovereign-guaranteed loans).

[56] The loans for Pará and Amazonas include, for example, actions to expand secondary school coverage, but it is unclear whether they provide vocational education. Two technical cooperation operations (BR-T1294 and BR-T1302) approved in 2014—before the period under evaluation and therefore, outside the scope of this CPE—included actions related to objective 3.

access to educational innovation technologies was canceled after having disbursed 11% of its proceeds, due to the recipient company's financial difficulties. The Bank focused on executing a legacy portfolio of four loans to the states of Pará (operation BR-L1327) and Amazonas (operation BR-L1328), and to the municípios of Manaus (operation BR-L1392) and Florianópolis (operation BR-L1329), with undisbursed balances of US$424.9 million at the start of 2015. In addition, four technical cooperation operations, not directly related to the loan portfolio but which helped maintain the sector dialogue (see Annex V), were approved during the period and are still in execution.

3.18 **The program addressed the North region, one of the country's most disadvantaged, and sought to adapt to the conditions of the environment.** Education is one of the sectors concentrating the greatest number of operations in the North region, with three active operations (operation BR-L1327 in Pará, operation BR-L1328 in Amazonas, and operation BR-L1392 in Manaus). Considering the dispersion of beneficiary locations, the remoteness of some areas, and the difficulties of access, the Bank adapted its program and financed real-time distance learning through the use of satellite technology in Amazonas and Pará. However, in Amazonas, the Bank failed to consider the difficulty and cost of maintaining a certain type of infrastructure or the limitations in terms of availability of the teachers needed for the planned classes at the full-time education centers.

3.19 **The execution of the education portfolio has involved significant delays, partly related to the difficulties of working in the country's North region.** None of the four loan operations that were active at the start of 2015 has been fully executed. The most advanced of these is the program in Pará, which was approved in 2013 and as of year-end 2018 is 65% disbursed after five years of execution. The programs in the state of Amazonas and the município of Florianópolis, which have also been in execution for almost five years, are respectively 44% and 42% disbursed. The Manaus project approved in 2014 began disbursing in 2017. Some execution problems are shared by the rest of the portfolio (e.g. changes of government and limited institutional capacity), while others reflect the challenges of working in the country's North region (e.g. difficulties in bringing equipment to more remote communities, in identifying available land for building new schools, and in finding teachers to cover the necessary disciplines).

3.20 **In terms of progress toward achieving the strategic objectives, more progress was made on expanding school coverage than on improving the quality of education.** In the three projects with the highest disbursement percentage (Pará, Florianópolis, and Amazonas), the main progress is in the construction and rehabilitation of educational units. Worth noting is the launch (Pará) and expansion (Amazonas) of distance learning centers, which in Pará serve close to 1,400 students from 39 communities. In terms of educational quality and management, while the IDB Group has tried to bring these issues to the fore with the subnational governments with which it has worked, implementation has only progressed in Pará and Florianópolis. In Pará, an accelerated learning methodology was implemented and is being more broadly adopted by the state. In Florianópolis, progress has been made in training teachers and in implementing a fiscal and educational planning and management system, but thus far no advances in implementing quality monitoring systems for child education centers. In Amazonas, there has been no progress made on outputs associated with the improvement of educational quality.

E. Expand and improve water and sanitation service

3.21 **The strategic objectives were relevant but fell short of addressing the problems identified in the Country Development Challenges.** The Country Development Challenges that served as a basis for the 2016-2018 country strategy identified four major challenges for the sector: (i) drinking water coverage, which is high at the national level but shows enormous disparities by region and income quintile; (ii) basic sanitation, where coverage is low and exhibits significant disparities by region and income quintile; (iii) existing service quality, which is characterized by high losses, service interruptions, and low quality of supplied water; and (iv) management of water resources and watersheds, which is weak and exhibits major coordination problems. In response, the country strategy laid out two objectives: expand the water and basic sanitation coverage and improve the existing services. Thus, the issue of water resource management played no part in the country strategy objectives, despite the fact that the country's Northeast region was experiencing its worst drought in 50 years, while certain actions did make progress during the period (see paragraph 3.24). The strategic objectives, while limited in scope, were relevant, particularly by focusing not only nationally but also on the North and Northeast, the country's most underserved regions and those with the greatest inequalities in terms of water and basic sanitation service coverage.

