DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

B R A Z I L

PROGRAM TO SUPPORT PARA URBE

Operation No. 1404/OC-BR
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DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

BRAZIL

PROGRAM TO SUPPORT PARÁ URBE

FIRST PHASE

(BR-0357)

LOAN PROPOSAL

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ANNEXES

ABBREVIATIONS

EIA	environmental impact assessment
GDP	gross domestic product
ICMS	goods and services tax
IDB	Inter-American Development Bank
MG	municipal government
OC	Ordinary Capital
PAII	Institutional Action and Investment Plan
PNAF	National Program for State Fiscal Management
PNAFM	Program for Modernization of Municipal Fiscal Management
SECTAM	State of Pará Department of Science, Technology and the Environment
SEDURB	State of Pará Department of Urban and Regional Development
SETRAN	State of Pará Department of Transportation

Inter-American Development Bank
Regional Operations Support Office
Operational Information Unit

Brazil

Tentative Lending Program

2002

Project Number	Project Name	IDB US$ Millions	Status
BR0301	Northeast Microenterprise	30.0	APPROVED
BR0355	Santa Catarina Highways Stage IV	150.0	APPROVED
BR0323	Prodetur II Northeast Region	240.0	APPROVED
BR0313	Acre Sustainable Development	64.8	APPROVED
BR0357	Para Urban Developmente (para Urbe)	48.0	
BR0364	Diversity in University	5.0	
BR0374	Urban Parana	100.0	
BR0378	PROMOTION OF ETHICS AND DEFENSE OF PUBLIC PATRIMONY	3.0	
BR0351	Goiania Water and Sanitation	50.0	
BR0365	Modernization Comptroller Office	5.0	
*BR0367	Termoacu Co-Generation Power Project	25.0	
*BR0370	Campos Novos Hydroelectric Power Project	75.0	
BR0324	Ceara Sanitation II	120.0	
*BR0394	Sao Salvador	37.0	
*BR0395	Termonorte	56.0	
	Total - A : 15 Projects	**1,008.8**	
*BR0377	Electropaulo Capital Expenditures	75.0	
BR0254	Florianopolis-Osorio Highway Moderniz.	300.0	
BR0302	Fortaleza Urban Transport	86.2	
*BR0368	Carioba II Thermoelectric Power Project	74.5	
	Total - B : 4 Projects	**535.7**	
	TOTAL 2002 : 19 Projects	**1,544.5**	

2003

Project Number	Project Name	IDB US$ Millions	Status
BR0373	Promotion of Cultural Development	10.0	
BR0318	Tourism Development Program Prodetur Sul	200.0	
BR0372	São Paulo Fiscal Administration	15.0	
BR0297	National Food/Agricultural Research Syst	60.0	
BR0366	Increase Eletric Power Supply	600.0	
BR0356	Espirito Santo Highways	73.0	
BR0391	Downtown São Paulo Rehabilitation Procentro	100.4	
BR0358	Financing of Private Delivery of Soc.ser	200.0	
BR0375	Urban Transportation Curitiba2	40.0	
BR0376	Sustainable Development in Amapa	21.0	
BR0369	State Reform Sector Loan	500.0	
BR0371	Sao Paulo Line #5	175.5	
	Total - A : 12 Projects	**1,994.9**	
BR0266	New Irrigation Model	90.0	

Total - B : 2 Projects	90.0
TOTAL - 2003 : 14 Projects	2,084.9
Total Private Sector 2002 - 2003	342.5
Total Regular Program 2002 - 2003	3,286.9

*** Private Sector Project**

INTER-AMERICAN DEVELOPMENT BANK
Regional Operations Support Office
Operational Information Unit

BRAZIL

IDB LOANS

APPROVED AS OF APRIL 30, 2002

	US$Thousand	Percent
TOTAL APPROVED	**24,002,295**	
DISBURSED	18,068,289	75.3%
UNDISBURSED BALANCE	5,934,005	24.7%
CANCELLATIONS	1,359,959	5.7%
PRINCIPAL COLLECTED	6,101,853	25.4%
APPROVED BY FUND		
ORDINARY CAPITAL	22,314,374	93.0%
FUND FOR SPECIAL OPERATIONS	1,558,545	6.5%
OTHER FUNDS	129,376	0.5%
OUSTANDING DEBT BALANCE	**11,966,436**	
ORDINARY CAPITAL	11,552,597	96.5%
FUND FOR SPECIAL OPERATIONS	413,316	3.5%
OTHER FUNDS	524	0.0%
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	955,282	4.0%
INDUSTRY, TOURISM, SCIENCE TECHNOLOGY	6,106,855	25.4%
ENERGY	2,301,141	9.6%
TRANSPORTATION AND COMMUNICATIONS	3,802,919	15.8%
EDUCATION	852,705	3.6%
HEALTH AND SANITATION	2,889,865	12.0%
ENVIRONMENT	591,178	2.5%
URBAN DEVELOPMENT	2,219,438	9.2%
SOCIAL INVESTMENT AND MICROENTERPRISE	2,861,640	11.9%
REFORM _PUBLIC SECTOR MODERNIZATION	1,075,192	4.5%
EXPORT FINANCING	244,977	1.0%
PREINVESTMENT AND OTHER	101,103	0.4%

**** Net of cancellations with monetary adjustments and export financing loan collections***

BRAZIL

STATUS OF LOANS IN EXECUTION AS OF APRIL 30, 2002

(Amounts in US$ thousands)

APPROVAL PERIOD	NUMBER OF PROJECTS	AMOUNT APPROVED	AMOUNT DISBURSED	% DISBURSED
Before 1996	13	2,601,100	2,313,047	88.93%
1996 - 1997	14	2,493,265	1,282,181	51.43%
1998 - 1999	15	2,805,000	1,213,314	43.26%
2000 - 2001	17	2,610,192	195,930	7.51%
2002	3	420,000	0	0.00%
TOTAL	62	$10,929,557	$5,004,472	45.79%

* Net of Cancellations . Excluding export financing loans.

PROGRAM TO SUPPORT PARÁ URBE
FIRST PHASE

(BR-0357)

EXECUTIVE SUMMARY

Borrower State of Pará

Guarantor: Federative Republic of Brazil

Executing agency: State of Pará Department of Urban and Regional Development (SEDURB)

Amount and source:

	Phase I (US$)	Phase II (US$)	Total (US$)
IDB (OC):	48 million	52 million	100 million
Local:	32 million	34 million	66 million
Total:	80 million	86 million	166 million

Financial terms and conditions:

Amortization period:	25 years
Grace period:	4 years
Disbursement period (maximum):	4 years
Disbursement period (minimum):	3 years
Interest rate:	variable
Inspection and supervision:	1.00%
Credit fee:	0.75%
Currency:	Currency pool

Multiphase modality: With Brazilian government authorization, the State of Pará requested that the program described in this proposal be considered as a multiphase operation. The phase I loan would be for US$48 million and the phase II loan for US$52 million with an estimated start date of 2005. The rationale for a multiphase approach is as follows: (i) the municipalities need support in order to carry through their institutional adjustment programs, including the commitment and implementation of municipal and state reforms, which will take up to eight years to reach fruition; (ii) Pará has many municipalities and the state government wishes to see an Institutional Action and Investment Plan (PAII) in place in all of them; and (iii) the experience and lessons learned from local communities' participation in the consensus-seeking process to produce PAIIs, which will call for adjustments in the participatory process.

With a multiphase approach in mind, a set of indicators was developed to be able to assess each phase's results in terms of institutional adjustments in municipalities and specific projects (see paragraph 2.4 of the proposal which follows).

Objectives:

The program's objective is to help the State of Pará pursue its policy to expand and improve the quality of services that local governments deliver to their communities. To that end the program would support improvements in the institutional, legal, and financial framework for municipal operations in two areas particularly: (i) state-municipal relations and (ii) the efficiency of municipal administration. In addition, the program will directly support the municipal and regional investment effort by funding local and regional development projects.

To achieve these objectives the program will provide financing for: (i) studies to improve the system of State of Pará transfers to municipalities, including the design of incentives for municipal governments to generate own resources locally and raise funds in the financial and capital markets, one focus of these efforts being to attract private investment; (ii) actions to make municipal administration more efficient so municipalities can mobilize additional fiscal resources and create an enabling environment for local economic development; and (iii) municipal and regional investment projects or actions to improve service coverage and quality (particularly services for the low-income population) and generate jobs and income, with the ultimate aim of lowering poverty levels and smoothing interregional disparities.

Description:

In pursuit of the above objectives the program would finance the following components.

1. Administration and supervision (US$3.7 million)

This budget category covers general administration and support for the program's execution. It includes costs of the SEDURB Management Unit, systems needed to supervise and manage the program, accounting-financial audits of the program, and technical auditing of construction work. There is funding in this component also to hire a management firm to assist the Management Unit and to engage an outside organization to conduct annual evaluations of the program.

2. Direct investments (US$75.8 million)

a. Municipal sector development (US$700,000)

Under this heading the program will fund the design and implementation of measures to develop the municipal sector, focusing on those that can help municipalities mobilize more private funding, boost local tax revenues, and make municipal services more efficient. Support also will be provided to transform SEDURB into an agency responsible for supervision and support to local governments.

(i) **Financing for the municipal sector and improvement of the state transfers system**: (a) studies to design new funding approaches, including the fostering of private funding for the sector, and (b) drafting of a bill to amend State Law 6,276/99 which mandates the apportionment of 25% of goods and services tax (ICMS) transfer proceeds among municipalities.

(ii) **Private sector participation**: studies to analyze the involvement of private enterprise and civil society in local service delivery and management and to propose institutional and legal mechanisms for such **participation**. Funding also will be provided to prepare models of legal and contractual documentation for the formation of consortia of municipalities for service delivery (sanitary landfills, solid waste collection, hospitals, etc.) to achieve economies of scale.

(iii) **Strengthening of SEDURB**: (a) design and implementation of systems to continually monitor municipal fiscal management and municipal service performance, including efficiency ratings; (b) design and **implementation** of a municipal project monitoring system; and (c) strengthening of SEDURB's technical and administrative capacity with a view to making it an intergovernmental relations agency, including agreements with specialized technical institutions.

b. Institutional strengthening of municipalities (US$4 million)

This component will finance the implementation of institution-strengthening programs to increase the efficiency of municipal administration, as measured against predetermined performance benchmarks set out in management contracts between the municipalities and SEDURB. These agreements will come out of the diagnostic assessments conducted in each municipality, embodied in Institutional Action and Investment Plans (PAIIs) that will be reviewed and worked out by consensus with civil society. They will identify institutional improvement measures and investment projects to be funded by the program.

Among the institutional measures that would be eligible for funding under this component are: (i) development of PAIIs and of the process to arrive at a consensus on these action plans with civil society; (ii) strengthening of municipal financial bases; (iii) implementation of internal management and control systems, including cost-center budgeting; (iv) increasing the efficiency of public services, including help to design privatization and concession schemes; (v) training for municipal employees, and (vi) rationalization of municipal human resources.

c. Municipal and regional investment projects (US$71.1 million)

This component will fund construction, rehabilitation and expansion projects in all sectors falling under municipal jurisdiction, such as: (i) urban and rural roads; (ii) autonomous water and sewerage systems; (iii) storm drainage; (iv) social services (education, health, daycare centers, community centers, etc.); (v) city services such as integrated solid waste management and street lighting; (vi) urban equipment such as transportation terminals, markets and slaughter-houses; (vii) environmental conservation and amelioration, flood and erosion protection structures, parks and green spaces; and (viii) support for microproducers and small producers by building and outfitting basic industrial and commercial premises, providing technical assistance and fostering business alliances to achieve economies of scale in marketing, export operations, etc.

The component also will finance state (regional) projects in Pará that are crucial for municipal development and capital projects. Some examples are highway rehabilitation and paving and health and education projects that fall within state jurisdiction.

The Bank's country and sector strategy: The Bank is focusing on five key areas in its operations in Brazil in 2000-2003: (i) modernization of the State; (ii) competitiveness; (iii) poverty; (iv) the environment; and (v) regional integration. For modernization of the State it will step up its support for administrative and fiscal modernization in the federal, state, and municipal spheres. As for competitiveness, two focuses of Bank support are boosting infrastructure investment and instituting sound regulatory frameworks. The fight against poverty entails implementing and deepening social-sector reforms and urban and municipal development, to enhance the efficiency, equity and quality of services to the citizenry. Specific targets for Bank support in the environmental sphere are urban sanitation, solid waste treatment and pollution abatement generally.

In accordance with its subnational development strategy approved by the Board of Executive Directors in May 2001, the Bank will support countries in implementing reforms and institution-strengthening measures needed to establish efficient, democratic subnational governments equipped to perform the following functions: (i) foster economic progress in their jurisdictions; (ii) provide services needed to assure a good standard of living for residents and a more equitable social and territorial distribution of the benefits of progress; and (iii) provide infrastructure that is essential to the population's well-being and to increase economic activity.

The proposed program is in line with both these strategies, inasmuch as it will help improve living conditions of the population by improving the efficiency, quality, and equity of services delivered by Pará municipalities, fostering local economic development, smoothing interregional disparities in the state, and strengthening municipalities' fiscal capacity so they can comply with the Fiscal Responsibility Act.

Environmental and social review:

The program will have positive environmental and social impacts, including improvements in: (i) quality of life and health indicators following the execution of storm drainage, slaughterhouse, integrated solid waste management, sanitation, and health center projects; and (ii) environmental conditions in the state, thanks to amelioration of degraded areas, control of erosion and silting, elimination of environmental liabilities, and new parks and green spaces. The program will give priority to projects involving environmental conservation and amelioration, solid waste management, slaughterhouses, sanitation, health, education, and social services.

Indigenous groups will benefit directly from the program by way of indigenous health projects. Many women and women's organizations are expected to take part in the program, to judge from participation levels during the preparatory stage. The program also will contribute to sustainable management of the state's natural resources and its balanced social and environmental development, because the program's environmental procedures will bolster the State of Pará's "Environmentally Friendly Development" policy. Such adverse impacts as might occur during the construction period will be kept to a minimum by applying Brazilian technical standards and through permit requirements of the State of Pará Department of Science, Technology and the Environment (SECTAM) that will be part of the bidding conditions.

Based on a representative sample of projects, environmental and social eligibility criteria were established, as were measures to attenuate any adverse impacts and procedures for building socioenvironmental considerations into the project cycle. SEDURB and SECTAM signed a cooperation agreement specifying their respective environmental protection responsibilities in the proposed program.

Benefits: The program will improve the coverage and quality of services that municipalities deliver to their residents, primarily the low-income population, through urban and social infrastructure rehabilitation and expansion projects that offer sound economic returns. The program will yield more aggregated benefits by virtue of improvements in the allocation and transparent use of municipal fiscal resources, heightened civil-society participation in municipal resource allocation, investment efficiency gains, and a more rational state transfers system.

The program will increase the efficiency of the State of Pará's constitutionally mandated transfers and improve investment targeting and local resource mobilization as a preference revealing mechanism of the population. These improvements will be achieved by: (i) revising the ICMS tax distribution formula; (ii) establishing a mechanism for the allocation of state resources that takes account of municipalities' relative development status and tax effort; (iii) recovering costs of works projects; and (iv) rationalizing discretionary transfers, making state priorities transparent but leaving decisions on project selection to the community. The program also will benefit municipalities by enhancing their management capacity. Thus strengthened, the municipalities will operate with fiscal accountability, increase their saving capacity, generate resources for investment projects and create an enabling environment for private investment, thereby helping to advance their local economies.

Risks: **Institutional weaknesses of municipalities**. Institutional and operational weaknesses of Pará municipalities and their inadequate structure and staffing are an obstacle to efficient municipal administration and operations. To attenuate this risk the program provides, by way of Institutional Action and Investment Plans (PAIIs), for institutional strengthening and adjustment actions to equip municipalities to improve their workings and deliver services to local residents more efficiently. The monitoring and evaluation actions planned in the proposed multiphase program format will allow for close, frequent monitoring of the municipal strengthening process, thus making it easier to adjust PAIIs as needed and offering the necessary technical support.

Achievement of the program's development objectives. Achievement of the program objectives will depend in large measure on the effective implementation and operation of the policy of dialogue and consensus-building between the state government and municipal governments and civil society organizations. The challenge lies in the responsiveness of small communities and state agents' willingness to support them. The program has sought to mitigate risks in this regard by creating avenues for consultation and consensus-building as part of the PAII preparation and approval process, and by funding promotional and information activities to help the community understand the commitments adopted by the state and municipal governments under the Pará Urbe program, and the benefits this will entail.

Special contractual conditions:

Conditions precedent to the first disbursement of the loan: (i) entry into effect of the General Operating Regulations of the Pará Urbe Program, in accordance with the text approved in advance by the Bank (see paragraph 3.15); and (ii) entry into effect of the Specific Operating Regulations for the Pará Urbe-IDB Program, in accordance with the text approved in advance by the Bank (see paragraph 3.39).

Conditions precedent to the first disbursement of the municipal and regional investment component: submittal of drafts of: (i) agreement between SEDURB and the state departments in charge of executing the program (see paragraph 3.12), and (ii) agreements between the municipalities and SEDURB for execution of the regional and municipal investment component under the Pará Urbe-IDB program (see paragraphs 3.13 and 3.14).

Conditions precedent to the tendering of a works project: (i) signature of the respective addendum to the core agreement between SEDURB and the municipality; (ii) securing of a setup permit and fulfillment of any other requirements of the state environmental agency; (iii) presentation of the project's detailed design; and (iv) if the works project entails resettlement of residents, the respective resettlement plan produced in accordance with Bank policies (see paragraph 3.35).

Conditions precedent to the start of works: (i) if the project requires resettlement, evidence of adherence to the respective resettlement plan prepared in accordance with Bank policies, such that construction work is not executed until the affected population has been duly resettled; and (ii) evidence that public utility companies that could be affected by the works have pledged to collaborate and expedite their execution (see paragraph 3.36).

Conditions during implementation: (i) terms of reference for consultant services to be engaged for municipal development activities are to be presented to the Bank for consideration within 90 days after signature of the loan contract (see paragraph 2.8); (ii) 120 days after each fiscal year-end, the borrower will provide the Bank with an evaluation report on the program prepared by an outside agency (see paragraph 3.54); the annual program evaluation is to be commissioned within nine months after the effective date of the loan contract, according to Bank-approved terms of reference (see paragraph 3.54); (iii) the borrower is to operate two separate bank accounts exclusively to handle the loan proceeds and the local counterpart funds (see paragraph 3.48(v)); (iv) maintenance of program-funded state roads must be outsourced (see paragraph 3.45); (v) the borrower must conduct a final evaluation of the program's execution when 50% of the program resources have been disbursed and 75% have been committed or in the last year of the program's execution, whichever occurs first (see paragraph 3.57); and (vi) each works project's operating, administration, maintenance, and capital costs are to be recovered through revenues raised by the municipality-state or by the utility or service provider, such revenues to be obtained from, *inter alia*, rates, taxes, betterment levies, rent, or concession fees, according to the law. When a project's beneficiaries cannot be clearly identified, no discrimination is justified, or the beneficiaries' socioeconomic situation so warrants, the municipality's or state's general revenues may be used for cost recovery. In such cases it must be demonstrated that the project will not create a primary deficit in the municipality's or state's finances (see paragraph 3.38).

Poverty-targeting and social equity classification: This operation qualifies as a social equity enhancing program, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). Furthermore, the operation qualifies as a poverty-targeted investment (PTI) because it supports the delivery of local services that benefit mostly (73% of the population of the state of Pará) low-income groups. The borrower will not be using the 10 percentage points in additional financing (see paragraph 4.30).

Exceptions to Bank policy: None.

Procurement: Bank procedures will be followed for works contracting, purchases of goods, and hiring of consulting services for the program. International competitive bidding will be required for works contracts worth US$5 million or more, goods costing US$350,000 or more, and services costing over US$200,000 (see paragraph 3.40). The Bank will conduct an ex post review of documents and of tendering processes when the cost of a contract for construction work or goods is below those thresholds and when contracts with consulting firms or individual consultants are below US$200,000 and US$50,000, respectively. Price can be used as a criterion for consultant service selection, as stipulated in document GN-1679-3 (see paragraph 3.41).

I. FRAME OF REFERENCE

A. Changing production patterns in Pará and their impact on the urbanization process

1.1 The state of Pará in northern Brazil is the country's second-largest state, with an area of roughly 1.2 million square kilometers. According to the 2000 census, this large expanse is home to only 6.2 million people, making it the ninth most populous state in the country. It ranks thirteenth among Brazil's 27 states in contribution to national GDP, accounting for 1.7% of the total, and twentieth in terms of per capita GDP (US$2,200—about 48% of the national per capita figure).