3.22 **The Bank worked with a lending program that was primarily comprised of legacy loans from previous periods.** The active loan portfolio included 18 operations[57] totaling US$2.2 billion[58] at both the state and municipal levels. It was largely a legacy portfolio, since only five operations amounting to US$643.4 million were approved during the 2015-2018 period, two of them NSG. Resources for several operations were canceled during the period.[59] In addition, one of the operations, the Environmental Sanitation and Territorial Management Program for the Federal District (operation BR-L1383, US$150 million), approved in 2016, was entirely canceled in 2017 when the fiscal situation of the Federal District prevented it from qualifying for a federal guarantee when the loan contract was to be signed. The program also included eight technical cooperation operations approved in the 2015-2018 period for a total of US$4.75 million, five client support operations and three to support the preparation of loans (operations BR-T1362, BR-T1321, and BR-T1318).[60] In all, 52% of the funds approved for technical cooperation operations were focused on environmental management, 21% on coverage, and 13% on treatment, and nearly one third of their resources were targeted to the country's North and Northeast regions.

3.23 **The implemented program reflects a more limited territorial approach than envisaged in the country strategy.** While the country strategy emphasized reducing regional inequalities, particularly in the North and Northeast regions, the

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[57] Includes 15 Water and Sanitation Division operations, one from the former Structured and Corporate Financing Department, one PROCIDADES operation that mostly consists of water and sanitation investments, and an IDB Invest operation.

[58] This figure includes: (i) the original amount of the operations approved between 2015 and 2018; and (ii) the undisbursed amounts as of 31 December 2014, for the legacy portfolio operations.

[59] The Social and Environmental Program for the Igarapés in Manaus – PROSAMIM III (operation BR-L1297) (8%); the Tietê River Cleanup Program – Stage III (operation BR-L1166) (1%); and the Porto Alegre Integrated Socioenvironmental Program (operation BR-L1081) (28%).

[60] Only one of these three is classified as operational support. However, OVE verified that, to date, the other two technical cooperation operations effectively support loans in preparation.

Bank's actions were more concentrated in the Southeast region, where there are large, highly populated urban areas. This region received 60% of the financing approved during the period, and accounted for 50% of the legacy portfolio's undisbursed balances.

3.24 **In addition, the implemented program displays a bias in favor of interventions to expand water and basic sanitation coverage.** Slightly more than half of the financing for the sector (including local counterpart resources) in the 2015-2018 period was directed to expanding water and sewerage coverage (53% of total financing for the sector). In addition, wastewater treatment actions—which also contribute to basic sanitation—received 17% of the financing for the sector. Environmental management actions[61] (17% of the resources) and drainage actions[62] (7% of the resources) were also financed, even though they do not directly contribute to the country strategy's strategic objectives. Only 6% of the financing for the sector was directed to improving the quality of existing services (second strategic objective of the country strategy), in the form of interventions to reduce losses, improve monitoring, and train operators. While these actions are directly associated with the aim of achieving better service, the size of the interventions was marginal in proportion to the financing for the sector. Only in late 2018 was the Municipal Efficiency Program (BR-L1503) approved with Banco do Brasil (US$600 million), which includes a US$100-million component for municipal projects with actions aimed at loss reduction. Lastly, financing was provided for activities related to water resource management as part of the institutional strengthening component for COMPESA (BR-L1295) as well as a technical cooperation operation (BR-T1351). There was no financing for actions related to strengthening watershed committees or developing PPP projects as proposed in the country strategy.

3.25 **Once the loans were eligible for disbursements, their execution was slow.** In total, eight projects from the active portfolio (as of January 2019) required extensions (886 days on average) for three main reasons: (i) the process of determining the feasibility of individual projects is weak; thus, it is common for final plans or designs not to be available at the start of execution (e.g. the Environmental Sanitation Company of the Federal District (CAESB) and the Rio de Janeiro Water and Sewer Company (CEDAE)). In addition, some executing agencies (e.g. operation BR-L1253), anticipating delays in Bank financing, fund investments with their own resources and, when eligibility is achieved, the investments to be financed have to be reprogrammed; (ii) many projects undergo changes in execution arrangements (e.g. change in coordinators and management firms) as well as changes in executive officers; and (iii) in some, very specific cases (São Paulo Water and Sewer Company (SABESP)), unexpected events, such as the 2016 drought, force the company to redirect its technical capacity to address the emergency.

3.26 **Moreover, the fiscal position of the states significantly affected the execution of some projects.** This was the case with the Environmental Sanitation Program for the Guanabara Bay (operation BR-L1282, US$452 million), which was approved in 2011 and is 22.5% disbursed. The loan operation was part of a set of programs with the state of Rio de Janeiro that were affected by the fiscal situation and the continuity of which has been suspended and made conditional by the federal

61 Includes, for example, reclaiming of riverbanks, resettlement of households located in risk areas, park strips, and supplementary road works.

62 Includes various works, such as channels, rainwater interceptors and collectors, and others, aimed at reducing the risk of flooding.

government on the approval of the state's fiscal recovery plan, which does not include the Environmental Sanitation Program for Municípios in the Guanabara Bay Area (PSAM). Since this is a crucial program, the Bank has proceeded to issue preventive extensions (24 months, to March 2019).

3.27 **Progress was made**[63] **on all fronts during the period, but above all on coverage and treatment issues.** In terms of **coverage expansion**, more than 1.3 million households have been connected to the water and sanitation network, more than 360 kilometers have been added to the network, and 19 elevator or pumping stations have been built. In terms of **treatment**, more than 20 kilometers of pipeline have been laid, and over 11 treatment plants have been built. The expansion of the Barueri treatment plant under the loan to SABESP (operation BR-L1166) increased the average volume of water treated from 14 m^3/second to 18.7 m^3/second. In addition, as part of the loan to CAESB (operation BR-L1215) 10 treatment plants have been improved out of the 19 planned, although this operation is still in execution (45% disbursed). Of the three loans completed during the period, only one is fully aligned with the country strategy: the Tietê River Cleanup Program, Stage III (operation BR-L1166). In addition to expanding the Barueri plant, Tietê III made it possible for more than 750,000 additional households to have treated wastewater, exceeding the target, and provided new or improved residential connections to more than 1.2 million households, although the construction of collectors and interceptors was slightly below the planned target (88% of the target). In terms of improving the quality of existing services, Tietê III included a component for the improvement of SABESP's operational and institutional processes, which supported diagnostic assessments for improvements, institutional strengthening, and environmental management and load control systems.

3.28 **In general, the contribution to the strategic objectives was only partial.** The implemented program made strides in terms of water and sanitation coverage, but the regional goals were not achieved. In terms of improving the quality of the existing water and sanitation services, progress was limited since the interventions targeting this objective accounted for approximately 6% of the resources directed to the sector. In addition, the size of the Bank's interventions was small in relation to the regional and national needs as well as in relation to the amount invested by the various executing agencies and companies in the sector.

F. Enhance efficiency in the management of public resources

3.29 **The Bank pursued the objective of making the management of public resources more efficient through interventions at the three levels of government, the state level being the recipient of the most funds.** Between 2015 and 2018, the Bank approved seven loans to states (US$356.8 million) under PROFISCO II.[64] In addition, 30 loans approved between 2008 and 2014, with undisbursed balances of US$503.4 million at the start of 2015, continued to be executed. Of these, five were state-level operations, 23 were loans to states under PROFISCO I, and two were for programs at the municipal level (PNAFM II and III). The state-level operations absorbed 75% of the resources over the period. Four

[63] This analysis included all sovereign-guaranteed projects that are at least 45% disbursed. Of these, three have been completed, four have disbursed 80% or more, two are more than 50% disbursed, and one is 45% disbursed.

[64] The seven states are: Ceará, Maranhão, Mato Grosso do Sul, Pará, Piauí, Pernambuco, and São Paulo.

technical cooperation operations were also approved during the 2015-2018 period,[65] one of which was canceled before disbursement and all of which dealt with issues unrelated to the loan portfolio.

3.30 **The Bank's approach was more strategic and relevant at the subnational level, although the amounts per operation, particularly for states, were small in relation to the complex agenda of intended reforms.** PROFISCO and PNAFM were designed as "umbrella" programs (the former as a CCLIP and the latter as an investment loan), making the approved operations subject to a common structure that was compatible with the financed activities, in response to the subnational financial integration and modernization requirements. The average amount of the PROFISCO loan operations was US$25 million, with seven projects for US$10 million or less, which is a small amount in view of the size of the reform agenda. Even so, in most of the states the Bank was the only provider of assistance in this regard. The PNAFM I loan amounts were also considered small by the municipalities; as a result, the amount allocated to each municipality was increased under PNAFM II, focusing support on municipalities that were fewer in number but had greater institutional capacity.