1.2 Until the 1970s, Pará's production structure was built around extractive activities involving natural Amazon products, including small-scale mining. In that decade the federal government launched a series of initiatives to put the thinly-populated Amazon region to productive use, through managed settlement programs and integration highways. The main roadway built during that era was the Trans-Amazon Highway, which paved the way for settlement programs, huge agricultural projects and large-scale mining operations.

1.3 These programs triggered mass migrations, mostly of rural dwellers, from northeastern and south-central Brazil to the state of Pará. This put pressure on the region's cities, which were ill-equipped to handle the influx. As a result, urban centers sprang up and spread along the highways, becoming major service hubs and labor pools for mining and agricultural operations.

1.4 After 1980 the federal government shifted the focus of its Amazon occupation policy, de-emphasizing managed settlement programs and concentrating on major export-oriented ventures, and wood, pulp and paper, and agricultural production projects. Construction of the Tucuruí hydroelectric plant was the key to tapping the state's hydroelectric potential on a large scale; that opened the door for large aluminum and magnesium operations and other mineral-based activities.

1.5 These projects spurred yet more migration to the state of Pará, particularly during the initial construction stage. When the construction projects were finished and workers found themselves with no other job prospects (the new ventures being capital-intensive), they remained in nearby cities, putting pressure on already-precarious urban infrastructure and worsening social problems. Meanwhile, as agricultural patterns shifted, rural workers moved from the countryside to small and mid-sized cities to do seasonal daywork in area fields.

B. Pará municipalities

1.6 Table I-1 illustrates, in figures, the urbanization process described above. Between 1991 and 1996 the share of the total Pará population living in cities held steady at around 50%. By 2000, city-dwellers clearly predominated (67% of total population). The state's growth rates for total population and urban population also surpassed the national figures. An important feature of this process is the concentration of economic activity and population in the eastern part of the state, which takes in the capital Belém and its metropolitan area, bounded by the Tocantins River, the state of Maranhão, and the Atlantic coast. That eastern region is home to 115 of the state's 143 municipalities, 83% of its total population, and 70% of the urban population, and contributes 70% of state GDP.

Table I-1
State of Pará – Urban and rural population 1991-2000 (thousands)

Years	Rural population	Urban population	Total population
1991	2,350	2,600	4,950
1996	2,562	2,949	5,511
2000	2,073	4,116	6,189
1991 – 1996	+212	+349	+561
1996 – 2000	-489	+1,167	+678
1991 – 2000	-277	+1,516	+1,239
Annual % growth	-1.38	+5.24	+2.51

Source: 2000 Population Census, Brazilian Bureau of Survey and Statistics (IBGE)

1.7 Table I-2 gives a breakdown of municipalities by population range. The only city not located in the eastern region is Santarém, with a population of about 260,000.

Table I-2
State of Pará: Distribution of municipalities by population range

Range (2000 population)	Municipal-ities (number)	Municipal-ities (%)	Total population (000)	(%)
Over 400,000	1	0.7	1,280	20.8
100,000 to 400,000	5	3.5	1,077	17.4
50,000 to 100,000	18	12.6	1,243	20.0
20,000 to 50,000	56	39.2	1,757	28.4
Under 20,000	63	44.0	832	13.4
Total	143	100.0	6,189	100.0

Source: 2000 Population Census (IBGE).

Cities with over 100,000 population
(in thousands)

Belém	1,280
Ananindeua	393
Santarém	263
Marabá	168
Castanhal	134
Abaetetuba	119

1.8 This rapid, haphazard migration toward urban parts of the state in recent decades without the attendant infrastructure outlays, particularly for basic social services, has taken a toll on the urban environment and has worsened people's economic and social situation and environmental conditions.

1.9 Another issue is the creation of numerous new small municipalities—38 in nine years—without a sound tax base, with little if any mobilization of local resources, and with a weak administrative apparatus, leaving these municipalities ill-equipped to deliver municipal services or create an enabling environment for local economic development. Approximately 80 of the state's 143 municipalities thus have Municipal Human Development Indexes (MHDI) below 0.50; close to 100 municipalities have an index below 0.55.[1] Furthermore, the state's network of cities is polarized around the 13 largest municipalities in several regions: Abaetetuba, Altamira, Belém, Breves, Cametá, Capanema, Castanhal, Itaiatuba, Marabá, Paragominas, Redenção, Santarém and Tucuruí. But even these larger centers lack the kind of investments that are state responsibilities, such as: (i) rehabilitating or upgrading access roads to municipalities located in their respective service areas and (ii) rehabilitating, expanding or installing infrastructure and equipment to meet the demands of area municipalities, particularly for health services and education.

C. Main issues for municipalities

1. Municipal responsibilities

1.10 Historically, Brazilian municipalities have had a large measure of operating independence and their mayors play a prominent political role. Since the enactment of the 1988 Federal Constitution the role and responsibilities of municipalities have been heightened. To compensate for the vertical and horizontal imbalances that have come out of intensified decentralization moves, the increase in functions passed down to municipalities was accompanied by a concomitant increase in constitutionally mandated federal transfers and by the institution of state transfers of proceeds of the goods and services tax (ICMS).

1.11 Municipalities are responsible for providing services throughout their territory, in rural and urban areas alike. Thus, in addition to basic urban utilities and services like city sanitation, street lighting, cemeteries, roads and urban transit, storm drainage, slaughterhouse operation or regulation, markets, water and sewer services, urban land use planning and regulation, etc., they are in charge of basic education, preventive and primary health care promotion and delivery, and building and maintaining local roads.

2. Municipal resources

1.12 To fund these mandates, municipalities have three main kinds of resources: taxes, transfers, and borrowings. Given the interfaces between these different funding sources, relations between the current incentives and local-resource mobilization need to be looked at carefully.

a. Tax revenues

1.13 Brazilian municipalities have full power to set local levies, namely the property tax, tax on services, tax on real property transfers, service fees, betterment levies, and utility rates.

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[1] The MHDI is a composite indicator of three variables: life expectancy, educational attainment, and per capita income in municipalities. The standardized scale goes from zero to one.

1.14 This fiscal autonomy notwithstanding, Pará municipalities are making very little use of local taxation sources, relying primarily on state and federal government transfers.

1.15 Table I-3 presents selected fiscal dependence indicators for clusters of municipalities.[2] It illustrates how heavily the municipalities rely on federal and state constitutionally mandated transfers (accounting for anywhere from 74% to 98% of current revenues), with scant recourse to their own taxing authority. This reliance on transfers correlates inversely to the municipalities' development status. But even in Belém, the only Cluster 1 municipality and the state's capital and largest city, locally generated revenues account for only 26% of current revenues. Cluster 5 municipalities (the least developed) obtain a mere 2.2% of their current revenues from such local sources.

Table I-3
Fiscal dependence indicators—1999

Cluster of municipalities	Tax and other fiscal revenues/ Curr.revenues (%)	Taxes/ Current revenues (%)	Current transfers/ Current revenues (%)
1	26.0	18.1	74.0
2	15.2	8.3	84.8
3	7.5	4.4	92.5
4	7.1	4.1	92.9
5	2.2	0.9	97.8
Average	12.8	8.3	87.2

b. The intergovernmental transfers system

1.16 In accordance with the Federal Constitution, Brazilian municipalities receive two forms of transfers from the federal and state governments: systematic (constitutionally mandated) transfers, described in Table I-4, and nonsystematic (discretionary) transfers. The primary sources of systematic federal transfers are: (i) the Municipal Revenue-Sharing Fund, and (ii) 50% of the municipal rural property tax. State-municipal transfers consist of 25% of the goods and services (ICMS) tax and 50% of the vehicle ownership tax.

Table I-4
Distribution of systematic transfers

Federal:
Municipal Revenue-Sharing Fund. State capitals (Belém, in the case of Pará) receive 10% of this pool, apportioned pro rata to population size and inversely to per capita income in the respective state. The other Brazilian municipalities share 86.4% of the Fund, based solely on population size. The 3.6% balance goes to municipalities that are not state capitals and have populations over 156,216.
State:
As mandated by the Federal Constitution, 75% of ICMS tax proceeds are distributed pro rata to value-added, and the 25% balance as prescribed in state law. In the State of Pará formula, that distribution is calculated according to surface area (5%) and municipal population (5%), with 15% being apportioned equally among the municipalities.

1.17 Though there are equity features in the federal transfer system, the distribution formula uses municipality size as a proxy for tax base and thus favors smaller

2 Using multivariate analysis, municipalities were grouped into homogeneous "clusters" according to social and economic variables.

municipalities, while state transfers favor the wealthier municipalities. According to studies on the state of Paraná in southern Brazil, one significant feature of the systematic-transfers system is the lack of incentive for any local tax effort. [3] This is a constraint for municipal policy autonomy, efficient allocation of local resources, and municipal responsiveness to residents' demands for services, neutralizing the transfers' effects on vertical imbalances.

1.18 The bulk of the nonsystematic (discretionary) federal and state transfers go to the health and education sectors.

1.19 The State of Pará created an Economic Development Fund to pay for programs and projects that could advance the state's economy and even out interregional disparities. The Fund transfers approximately US$25 million annually to the municipalities. These non-mandated, discretionary transfers do not cover all municipal expenditures, but as they require only modest local counterpart contributions, they also contribute to fiscal laxity in the municipalities.

Table I-5
Article 3 of Law 5,674 of 21 October 1991
Economic Development Fund holdings

I.	Monies from the following sources: (a) up to 10% of the State of Pará's share of the State and Federal District Revenue-Sharing Fund; (b) up to 10% of the funds corresponding to the share of the manufactured goods tax referred to in Article 159, section II, of the Federal Constitution, net of the municipalities' share.
II.	Other budgetary resources.
III.	Returns on financial investments of Fund holdings.
IV.	Proceeds of domestic or external borrowings for the Fund (with or without the Fund's guarantee) or domestic or external grants to the Fund.
V.	Repayments of principal, interest, returns, and any other income from operations transacted with Fund monies that are not equity participations.
VI.	Income from dividends, gains and cash bonuses distributed by companies in which the State holds an interest, with prior authorization from the State Council on Economic Development.

c. Municipal borrowing

1.20 Though Brazilian law permits municipalities to borrow on the financial and capital markets, Pará municipalities rarely use that funding avenue. According to data from the Accounting Office of Municipalities of the State of Pará, in 2000 only the municipality of Belém, the state capital, had debts outstanding to financial institutions, totaling around US$20 million. The other municipalities had debts only to government agencies, chiefly the social security system. Those borrowings are negotiated with the federal government under a debt rescheduling program.

1.21 There are several reasons why municipalities so rarely exercise their borrowing authority: (i) under the current transfers system there are no requirements at all for matching funding or prudent fiscal management; (ii) at times of crisis a municipality can count on state and federal government bailouts; and (iii) there are

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[3] Rémy Prud'homme, *State and Local Public Finance in Paraná. Structure and Issues*, and Jeronimo Meira, *Impact of Intergovernmental Transfers on Paraná Municipalities' Tax Efficiency*. Paranácidade, 1998.

legally prescribed ceilings and ratios for debt stock to revenues, debt service to revenues, and primary surplus. Furthermore, Central Bank authorization is needed for domestic borrowings and Federal Senate authorization for borrowings outside the country.

1.22 Considering the annual debt cap, the estimated aggregate 2000 borrowing capacity of Pará's 143 municipalities would be only US$42.8 million, US$7 million of this figure corresponding to Belém. If the primary-surplus requirement is factored in, the aggregate capacity would drop to US$15 million. What this exercise suggests is that before borrowing from banks or the capital markets, municipalities need to make efforts to mobilize resources locally if they are to increase their investment capacity, by means of an intensified tax effort with greater administrative efficiency and attracting private investors for municipal service delivery.

Table I-6

Federal Senate Resolution 78/98
Debt ceilings

Annual new borrowings: 18% of net revenues less disbursements on existing operations
Primary surplus: Total revenues less borrowings less total expenditures plus debt service greater than zero
Debt stock: One times net annual revenues less existing debt stock

3. Municipal expenditure

1.23 Municipalities spend the bulk of their revenues to defray current expenditures, which make up about 85% of total spending. Most of those outlays are for personnel costs. As Table I-7 shows, all the municipalities except those in Cluster 4 exceed the 60% ratio of payroll to net current revenues mandated in the Fiscal Responsibility Act. These high expenditure levels can be attributed to large municipal staff rolls—in some cases, 40 employees per 1,000 population, when a more reasonable ratio would be around 7 per 1,000. The combination of this spending structure and the municipalities' fiscal laxity makes for unsatisfactory operation and maintenance of urban equipment, and capital spending levels that are not keeping pace with mounting demands for services in this rapidly urbanizing state.

Table I–7 Expenditure ratios 1999

Cluster of munici-palities	Personnel costs / Net current revenues (%)	Current expenditure / Total expend. (%)	Capital expenditure / Total expend. (%)	Capital transfers / Capital expend. (%)
1	78.6	85.0	12.1	1.4
2	67.9	85.3	14.0	12.3
3	75.8	86.6	11.6	78.2
4	55.4	83.7	14.8	67.2
5	62.6	83.4	15.2	56.5

4. Municipal institutional capacity

1.24 One expectation of the decentralization process was that services would be better managed as local government performance improved and the community gained a greater say in decision-making and held those in power accountable for local service coverage and quality. Though strides certainly have been made on this front, among them the improvements achieved by the National Program for Modernization of Municipal Financial Management, there are still a number of serious obstacles to be surmounted, such as weak municipal institutions, too few staff with expertise in municipal services (despite the large numbers hired), and the municipalities' limited experience in managing urban and social services.

5. Fiscal management of the local tax base

1.25 A necessary counterpart to local autonomy is fiscal responsibility. But, with some exceptions, Pará municipalities have no up-to-date cadastre or assessment roll, no methods to track or control expenditure, no integrated financial management systems, and few staff with the expertise to perform the necessary tasks and operate financial systems. Above all, there is little incentive for municipalities to raise revenues locally.

6. The government's response to municipal finance issues

1.26 To address the problems outlined above, the Brazilian government set out to institute public finance rules and standards in pursuit of responsible fiscal management. In May 2000 it secured passage of Law 101, the "Fiscal Responsibility Act". For the three levels of government this law mandates, *inter alia*, the concepts of multiyear budgeting with fiscal targets, contingent liabilities and cost controls, and introduces balanced-budget principles and incentives for mobilizing own resources. Table I-8 summarizes some provisions of the Act that pertain specifically to municipal finances.

Table I-8

Fiscal Responsibility Act provisions pertaining directly to municipalities
Revenue intake: Levying and effective collection of all taxes falling under municipal jurisdiction.
Personnel costs: Capped at 60% of net current revenues.
Discretionary transfers: Receipt of these funds will be contingent on compliance with provisions on revenue intake, ceilings on payroll costs and debt, and checks of the use of previous transfers.

1.27 With these legal underpinnings the State of Pará will be able to implement a discretionary transfers system (Pará Urbe) with the aim of increasing the municipal tax effort, making municipal spending more efficient, and helping municipalities comply with the Fiscal Responsibility Act.

1.28 The Pará Urbe program will be a permanent system of non-mandated "matching grant" type transfers to municipalities for investments in infrastructure and local and regional services, along with actions to enhance municipalities' administration and tax effort and programs and projects to build and upgrade regional infrastructure in strategic segments, with a view to optimizing intermunicipal integration. The State has already created Pará Urbe, which will be administered by the State of Pará Department of Urban and Regional Development.

1.29 Pará Urbe will be funded with at least 40% of the funds allotted to the Economic Development Fund (pursuant to Article 3 of Law 5,674, section I, paragraphs a and b—see Table I-5) and other resources, including funds from the program described in this proposal. The aforementioned percentage is prescribed in Decree 5011 of 30 November 2001 which regulates Law 5,674 of 21 October 1991.

D. The Bank's strategy

1.30 The Bank is focusing on five key areas in its operations in Brazil in 2000-2003: (i) modernization of the State; (ii) competitiveness; (iii) poverty; (iv) the environment; and (v) regional integration. For modernization of the State it will step up its support for administrative and fiscal modernization in the federal, state, and municipal spheres. As for competitiveness, two focuses of Bank support are boosting infrastructure investment and instituting sound regulatory frameworks. The fight against poverty entails implementing and deepening social-sector reforms and urban and municipal development, to enhance the efficiency, equity and quality of services delivered to the citizenry. Specific targets for Bank support in the environmental sphere are urban sanitation, solid waste treatment and pollution abatement generally.

1.31 In accordance with its subnational development strategy approved by the Board of Executive Directors in May 2001, the Bank will support countries in implementing reforms and in institution-strengthening measures needed to establish efficient, democratic subnational governments equipped to perform the following functions: (i) foster economic progress in their jurisdictions; (ii) provide services needed to secure a good standard of living for residents and a more equitable social and territorial distribution of the benefits of progress; and (iii) provide infrastructure that is essential to the population's well-being and to increase economic activity.

1.32 The proposed program is in line with both these strategies, inasmuch as it will help improve living conditions of the population by improving the efficiency, quality, and equity of services delivered by Pará municipalities, fostering local economic development, protecting the environment, smoothing regional disparities in the state, and building fiscal capacity in municipalities so they can comply with the Fiscal Responsibility Act.

E. The Bank's experience and relation of this operation to others

1.33 The Bank has a great deal of experience as a participant in the design of this kind of operation. Lessons learned from the following programs were drawn on in designing the operation proposed here: Support for Urban Development in Paraná (917/OC-BR) (see paragraphs 4.9 and 4.10); Large Urban Areas in the Argentine Interior (1068/OC-AR), and Local Development and Fiscal Accountability (1075/SF-BO).

1.34 Those earlier operations revealed that: (i) resources are allocated efficiently when society has information on cost recovery mechanisms (preference revealing mechanisms) to be able to take part in spending decisions; (ii) investments must be one of the incentives for institutional change; (iii) adjustments are more efficient when targets are agreed on with the municipalities, institutional projects being shaped by demand and not by the program; and (iv) programs targeted to municipalities need to have sound, transparent, easy-to-understand incentive mechanisms such as simple resource transfer formulas using readily forecastable indicators (per capita revenue intake, service coverage and quality, etc.).

II. THE PROGRAM

A. Objectives

2.1 The program's objective is to help the State of Pará pursue its policy to expand and improve the quality of services that local governments deliver to their communities. To that end the program would support improvements in the institutional, legal, and financial framework for municipal operations in two areas particularly: (i) state-municipal relations and (ii) efficiency of municipal administration. In addition, the program will directly support the municipal and regional investment effort by funding local and regional development projects.

2.2 To achieve these objectives the program will provide financing for: (i) studies to improve the system of transfers from the State of Pará to municipalities, including the design of incentives for municipal governments to generate own resources locally and raise funds in the financial and capital markets, one focus of these efforts being to attract private investment; (ii) actions to increase the efficiency of municipal administration so municipalities can mobilize additional fiscal resources and create an enabling environment for local economic development; and (iii) municipal and regional investment projects or actions to improve service coverage and quality (particularly for the low-income population) and generate jobs and income, with the ultimate aim of lowering poverty levels and smoothing interregional disparities

B. Program description

2.3 With Brazilian government authorization, the State of Pará requested that the Bank consider the program described here as a multiphase operation. The phase I loan would be for US$48 million and the phase II loan for US$52 million with an estimated start date of 2005. The rationale for a multiphase approach is as follows: (i) the municipalities need support in order to carry through their institutional adjustment programs, including the commitment and implementation of municipal and state reforms, which will take up to eight years to come to fruition; (ii) the state of Pará has many municipalities, and the state government wishes to see an Institutional Action and Investment Plan (PAII) in place in all of them; and (iii) the experience and lessons learned from local communities' participation in the consensus-seeking process to produce PAIIs, which will call for adjustments in the participatory process.

2.4 With a multiphase approach in mind, a set of indicators was developed to be able to assess each phase's results in terms of institutional adjustments in municipalities and specific projects. The program's Logical Framework appended as Annex II-1 to this proposal describes the proposed indicators. Approval for phase II of the operation would be contingent on demonstrated attainment of the following targets (see paragraph 3.54):

Table II-1
Targets for phase II

• System of discretionary state transfers	Implemented
• New ICMS (goods and services tax) apportionment formula	Implemented
• Municipal fiscal management monitoring system	Implemented
• SEDURB project monitoring system	Implemented
• Program for Modernization of Municipal Fiscal Management (PNAFM) in 70 municipalities	Implemented
• 75% of phase I resources 50% of phase I resources	Committed Disbursed

2.5 In pursuit of the above targets, the program would finance the following components.

1. Administration and supervision (US$3.7 million)

2.6 This budget category covers general administration and support for the program's execution. It includes costs of the State of Pará Department of Urban and Regional Development (SEDURB) Management Unit, systems needed to supervise and manage the program, accounting-financial audits of the program, and technical auditing of construction work. There is funding in this component also to hire a management firm to assist the Management Unit and to engage an outside organization to conduct annual evaluations of the program.