3.31 **In contrast, the federal loans were efforts without significant coordination among each other and were affected by significant cancelations of resources.** For example, the Program for Modernization of Pension System Management II (operation BR-L1269) sought to help improve the financial sustainability of the municipal government pension plans and generate knowledge to support municipal pension policy formulation. However, due to the devaluation of the real, the economic crisis, and turnover in authorities during execution, 57% of the program's resources were canceled and progress was therefore significantly less than envisaged. The training outputs for municipalities were canceled and advances mere made only on updating records and improving computer equipment. Only one of the PROFISCO federal loans (BR-L1349) sought integration with other levels of government, which is a constitutional mandate. The contribution to achieving the strategic objective was also limited by the cancelations, which ranged from 36% to 84%.

3.32 **At the municipal level, PNAFM has supported fiscal reforms in a considerable number of municípios.** Unlike direct loans to states, PNAFM is a loan to the Ministry of Finance, which in turn grants subloans to municípios. This makes it possible to reach municípios that would otherwise be unable to obtain IDB resources. However, it also obscures the link to the Bank, especially in the case of small municipalities (in interviews with OVE, several PNAFM beneficiaries were unaware that the resources came from the Bank). PNAFM has included three phases: an initial phase, executed from 2001 to 2012, that benefited 60 municípios; a second phase, executed from 2010 to 2017, that benefited 22 municípios; and a third phase, initiated in 2017, that in 2018 allocated resources to 12 municípios, with an additional 26 currently in the process of applying for credit. PNAFM has evolved, developing increasingly standardized products, and has tended to provide greater support for tax management actions than for public planning and management actions.

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[65] Support for the Eradication of Civil Under-registration in Brazil (operation BR-T1329), Support for Public Administration Improvement for Citizens (operation BR-T1332), Strengthening of Fiscal Management in Brazilian States (operation BR-T1335), and Strengthening Transparency in Brazil (operation BR-T1352).

3.33 **The Bank continued to develop a niche with PROFISCO that enabled it to reach practically all states through standardized products.** The states' common need to strengthen their financial administration in compliance with the constitutional and legal requirements regarding financial integration and modernization enabled the Bank to finance a menu of 20 emblematic standardized products. Implementation of two of these—the electronic invoice and the government digital accounting system—was mandatory, using either PROFISCO funds or alternative means. Loans were approved in all of the country's states. In 2016, four loans were canceled in the North region (Amazonas, Roraima, Acre, and Amapá) before the signing of the loan contracts, as the states were unable to obtain a federal guarantee due to their fiscal position. Despite the flexibility in defining the most suitable products for each state, the high level of standardization created execution problems in some cases in projects that were not adapted to the capacities of the executing agencies (e.g. Rio Grande del Norte (operation BR-L1207), Paraíba (operation BR-L1208)). In PROFISCO II, the third-generation Integrated Financial Administration System (SIAF) has been included as a mandatory product. The emblematic products include the use of new methodologies and technologies of the digital economy (e.g. machine learning, big data, electronic tax auditing) and tax process automation to reinforce the changes created under the program's first phase.

3.34 **While PROFISCO contributed to some advances in public planning and management at the state level, they were less significant than expected.** The 11 PROFISCO loans reviewed have an average of three outcome indicators related to the improvement of public planning and management. The progress achieved is mixed. On one hand, Pernambuco, Paraíba, and Rio de Janeiro reached or exceeded the target on three or more indicators, but on the other, São Paulo and Sergipe made no progress on any indicator and for Tocantins there is no information for monitoring. The monitoring indicators were very heterogeneous, including issues related to planning (e.g. difference between projected and actual revenue), human resources management (e.g. satisfaction level of public servants), and efficiency of processes (e.g. average time for cadastral registration). In terms of planning outcomes, worth noting is the achievement of 75% of the targets under the Rio de Janeiro strategic organizational plan, and the introduction of faster and more economical technologies in Pernambuco (although targets related to the satisfaction of public employees were not achieved there or in Maranhão). In PROFISCO II, under the tax component, actions were also included aimed at improving the business climate by increasing the quality and quantity of services offered to enterprises and taxpayers, and simplifying the processes to open new businesses and pay taxes. Nevertheless, as of late 2018, of the seven loans approved, only one (BR-L1502) had achieved eligibility, so it is still too early to assess the effectiveness of this support.

3.35 **In terms of promoting subnational fiscal sustainability (second expected outcome of the country strategy), the tax administration outputs prevailed over the expenditure management and control outputs.** The tax component of PROFISCO loans absorbed an average of 40% of the proceeds, and in 10 of the 23 beneficiary states this was the component with the most resources. The expenditure control component averaged only 10.5% of the proceeds. Three factors are at play here: (i) the outputs related to public fiscal management are generally more costly to implement and require changes in culture and procedures in generally static environments characterized by deeply entrenched processes; (ii) the project teams were primarily comprised of professionals in the revenue area; and (iii) public fiscal management reforms generate medium- and long-term impacts, unlike tax reforms, the benefits of which tend to be more readily visible. These factors, coupled with the absence of a comprehensive approach based on fiscal sustainability, produced an imbalance between the revenue and expenditure components.

3.36 **The Bank helped to boost state revenue, but there was no progress on the expenditure side.** Implementing eight emblematic outputs for boosting revenue (e.g. oversight of goods in transit, electronic invoice, taxpayer records), PROFISCO helped to increase revenue by facilitating the taxation of transported goods, reducing tax evasion, and providing real information on the business volume of companies. According to the Brazilian Planning and Taxation Institute, the electronic invoice (implemented in 12 states with the support of PROFISCO and in all other states with state resources) has made it possible to reduce the tax evasion rate from 32% in 2010 to 25% in 2017. In some states (Rio Grande do Norte, Paraíba, Rio Grande do Sul, and São Paulo), progress was made in outputs to improve control of expenditure, but there is no evidence that PROFISCO has helped to streamline expenditure or seek greater spending efficiency. This partly explains why, despite having participated in the program and boosted their revenue, states such as Rio de Janeiro and Rio Grande do Sul fell into a calamitous state due to the rigidity of their public expenditure, particularly in pensions and wages. PROFISCO II has attempted to correct this situation by setting “contribute to fiscal sustainability” as its main objective and through a more balanced allocation of resources, giving the tax component an average of 30% of the proceeds and the expenditure component an average of 20%.

3.37 **Municípios that received financing from PNAFM II performed better on revenue collection than those that did not have access to the program**. Most of the PNAFM II beneficiary municipalities focused on land use administration (61% of the municípios developed a related output) and on improvements in tax administration efficiency and effectiveness (half of the municípios invested resources in related outputs). Ministry of Finance estimates show that the municípios participating in PNAFM II collected 6% more in property tax (IPTU) and service tax (ISS) than non-participating municípios. In expenditure control, 21.4% of the municípios allocated resources to improving the efficiency and effectiveness of material and asset management and 18% developed an output to improve the efficiency and effectiveness of budget and financial management, although there is no evidence in terms of outcomes.

3.38 **An additional result of the support was the promotion of forums for discussion and cooperation among states, municipalities, and the federal government.** The Bank helped to strengthen two ongoing forums for sharing experiences aimed at tax coordination: the Fiscal Management Commission (COGEF) at the state level and the PNAFM Network Management Committee (COGEP) at the municipal level. COGEF was created in 2008 to ensure the effectiveness of PROFISCO, foster fiscal management improvements, and develop a network for monitoring and evaluation of states. The major advantage is the states’ adoption of coordinated and aligned actions, enabling faster and more efficient implementation and making the tax system more homogeneous. The network facilitates the sharing of experiences, terms of reference, monitoring of outcomes, innovative tools, and good practices. COGEF is a leader in the region as an incentivizing and support structure for government reforms. While COGEP’s repercussions have not been as powerful as

COGEF's, it is also an important forum and has contributed to the success of municipal fiscal reforms.