2. Direct investments (US$75.8 million)

a. Municipal sector development (US$700,000)

2.7 Under this heading the program will fund the design and implementation of actions to develop the municipal sector, focusing on activities that can help municipalities mobilize more private funding, boost local fiscal revenues, and make municipal services more efficient. Support also will be provided to transform SEDURB into an agency responsible for supervision and support to local governments.

(i) **Financing for the municipal sector and improvement of the state transfers system**: (a) studies to design new funding approaches, including the fostering of private funding for the sector, and (b) drafting of a bill to amend State Law 6,276/99 which mandates the apportionment of 25% of ICMS tax proceeds among municipalities.

(ii) **Private sector participation**: studies to analyze the involvement of private enterprise and civil society in local service delivery and management and to propose institutional and legal arrangements for such participation. Funding also will be provided to draft models of legal and contractual documentation for the formation of consortia of municipalities for some services (sanitary landfills, solid waste collection, hospitals, etc.) to achieve economies of scale.

(iii) **Strengthening of SEDURB**: (a) design and implementation of systems to continually monitor municipal fiscal management and municipal service performance, including efficiency ratings; (b) design and implementation of a municipal project monitoring system; and (c) strengthening of SEDURB's technical and administrative capacity with a view to making it an intergovernmental relations agency, including agreements with specialized technical institutions.

2.8 The terms of reference for consulting services to be engaged for activities listed in points (i), (ii) and (iii) above would have to be submitted to the Bank for consideration within 90 days after signature of the eventual loan contract.

b. Institutional strengthening of municipalities (US$4 million)

2.9 This component will finance the implementation of institutional strengthening programs intended to increase the efficiency of municipal administration, measured against predetermined performance benchmarks set forth in agreements between the municipalities and SEDURB. These agreements will come out of diagnostic assessments conducted in each municipality, embodied in Institutional Action and Investment Plans (PAIIs) that will be reviewed and worked out by consensus with civil society. They will identify institutional improvement measures and investment projects to be funded by the program.

Table II-2

Institutional Action and Investment Plans (PAIIs)

As a prerequisite for a municipality to join the program it must have a PAII worked out by consensus with local civil society organizations. PAIIs will be prepared with a four-year horizon. They will contain an institutional and financial analysis of the municipality taking part in the program and an action plan of specific activities to improve municipal government efficiency and fiscal management, such that—at a minimum—the municipality will comply with the Fiscal Responsibility Act. Key elements in the diagnostic assessment are: (i) an analysis of the municipality's fiscal situation with four-year financial projections of spending, municipal debt, and fiscal indicators; (ii) recommended institutional reforms and how they will impact the municipality's finances; (iii) recommended institution-strengthening projects to help the municipality achieve fiscal targets and outcomes relating to service coverage and quality improvements agreed on with SEDURB; and (iv) investment projects to be developed following project preparation guidelines, and analyses of their technical, economic, financial, institutional, and environmental viability in accordance with the program Regulations agreed on with the Bank.

2.10 Among the institutional measures that would be eligible for funding under this component are: (i) development of PAIIs and of the process to forge a consensus on these action plans with civil society; (ii) strengthening of municipal financial bases; (iii) implementation of internal management and control systems, including cost-center budgeting; (iv) increasing the efficiency of public service delivery, including help to design privatization and concession schemes; (v) training for municipal employees, and (vi) rationalization of municipal human resources.

c. Municipal and regional investment projects (US$71.1 million)

2.11 This component will fund construction, rehabilitation and expansion projects in all sectors falling under municipal jurisdiction, such as: (i) urban and rural roads; (ii) autonomous water and sewerage systems; (iii) storm drainage; (iv) social services (education, health, daycare centers, community centers, etc.); (v) city services such as integrated solid waste management and street lighting; (vi) urban equipment such as transportation terminals, markets and slaughterhouses; (vii) environmental conservation and amelioration, flood and erosion protection structures, parks and green spaces; and (viii) support for microproducers and small producers by building and outfitting industrial and commercial spaces with basic services,[4] providing technical assistance and fostering business alliances to achieve economies of scale in marketing, export operations, etc.

2.12 The component also will finance state (regional) projects that are crucial for municipal development and capital projects. Some examples are highway rehabilitation and paving and health and education projects that fall within state jurisdiction.

C. Sizing of the program and its cost and financing

2.13 The following factors were considered when deciding on the scale of the program:

a. The development and institution-strengthening needs of Pará municipalities (according to a diagnostic assessment of a representative sample of 23 municipalities), of SEDURB, and of the State Departments of Health, Education, and Transportation. From the assessment of municipalities eight institution-strengthening actions were devised, including PAII preparation, at an average cost of US$28,200 per municipality. Taking in the other 120 municipalities the cost would be around US$4 million. The municipal development activities, including SEDURB institution-strengthening, would cost US$0.7 million.

b. The shortfall in urban infrastructure investment and strategic state investment as estimated from the above-mentioned assessment. Forty investment projects

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[4] Buildings equipped with basic electrical facilities and water service, suitable for accommodating fledgling microenterprises long enough for them to consolidate their operations.

totaling US$42 million were identified; these served as a sample for the proposed program.

c. The municipalities' investment capacity, measured by their capital spending in recent years, which came to about US$25 million annually.

d. The institutional capacity of SEDURB, the municipalities, and the other participating state agencies to implement the program, measured by project identification and preparation and diagnostic assessments of the sample.

e. What it would cost SEDURB to administer, supervise and evaluate the program, taking into consideration the cost of previous similar operations, including the hiring of a management firm.

2.14 The following table breaks out the total program cost by expenditure line and funding source.

Table II-3
Program cost table (US$million)

	COST CATEGORY AND EXPENDITURE ITEM	IDB/OC	LOCAL	TOTAL	%
1.	**Administration and supervision (consulting services, equipment)**	**1.2**	**2.5**	**3.7**	**4.6**
1.1	General administration	0.3	1.2	1.5	
1.2	Implementation and evaluation support	0.4	1.3	1.7	
1.3	External audits	0.5	-	0.5	
2.	**Direct investment**	**46.3**	**29.0**	**75.3**	**94.8**
2.1	**Municipal sector development (consulting services, equipment)**	**0.7**	-	**0.7**	**0.9**
2.1.1	Funding for the sector and overhaul of the state transfers system	0.2	-	0.2	
2.1.2	Participation and privatization	0.1	-	0.1	
2.1.3	Strengthening of SEDURB	0.4	-	0.4	
2.2	**Institutional strengthening of municipalities (consulting services, equipment)**	**2.1**	**1.9**	**4.0**	**5.0**
2.2.1	Preparation and approval of PAIIs	0.4	-	0.4	
2.2.2	Institution-strengthening	1.7	1.9	3.6	
2.3	**Municipal and regional investment projects (consultant services, equipment, works)**	**43.5**	**27.1**	**70.6**	**88.9**
2.3.1	Preinvestment	1.1	1.6	2.7	
2.3.2	Municipal works	20.8	14.3	35.1	
2.3.3	Strategic (state) projects	21.4	11.2	32.6	
2.3.4	Construction auditing and supervision	0.2	-	0.2	
Subtotal		**47.5**	**32.0**	**79.5**	**99.4**
3.	**Financial costs**	**0.5**	**-**	**0.5**	**0.6**
3.1	Inspection and supervision	0.5	-	0.5	
	TOTAL	**48.0**	**32.0**	**80.0**	**100.0**
	Percentage	**60.0**	**40.0**	**100.0**	

2.15 The proposed program would coordinate with all the federally-funded programs for local governments, to make full use of the resources available and maximize the impact of the different programs currently in progress, including the Program for Modernization of Municipal Fiscal Management (PNAFM) funded by the Bank by way of loan 1194/OC-BR.

III. PROGRAM IMPLEMENTATION

A. Borrower and guarantor

3.1 The borrower will be the State of Pará, with the guarantee of the Federative Republic of Brazil. The Government of the State of Pará has designated its Department of Urban and Regional Development (SEDURB), which is responsible for shaping and implementing the state's urban and regional development policies, as the program's executing agency. SEDURB will perform the following functions: (i) institutional financial evaluation of municipalities; (ii) approval of PAIIs and their financing, which entails an analysis of municipal institution-strengthening projects and the technical, economic, financial, environmental, and institutional appraisal of investment projects; (iii) technical support to coexecuting agencies for project implementation; (iv) supervision, monitoring and control of funded projects; and (v) administration of the program, including spending commitments and authorization of payments and/or transfers to municipalities.

B. Program implementation

3.2 The program will operate within a framework of reform of the discretionary transfers system to be administered by SEDURB as described below.

1. Executing agency

3.3 Responsibility for the program's execution will rest with a Management Unit set up under the Office of the Deputy Secretary of SEDURB, which is in charge of the Bank-funded macrodrainage program and other municipal programs financed from the Economic Development Fund and federal transfers.

3.4 Even with the experience acquired by the Management Unit during the preparatory phase of the program it will be supported by a management firm in all areas pertaining to the program's execution, including the implementation of systems planned for the SEDURB strengthening component. To that end, the executing agency, in accordance with local legislation, has already hired Paranácidade, which is managing the IDB-funded Paraná Urbano I program in the state of Paraná and has developed project supervision and control systems that will be implemented in SEDURB.

2. Coexecuting agencies

3.5 Under the decentralized format adopted for the program's implementation, the following agencies would take part:

a. Pará municipalities

3.6 The municipalities will be responsible for preparing their respective PAIIs and for executing eligible institution-strengthening and investment projects.

b. State of Pará Department of Transportation

3.7 The State Transportation Department, which is responsible for devising state transportation programs, will develop regional road rehabilitation and paving projects, which will be key to the viability of municipal investment projects to be submitted subsequently to SEDURB for approval. This department will be in charge of tendering, execution, and supervision of approved transportation projects.

c. State of Pará Department of Health

3.8 This agency will develop state health programs on the basis of which local projects will be developed in consultation with the municipalities for SEDURB approval. It will organize the requisite tenders and implement and supervise the projects.

d. State of Pará Department of Education

3.9 The State Education Department will be responsible for preparation of projects addressing such areas as: accreditation of elementary and middle-school teachers; organization of services and procurement of school transportation vehicles; laboratory equipment and library books for elementary and middle schools; and organization and equipment for programs targeted to at-risk youth, involving investments in multi-sports courts. Like the other agencies, the Education Department will be in charge of tendering, executing, and supervising implementation of its projects.

e. State of Pará Special Management Department

3.10 This department will be in charge of executing the component relating to municipal finance and reworking of the system of constitutionally mandated and discretionary state transfer payments.