G. Dialogue areas

1. Energy

3.39 **Despite the absence of a strategic objective in this area, the IDB Group had a significant portfolio of operations, primarily resulting from an increase in the number of operations to finance private-sector projects.** In the case of the public sector, the Bank's action has primarily consisted of loans to support investment plans of state energy companies aimed at enhancing the reliability of the electricity supply. In 2017, the Bank approved a loan to support investments by CELESC, the utility in Santa Catarina (operation BR-L1491, US$276 million). Previously, in 2012, the Bank had approved two loans to CEEE, the power company in Rio Grande do Sul, for investments in power generation and transmission (operation BR-L1303, US$88.6 million) and in distribution (operation BR-L1303, US$135.5 million). However, as of January 2015, these two loans were respectively 93% and 72% undisbursed. As part of its renewed work with BNDES through the CCLIP approved in late 2016, the Bank approved a sovereign-guaranteed operation (BR-L1442, US$750 million) to support BNDES lines of credit focused on private-sector renewable energy and energy efficiency projects.[66] Meanwhile, IDB Invest has had a more active participation during the period in supporting renewable energy projects in tandem with public banks through a combination of innovative financial products, including bridge and senior loans in local currency, partial guarantees, and full guarantees to cover the issuance of debentures. Between 2017 and 2018, four operations were approved (US$375 million) to support the development of a photovoltaic plant (195 MW) and three wind farm complexes (430 MW), in addition to an operation for US$288 million for a combined-cycle thermoelectric plant (1,516 MW) and associated facilities.[67]

3.40 **There were improvements in the reliability of the electricity system of Rio Grande do Sul, although the power generation results were adversely affected by the extended droughts in the country.** The two loans to CEEE have already been disbursed. In terms of power distribution, outages were reduced from 26.9% in 2010 to 17.9% in 2017 (target: 21.5%), while power outage frequency went from an average of 15.8 times in 2010 to 10.5 times in 2017, likewise exceeding the projected target (13.66). However, total energy losses were modestly reduced from 18.74% in 2010 to 17.5% in 2017 (target: 12.38%), primarily due to a rise in nontechnical losses that offset the drop in technical losses. The second operation focusing on generation and transmission had mixed results. The power generated by the supported investments decreased in 2015-2017 to an average of 78 gigawatt hours (GWh), well below the established target (118.26 GWh), primarily due to the extended droughts in the project's areas of influence. However, in terms of transmission, the number of substations with adequate voltage levels increased and

[66] In 2009, the Bank had also approved an investment grant operation (BR-X1018, US$10.1 million) to support the development of a finance market for investments in energy efficiency in buildings. The sector portfolio also includes two technical cooperation operations to support the operational structure of Furnas Centrais Elétricas S.A (operation BR-T1283), approved in 2013, and another to support the state of São Paulo in diversifying its energy mix (operation BR-T1340).

[67] This operation included support from the Energy Division as part of the project team.

the number of transformers operating above capacity declined. The forced outage rate fell from 2.59% to 1.21%, below the 2% target.

3.41 **The support for private projects has made it possible to expand the installed capacity for renewable energy, although the efforts in the area of energy efficiency have not yielded the expected results.** Of the IDB Invest projects, the supported stage (195 MW) of a photovoltaic plant that will have the largest capacity of any in Latin America and the Caribbean, as well as a wind farm complex (207 MW), are in commercial operation. Another wind farm complex with the same client (195 MW) is close to entering commercial operation, while a guarantee operation for wind farms did not close. The sovereign-guaranteed loan to BNDES rapidly disbursed its proceeds because a large portion of it retroactively financed large-scale projects. Specifically, it supported four wind farm complexes with a total capacity of 778 MW, three of which (555 MW) were in commercial operation at the time of disbursement. The fourth complex (223 MW) was already built at the time of disbursement and only needed to enter commercial operation. One of the complexes already financed by BNDES and selected for IDB retroactive financing was owned by an IDB Invest client for whom a guarantee had already been approved in 2018. However, the latter operation was canceled, never having been signed. There is no evidence that the public and private windows of the IDB Group were coordinated in these operations. While the loan to BNDES considered financing for medium- and large-scale energy efficiency projects, the country's economic situation and the limited development level of this market dampened actual demand for financing. Thus, the entirety of the loan's proceeds ended up being used to finance renewable energy projects.[68] Along similar lines, the reimbursable investment operation (BR-X1008) to develop the finance market for energy efficiency investments in buildings, despite having been approved in 2009, is only 11% disbursed.[69]

IV. Conclusions and Recommendations

4.1 **The objectives the IDB Group set for the 2016-2018 period were relevant and aligned with the government's priorities, but were broad, given the number of possible areas of cooperation considered.** Despite the effort made to create a country strategy that was more targeted than in the previous period, the 2015-2018 country strategy ended up including most of the strategic objectives and priority sectors from the preceding strategy. The broad definition of the potential areas of support allowed the implemented program to be easily framed within the country strategy, but a significant number of approvals were in areas of dialogue for which the IDB Group had not defined strategic objectives (e.g. energy, science and technology, urban development, tourism, and agriculture). The implementation approaches (strengthening of PPPs, sustainable economic development of metropolitan areas, and reduction of regional socioeconomic inequalities), which were included for the first time in the country strategy, were difficult to put in practice. For example, the deepening of the work in regions with greater inequalities (North and Northeast) was limited. As in the previous evaluation period, 30% of the amounts of approved loans with subnational entities during 2015-2018 was

68 While the program did not establish specific amounts for each type of project, it was expected that approximately 10% of the proceeds would be allocated to energy efficiency projects.

69 More recently, in partnership with local financial institutions, the Bank launched a US$25 million-dollar project to provide performance risk insurance to small and medium-sized enterprises that are looking to invest in distributed solar energy and energy efficiency projects.

concentrated in the Northeast region. However, approvals in the North region declined significantly (from 13% to 2%), while the South went from representing 16% of approved amounts with subnational entities (2011-2014) to 28% (2015-2018).

4.2 **The 2015-2018 program unfolded in a particularly complex context, in which the Bank adjusted its program and mode of intervention.** The establishment of subnational debt ceilings and adjustments in the criteria for granting sovereign guarantees translated for the Bank into a significant reduction in the demand for subnational financing and created a need to adjust its business model, based on direct lending to states and municípios. The Bank responded by adjusting its program in order to resume work with State-owned financial intermediaries, approving four loans with three institutions (BNDES, FINEP, and Banco do Brasil) between late 2016 and 2018 for US$2.7 billion. These loans represented 53% of total sovereign guaranteed approvals during the period under evaluation. In addition to the significance of these operations for reaching the level of approvals projected in the country strategy, the Bank has tried to use them to expand the variety and coverage of clients, while at the same time reducing the transaction costs of working in the country with State-owned financial intermediaries like BNDES, Banco do Brasil, and FINEP.

4.3 **Although it is still too early to assess the effectiveness of the operations with State-owned financial intermediaries, to date, the Bank's additionality has been mixed.** The first operations under the CCLIP with BNDES support large, established lines of BNDES financing (renewable energies and SMEs), and in the first operation, the IDB resources primarily provided retroactive financing for wind power projects. The possibility of operations with lines of finance less developed by BNDES, where the Bank would play a greater role in technical support for structuring is currently being explored. In the case of the operation with Banco do Brasil, clearer elements of additionality have been identified. The operation seeks to expand a small Banco do Brasil line of financing with municípios, since it had been working predominantly with states. The Bank is also actively supporting the strengthening of institutional capacities at Banco do Brasil for the design and supervision of the program.

4.4 **Despite the restrictions, the Bank found room to lend to subnational governments.** In 2016, for example, the Bank approved seven direct loans to subnational entities corresponding to operations that had started preparation between 2013 and 2015. In addition, in June 2017, the second conditional credit line (CCLIP) was approved for PROFISCO for up to US$900 million (BR-X1039), of which US$356.8 million were approved during 2017-2018. Thus, the PROFISCO loans represented more than half (54%) of the number of loans with subnational entities during 2015-2018.

4.5 **At the federal level, the Bank worked to create opportunities for dialogue on sector and operational issues, especially starting in 2016, although there is still room to strengthen its position.** The dialogue at the federal level resulted in technical cooperation operations in sectors with an outstanding portfolio and allowed an adjustment in the work program without amending the country strategy. Nonetheless, there is still room for further support for policy reforms (e.g. energy), for greater coordination of work at the subnational level with the federal level (e.g. tourism), and for developing new opportunities to support the government on emerging policy issues with long-term implications for the country through the use of instruments like technical cooperation operations, knowledge products, and fee for service arrangements.