C. Normative instruments for the program

3.11 In addition to the loan contract to be signed by the State of Pará and the Bank, the program would be governed by the following instruments.

1. Technical cooperation agreements

3.12 SEDURB would sign these agreements with the state departments in charge of executing regional projects, to delineate the parties' responsibilities for implementation of projects falling within each department's purview. Forms of agreement have been worked out with the Bank. Signature of these agreements would be a condition precedent to the first disbursement.

2. Agreements between SEDURB and the municipalities

3.13 Three kinds of agreements will govern relations between SEDURB and the municipalities:

a. **Terms of Participation** setting out the general objectives of the Pará Urbe program, the funding envisaged initially for the municipality for four years, terms and conditions for receiving those funds, and a pledge to observe Pará Urbe rules and requirements.

b. **Core Agreement** between SEDURB and the municipalities, setting targets and specifying planned actions for the municipality's implementation of its PAII. The targets will address municipal fiscal, institution-strengthening, and investment elements.

c. **Addendum to the Core Agreement** between SEDURB and the municipality, which will be executed for each works or institution-strengthening project. It will specify the funding allotted for implementation of the respective activities.

3.14 Submittal of drafts of the above-listed agreements for the Bank's approval will be a condition precedent to disbursement of the municipal and regional investment component.

3. General Operating Regulations for the Pará Urbe program

3.15 The entry into force of these General Regulations would be a condition precedent to the first disbursement. They contain, *inter alia*, a description of the mechanism for allocating resources to participating municipalities and state agencies, eligibility criteria for municipalities, sectors, and projects, and forms of agreement. The following is a summary of the main sections of the Regulations.

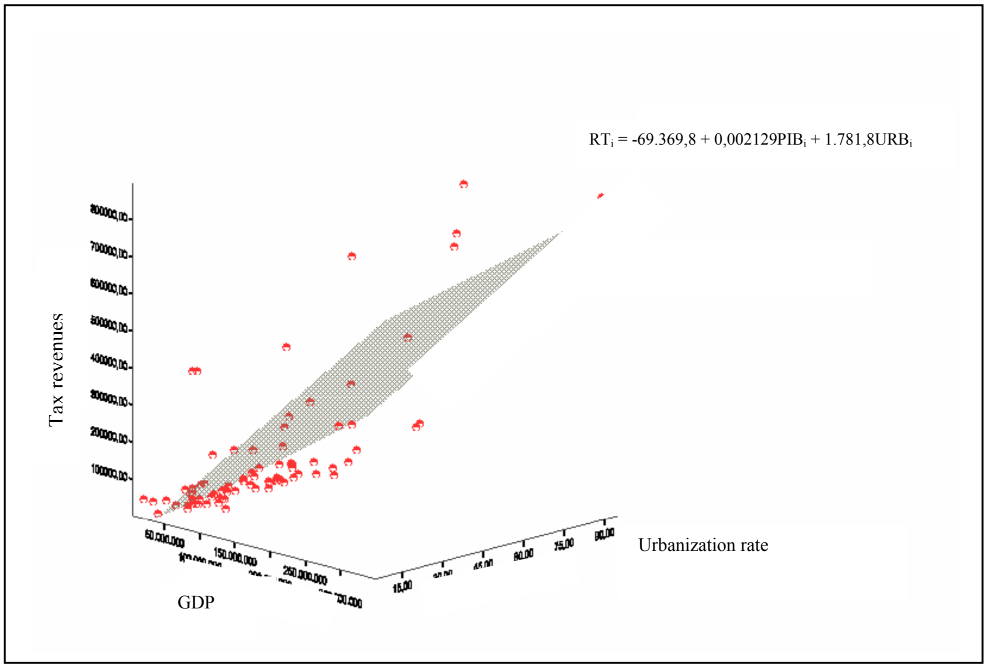
a. Apportionment of program funds

(i) To municipalities

3.16 The object of the system devised for distributing funds to municipalities is to make sure that those with weaker implementing capacity have access to funding at the start, without compromising the complete and timely use of funds by the more efficient municipalities and providing incentives for local tax effort.

3.17 The Economic Development Fund holdings, which would include proceeds of the Bank loan proposed here, will be apportioned among the municipalities each year for four years as follows: (a) 50% pro rata to the municipalities' population and the other 50% according to their tax effort (block grants). Tax effort will be determined as a linear function of municipal GDP and urbanization rate.[5] Each municipality's share of the funding will depend on its position relative to the plane in Figure III-1 which represents that function, rewarding municipalities that lie above the plane and penalizing the ones that are below; (b) allocable funds will be the sum of the previous year's uncommitted funds[6] and those envisaged for the four-year period; and (c) the funds allocated would finance actions and projects according to a municipal matching-grant matrix reflecting state priorities, ranging from a minimum of 10% to a ceiling of 40% and averaging 20%.

Figure III-1. Tax effort



(ii) To state agencies

3.18 Funds will be distributed among state organizations in amounts determined in advance by reference to the projects the agencies have submitted.

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[5] In this function RT_1 represents the tax revenues of $municipality_1$, GDP_1 is the GDP of $municipality_1$, and URB_1 is $municipality_1$'s urbanization rate (the ratio of its urban population to its total population).

[6] "Funds committed" means that a construction, services, and/or procurement contract has been signed.

b. Eligibility criteria

(i) For municipalities

3.19 All municipalities in the state of Pará, except for Belém, are eligible if they satisfy the following conditions: (a) they must have an Institutional Action and Investment Plan (PAII) prepared using the methodology agreed on with the Bank and appended to the General Operating Regulations, reviewed and worked out by consensus with the community; (b) they must be attaining the institutional and fiscal targets stipulated in the Core Agreement with SEDURB; (c) they must be in compliance with the Fiscal Responsibility Act; and (d) they must be current on compliance with the covenants of previous Pará Urbe agreements. As for the municipality of Belém, because of its size and tax base it will only be participating in association with Metropolitan Region municipalities, to execute metropolitan projects.

3.20 Since all the municipalities will be preparing their PAIIs in 2002 they will be permitted, as an exception, to use their Pará Urbe funding allotments for that year for works projects, provided their PAII is in preparation and they are also funding institution-strengthening actions.

(ii) For state agencies

3.21 The State Departments of Transportation, Education, and Health will qualify for program funding once they demonstrate that they have sufficient budgetary funds for the counterpart contribution and are complying with the covenants in previous Pará Urbe agreements.

(iii) For projects and sectors of activity

3.22 The General Operating Regulations specify technical, economic, financial, environmental, social, and institutional requirements for each type of project. The following table summarizes these eligibility criteria for selected sectors.

Table III-1

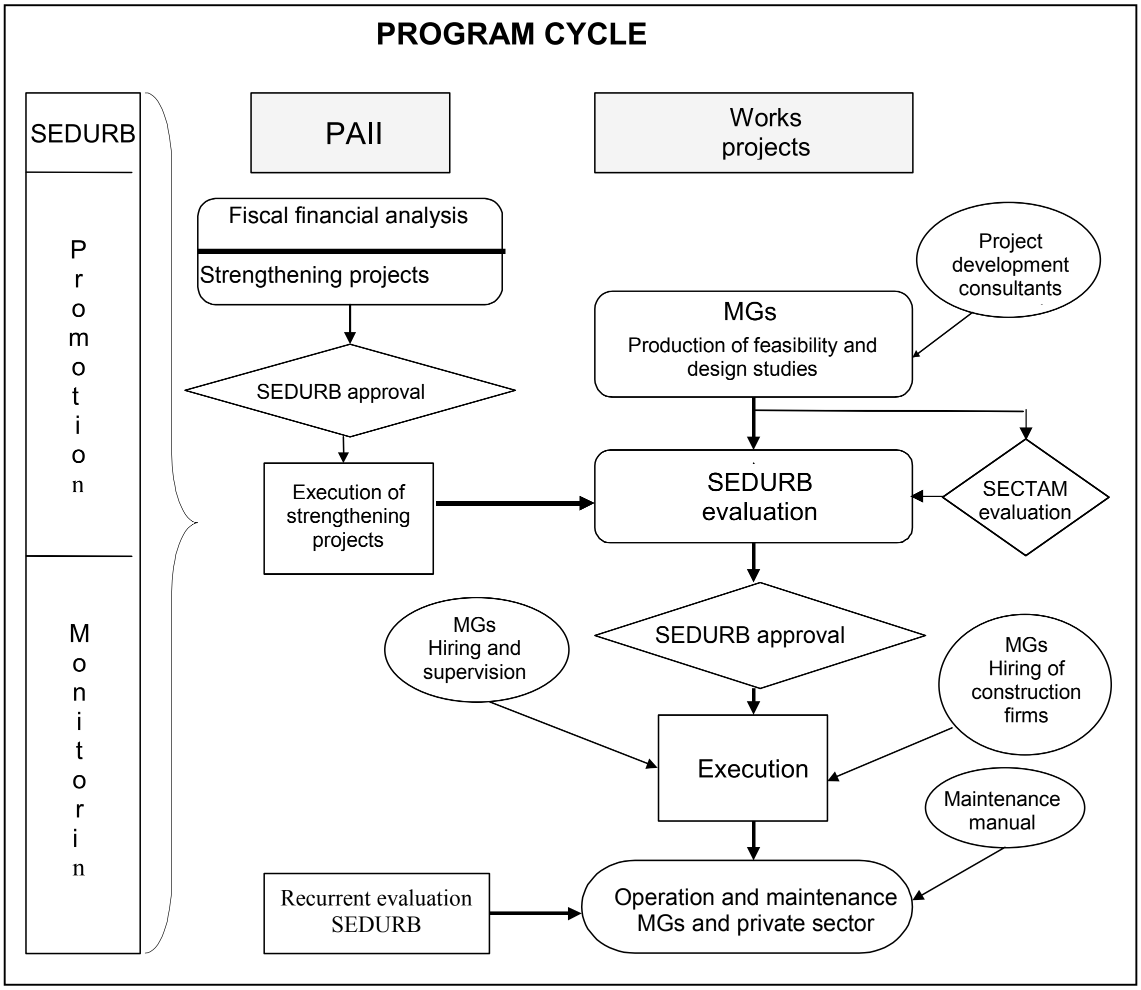
SECTOR	ELIGIBILITY CRITERIA			
	TECHNICAL	**ECONOMIC**	**FINANCIAL**	**ENVIRONMENTAL**
Urban roads	• Justify works in a road system explaining road selection criteria • Study of paving alternatives • Geotechnical studies, dimensioning of the solution and quantity calculation • Plane altimetric profile, traffic definition, geometric design. Signage and markings: CONTRAN standards. Existence of storm drainage • Designs, specifications, descriptive summary, budget, implementation timetable. Maintenance plan	• Analysis of cadastral status of adjacent lots for streets in the proposal • Benefit-cost analysis with economic internal rate of return (EIRR) >12% • Cost-efficiency parameter: US$600 per family • Quantify beneficiaries	• Financial analysis with recovery via betterment levy	• Public consultations • Adhere to resettlement policy • Environmental control report (RCA) • Environmental management plan (PCA), or • Terms of reference environmental impact assessment or report (TORs EIA/RIMA)
Environmental conservation and amelioration	• Watershed analysis; dimensioning of drainage project • Boreholes, materials alternatives, structural dimensioning • Designs, specifications • Descriptive summary, budget, implementation timetable. Maintenance plan	• EIRR >12% • Quantify beneficiaries	• Institutional arrangement to assure sustainability	• RCA, PCA or TORs EIA/RIMA • Mitigate impacts final outfall and access roads. Consultation with affected population • Environmental diagnosis area of influence. Decide on amelioration solution
Education	• Siting and dimensioning study by reference to current supply and potential demand • Designs, specifications • Descriptive summary, budget, implementation timetable. Maintenance plan	• Scaling and least-economic-cost solution • Quantify beneficiaries	• Financial analysis of municipality	
Health (complex and moderately complex projects)	• Scaling, including private providers • Consider avoided transportation cost • Impact on morbidity and mortality • Equipment and provider alternatives	• Analysis of investment alternatives • Present operating and maintenance costs and demonstrate financial sustainability	• Indicate sources of funding for project and its sustainability	• SECTAM environmental brief • Hospital waste management plan • Implement safe equipment-use standards
Intercity roads	• Studies of road system, traffic, volume and origin-destination counts • Studies of pavement and bridge alternatives	• Benefit-cost: EIRR >12%, calculated using High Density Model • Quantify beneficiaries and value of time	• SETRAN financial analysis	• Specifications DNER services • Determine environmental liability; devise amelioration solution • With origin-destination analysis define socioenvir-onmental impacts and mitigation measures • Consult affected population; adhere to resettlement policy • RCA, PCA or TORs • EIA/RIMA