4.6 **The expanded presence of IDB Invest in operations targeting sectors other than TFFP is a positive development and includes elements of additionality**. The NSG amounts approved during the period doubled with respect to the 2011-2014 period. Unlike the previous period in which NSG operations were concentrated in operations to finance foreign trade (TFFP), as of the reorganization of the IDB Group's private sector windows in 2016, the NSG amounts approved were concentrated in energy (42%), financial markets (23%), agriculture (12%), and water and sanitation (11%). IDB Invest found opportunities to participate primarily in renewable energy and support for SMEs.

4.7 **Coordination between the IDB and IDB Invest remains incipient.** There is no significant evidence of coordination between the two institutions in the areas in which they both worked during the period, or in the application of criteria defining the cases justifying use of sovereign-guaranteed and NSG financing for the same purposes. The greater presence of IDB Invest staff in the country and the opening of the new IDB Group office in São Paulo in 2017 contributed to increasing IDB Invest activity.

4.8 **The use of instruments has been limited during the evaluation period.** Due to the preference of the federal government, investment loans have been the main instrument used by the Bank to support subnational entities. During 2015-2018, all direct financing to subnational entities was channeled through specific investment loans and multiple works loans. At the end of the period under evaluation (December 2018), the only loan based on results was approved, which was also the only loan at the federal level. The Bank has also been exploring the possible use of guarantees. These experiences, as well as the use of programmatic approaches in certain sectors (e.g. the PROFISCO CCLIP) can serve as the basis for promoting a broader use of the available loan instruments, differentiating by project type and the executing agencies' level of sophistication and work experience with the Bank. The technical cooperation portfolio, executed for the most part (80%) by the Bank, has been used primarily to support sector agendas, and to a lesser extent, to support program management.

4.9 **The actions implemented by the Country Office in Brazil, starting in the second part of the period under evaluation to manage the size of the portfolio and improve execution, have had positive results on portfolio performance.** The cancellation of 15 loans (US$791.8 million) that were pending signature and uncommitted and unused resources from loans in execution for nearly US$200 million were among the most significant measures undertaken during the period. Thus, between January 2015 and December 2018, the number of outstanding loans fell from 123 to 97. In addition, the percentage of projects classified as satisfactory in the Bank's project monitoring reports went from 45% in 2015 to 88% in 2018.

4.10 **Despite this progress, at the end of 2018, a significant portion of the outstanding portfolio had extensions.** In late 2018, there were 17 loans approved between 2017 and 2018 pending signature, and of the 80 signed loans, 43% had extensions of their disbursement periods averaging 28.9 months. According to the executing agencies interviewed, there were a number of factors that delayed project implementation. The most commonly mentioned included difficulties in using the Bank's procurement rules, particularly in cases of limited institutional capacity or executing agencies that were working with the Bank for the first time, the complexity of executing projects involving numerous actors and requiring a high degree of coordination, the lack of final designs in infrastructure projects, and the use of the multiple works modality.

4.11 **Based on the findings of this evaluation, OVE recommends the following:**

1. **Develop individual business models for working with each type of borrower (federal government, states, municípios, private sector, or public financial institutions), establishing key considerations in each case,** such as: (i) objectives that the IDB Group intends to achieve; (ii) engagement conditions; (iii) potential use of instruments; (iv) areas requiring particular attention or support; (iv) replicable factors of success in working with each borrower; and (v) the way in which activities requiring other borrowers to participate will be coordinated.

   By way of example, the objectives at the federal level could include: (i) positioning the Bank as a strategic partner on emerging key issues with long-term implications for the country and on which the Bank has experience and knowledge. To this end, the Bank should use instruments such as technical cooperation operations, fee for services, and even loans to the extent that they are able to leverage resources, knowledge, or good practices; and (ii) delineating policy guidelines to orient interventions at the subnational level and enable greater coordination between the federal and subnational levels.

2. **Consolidate the efforts to manage the size of the portfolio and explore new mechanisms for assisting executing agencies, considering their institutional capacity, with a view to improving the execution of projects.**

3. **In the context of new approvals, promote a greater use of available loan instruments, considering the type of project and the executing agencies' experience and capacity.**

4. **Strengthen coordination between the Bank and IDB Invest and identify cases in which the use of sovereign-guaranteed and NSG financing for the same purposes is justified.**

5. **Emphasize expenditure control and quality considerations in the Bank's sector work at the subnational level in view of the fiscally restrictive context that will frame the next country strategy.**

Office of Evaluation and Oversight — OVE

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