DNER: National Roads and Railways Directorate
RCA: environmental control report
EIRR economic internal rate of return
PCA: environmental management plan
RIMA: environmental impact report
TORs: terms of reference

c. The project cycle

3.23 The flow diagram below illustrates the project cycle.

Figure III-2



(i) Promotion

3.24 The first planned promotional event will be program launch seminars to which municipal executives and civil society representatives will be invited, to learn about the program and its operating rules.

(ii) Development and approval of PAIIs

3.25 SEDURB will commission a financial-institutional diagnostic assessment of municipal governments (MGs) that apply to join the program. It will promote a community mobilization process to select investment projects. SEDURB and each MG will reach agreement on the municipality's PAII, outlining the institutional actions needed to build management capacity in that MG and its investment program for the next four years.

3.26 The Management Unit in SEDURB will evaluate and approve PAIIs. The Secretary of SEDURB will sign a Core Agreement with the municipalities for the PAIIs' implementation.

3.27 The PAII cycle starts off with a social mobilization process conducted by two teams of support consultants working simultaneously. Consultants comprising the first team have experience in mobilizing organized society. Those making up the second team have technical expertise in infrastructure projects and institutional analysis. The first team contacts civil society organizations and convenes sectoral meetings, to be held in the near future.

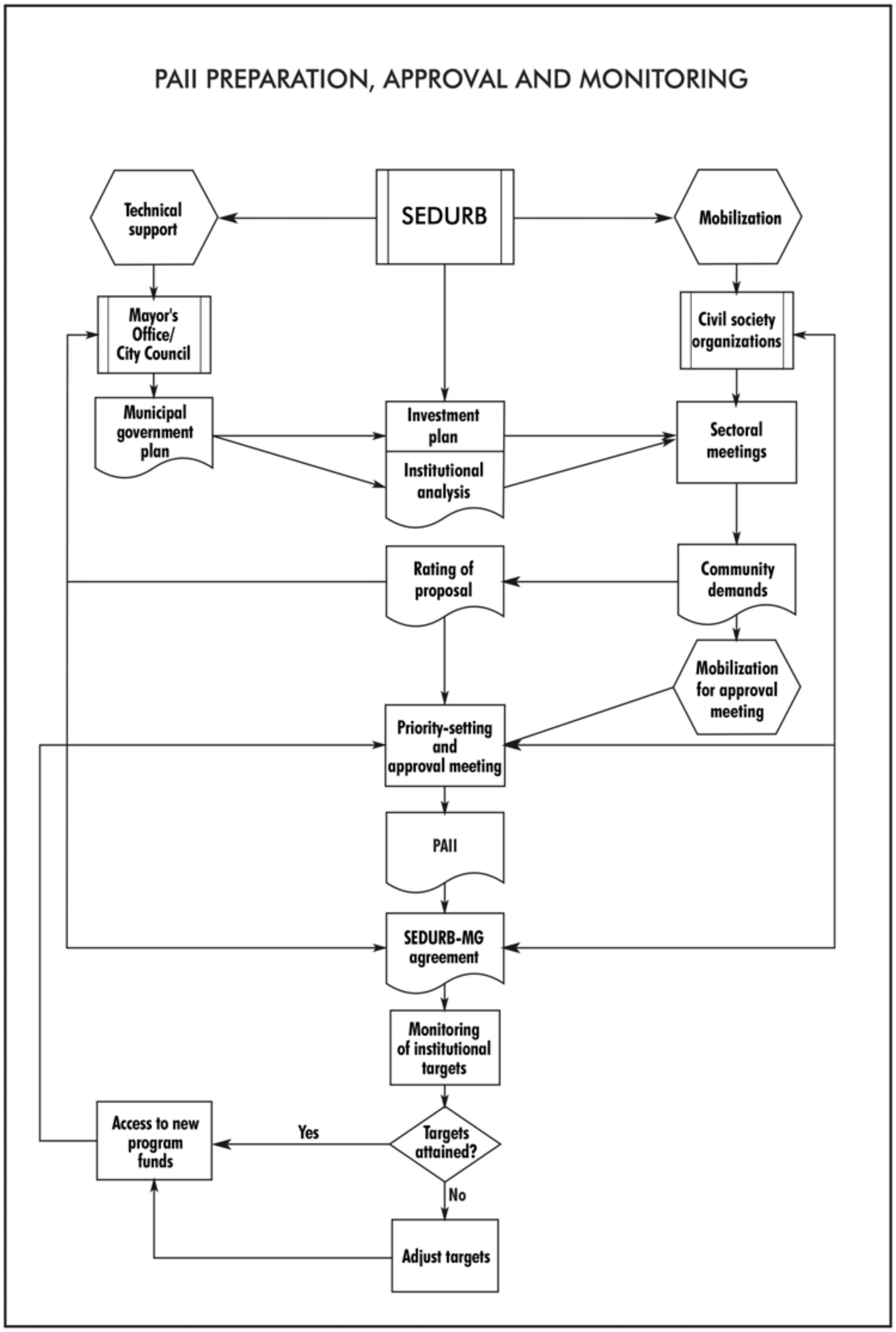
3.28 Meanwhile, the second team contacts the MG and City Council and explains the program's objectives and the need for local authorities' support and involvement in actions to secure approval of the PAII. The MG makes available the institutional-financial information and the municipality's investment plan. The technical consultants determine costs and basic parameters of the investment plan and, with the MG, draft an institutional action plan consonant with the Fiscal Responsibility Act, specifying performance indicators to include in the Core Agreement.

3.29 The community-mobilization consultants receive proposals prepared by the technical team and the MG and present them at sectoral meetings with civil society organizations. The various groups (sectors) of organized society add new proposals to the plan developed initially by the technical team and the MG.

3.30 The technical team rates the proposals received from civil society organizations (as to scale, cost, etc.) and presents them to the MG for information. With the proposals integrated and rated (government + society) the PAII approval meeting is scheduled. The specialized consulting team again mobilizes civil society organizations and the MG to organize a public wind-up meeting. At the PAII approval meeting attended by representatives of all the stakeholders, including SEDURB and civil society organizations, decisions are made on sector and investment project priorities in accordance with the amount of funding available for the four years and cost recovery considerations. The approved PAII is appended as an annex to the Core Agreement. Once the agreement is signed the MG will publish a summary of the agreed PAII in one or more local media.

3.31 SEDURB will track the attainment of the institutional and fiscal targets agreed on in the Core Agreement and will perform annual checks of indicators in order to make sure municipalities adhere to the program rules; otherwise, access to program funds would be suspended. MGs could regain access to program funding only when they demonstrated that they were in compliance with the program requirements, either as originally arranged or as reprogrammed by mutual consent. The PAII exercise is graphed below.

Figure III-3



3.32 The PAII will be reviewed yearly, taking account of the outcomes disseminated by civil society groups.

(iii) Funding for preinvestment and project development

3.33 SEDURB will have a preinvestment funding facility involving consulting services. Municipalities may apply for this support to develop strengthening and physical investment projects. The preinvestment financing would be assimilated into the matrix agreed on in successive stages, in the same proportions established for transfers. If a project submitted to SEDURB is not approved, Pará Urbe would absorb the preinvestment costs, which would be charged against the MG's block grant for the sector in question.

(iv) Project approval

3.34 SEDURB will assess the feasibility studies, applying the criteria set out in the Operating Regulations. One requirement in those regulations for public utilities infrastructure projects will be the approval of the utility administrator.

(v) Project implementation

3.35 Before tendering any contract a municipality must have: (a) signed the respective addendum to the Core Agreement with SEDURB; (b) obtained a setup permit and satisfied any other requirements of the State of Pará Department of Science, Technology and the Environment (SECTAM); and (c) provided the Bank with the detailed designs for the project.

3.36 Before any works project begins, the municipality must demonstrate: (a) for works requiring resettlement, that the resettlement plan prepared in accordance with Bank policies has been complied with, such that no works are executed until the affected population has been duly resettled; and (b) for public utility projects, that public utilities that may be affected by the works have pledged to collaborate and expedite the projects' execution.

(vi) Works inspection and supervision

3.37 The municipality or state contracting entity will be responsible for construction audits, using specialized consultants or firms. SEDURB will supervise the works, likewise by hiring specialized consultants or firms. Costs incurred for this work may be recognized as part of the project costs.

d. Cost recovery mechanisms

3.38 A works project's operating, administrative, maintenance, and capital costs are to be recovered through revenues raised by the municipality-state or service or utility provider from taxes, rates, betterment levies, rent, concession fees, etc., that they charge according to the law. When a project's beneficiaries cannot be clearly identified, no discrimination would be justified, or the beneficiaries' socioeconomic situation so warrants, the municipality's or state's general revenues can be used for cost recovery. In such cases it must be demonstrated that the project will not create a primary deficit in the municipality's or state's finances.

4. Specific Operating Regulations for the Pará Urbe-IDB program

3.39 The entry into force of these regulations will be a condition precedent to the first disbursement. They itemize Bank requirements relating to the proposed loan, covering the following topics:

a. Procurement

(i) Goods, construction work and services

3.40 In keeping with Bank policies, international competitive bidding will be required when a contract estimate is US$5 million equivalent or more for construction work or US$350,000 or more for equipment purchases. Annex III-1 to this proposal contains the program's procurement plan.

(ii) Consulting services

3.41 Consulting services will be selected and engaged following Bank procedures. International competitive bidding will be required when the estimated value of a contract with a firm exceeds the equivalent of US$200,000. Price may be used as a criterion for consultant service selection. When the decision is based on a combination of best price and best technical proposal, the maximum weighting for price will be 30% and the minimum weighting for the technical proposal will be 70%.

(iii) Thresholds for procurement with ex post review

3.42 The proposed program will require numerous contracts. To expedite the program and facilitate supervision work, at the Country Office's discretion an agreement may be reached with the executing agency to the effect that procurement operations worth up to US$5 million for works, up to US$350,000 for equipment and goods, up to US$200,000 for consulting firms, and up to US$50,000 to hire individual consultants will be reviewed ex post by sampling.

3.43 The above-mentioned thresholds may be lowered as a result of annual evaluations of the program.

b. Conditions precedent to tendering of a works project

3.44 As an additional condition, for works tenders included in the annual work plan, the municipality or state department in charge of the project must provide SEDURB with the following before tenders are called: (a) detailed design of the project and (b) evidence that SECTAM requirements have been satisfied, including—for works projects requiring resettlement of the population—the respective resettlement plan produced in accordance with Bank policy OP-710. If the project involves state road works, outsourcing of maintenance of the works must be included in the bidding conditions.

c. Operation and maintenance

3.45 Measures required (and acceptable to the Bank) to maintain program-funded works and equipment in accordance with generally accepted technical standards must be adopted. Such maintenance may be direct, in the case of program-funded works and equipment owned and operated by the state, or through agreements executed with municipalities if a municipality is responsible for operation of the works or equipment. If, from inspections it performs or reports it receives, the Bank ascertains that operation and maintenance are not up to the agreed standard, the state or municipality will be required to see that measures needed to completely remedy such deficiencies are adopted. Maintenance of state road works is to be outsourced.

d. Program implementation period, advances of funds, reimbursement of payments and accounting for funds expended

3.46 The loan proceeds are to be fully disbursed five years after the effective date of the contract.

3.47 Funds will be advanced and payments reimbursed following Bank rules. A revolving fund equal to 5% of the proposed loan would be set up.

3.48 The executing agency will be accountable to the Bank for: (i) implementing and maintaining sound contract administration, accounting-financial management, and internal control systems to handle program funds pursuant to clause 7.01 of the General Conditions of loan contracts; (ii) submittal of disbursement requests and justifications of expenditures in accordance with Bank requirements; (iii) presentation of semiannual reports on the Revolving Fund, within 60 days after the end of each six-month period; (iv) preparation and presentation of the program's consolidated financial statements and any other financial report requested by the Bank; and (v) operation of separate bank accounts exclusively to handle the loan proceeds and local counterpart funds. In addition, in the agreements the executing agency signs with coexecuting agencies the latter must undertake to: (i) account to the executing agency for funds received and prepare financial reports on request; (ii) maintain complete and accurate accounting and financial records on the use of program funds; (iii) maintain complete and accurate files of supporting documents for contracts awarded and expenditures incurred using the loan proceeds and counterpart funds, and make such records available for review by external auditors and Bank employees; and (iv) operate separate bank accounts exclusively to handle the loan proceeds and counterpart funds.

3.49 Because of the program's decentralized design, supporting documentation for disbursement requests sent to the Bank will be reviewed ex post. The executing agency will send the Bank the disbursement request along with a *Control of Disbursements and Local Contributions* form and a breakdown of payments according to the format to be agreed on with the Country Office. The executing agency and/or coexecuting agencies will keep original payment documents (receipts, invoices, etc.) on file and make them available to Bank staff and external auditors during inspections.

D. Recognition of expenditures

3.50 The executing agency has incurred a series of expenditures to prepare the operation proposed here, to develop projects in the sample, and to prepare PAIIs. The anticipated total outlay up to approval of the loan is US$1.5 million. This sum will be charged against the local counterpart provided that procedures substantially similar to the procedures prescribed in the eventual loan contact have been followed.

E. Program monitoring

1. Monitoring by the Bank

3.51 The program will be supervised by the Bank's Country Office in Brazil. Two items that will come in for particular attention are compliance with the project preparation and implementation conditions in the Operating Regulations and compliance with eligibility criteria for municipalities. A thorough midterm review of the program is planned to identify and remedy any implementation problems.

2. Semiannual progress reports

3.52 The executing agency, on the borrower's behalf, will provide the Bank with semiannual status reports on the program, indicating actions and activities completed, outputs and outcomes, targets achieved, and any serious problems encountered and solutions proposed. The reports also will state the funds expended by component and compare programmed and actual expenditures. The report format is to be agreed on in advance with the Country Office.

3. Annual reviews and work plans

3.53 Within the first four months of each year the executing agency and the Bank will review the program, looking at the progress report covering the second half of the previous year. The annual work plan for the current year to be agreed on during these reviews will adjust activities and targets and map out the program to its completion. The yardstick to be used in both the annual reviews and annual work plans will be fulfillment of the commitments stipulated in the program's Logical Framework (Annex II-1).

4. Evaluation of the program

3.54 Ninety days after each fiscal year-end, the executing agency, on the borrower's behalf, will provide the Bank with a program evaluation report produced by independent consultants. The evaluation will analyze, in particular, compliance with conditions required to trigger consideration of phase II and the impact evaluation using the methodology agreed on with the Bank, by reference to the monitoring studies, the Logical Framework, the indicators system (see paragraph 2.7(iii)) and other agreed tools. The evaluation is to be commissioned within nine months after the effective date of the loan contract, in accordance with terms of reference approved by the Bank. The cost of these evaluations will be defrayed with program funds.

Table III-4

Program evaluation methodology

The planned evaluation methodology to measure progress achieved on reducing disparities in public-service delivery among Pará municipalities is based on an Index of Supply of Public Services (IOSP). This index assesses the relative status of municipalities in terms of the delivery of services supported by the program in the health, education, urban development, and fiscal efficiency sectors. The IOSP is a simple average of the Indices of Relative Shortcomings (ICRs) of four variables: education, health, urban development, and fiscal efficiency.

For **education** the variable used to construct the ICR is enrollment ratio—the ratio of number of enrolled students aged 7-14 to total population aged 7-14. For **health** the measure is the average of the ICRs for two variables: number of ambulatory procedures per capita/per year and complete coverage of the vaccination cycle. For **urban development** an average is taken of ICRs for (a) sanitation; (b) drainage and (c) paving. For **fiscal efficiency** the variable will be municipal tax revenues as a percentage of municipal GDP.

The evaluation will be based on two indicators: (a) a disparity indicator, given by the Gini coefficient of the IOSP in the different municipalities, and (b) a public services delivery improvement indicator, defined through an analysis of improvements in average IOSP for each decile in municipalities in the IOSP ranking.

To implement this methodology, SEDURB will determine the baseline against which to measure the IOSP value of each municipality. Each year a date will be set for the measurement exercise and to evaluate the IOSP in the different Pará municipalities.

F. External audits

3.55 The executing agency will submit the program's annual financial statements to the Bank within 120 days after each fiscal year-end, after they are audited by a private independent audit firm in accordance with Bank requirements. The executing agency also will provide the Bank with a semiannual operational and financial audit report on the program within 60 days after the end of each six-month period, including a specific report on the examination of disbursement requests submitted to the Bank. The audit terms of reference are to be approved in advance by the Bank.

3.56 Bank procedures will be followed to select and hire the audit firm. It is recommended that the auditor be hired for a minimum of three years, subject to a contract termination clause in the event of unsatisfactory performance. The same auditor will be responsible for external audit work. Audit costs will be defrayed out of the Bank's loan proceeds.

G. Final evaluation

3.57 The final evaluation of the program will be conducted when 50% of the program resources have been disbursed and 75% committed or in the last year of the program's execution, whichever occurs first. It will include an analysis of fulfillment of conditions to trigger phase II. Information gathered in the course of the program and data from the indicators system would provide input for an ex post evaluation, after implementation of both phases of the program.

IV. RATIONALE, VIABILITY AND RISKS

A. Rationale

4.1 The proposed program will improve the coverage and quality of services that municipalities deliver to their residents, primarily the low-income population, through urban and social infrastructure rehabilitation and expansion projects that offer sound economic returns.

4.2 The program will yield more aggregated benefits by virtue of improvements in the allocation and transparent use of municipal fiscal resources, heightened civil-society participation in municipal resource allocation, and investment efficiency gains.

4.3 The program will increase the efficiency of the State of Pará's constitutionally mandated and discretionary transfers, and improve investment targeting and local resource mobilization as a preference revealing mechanism of the population. These improvements will be achieved by: (i) establishing a mechanism for discretionary state transfers of funds that takes account of municipalities' relative development status and tax effort; (ii) revising the ICMS tax distribution formula that falls to the state to legislate; (iii) recovering costs of works projects; and (iv) rationalizing discretionary transfers, making state priorities transparent but leaving decisions on project selection to the community.

4.4 The program also will benefit municipalities by enhancing their management capacity. Thus strengthened, the municipalities will operate with fiscal accountability, boost their saving capacity, generate resources for capital projects and create conditions for access to financial and capital markets and a climate conducive to private investment, thereby helping to advance their local economies.

B. Program viability

4.5 The analysis of the program's viability focused on several issues: (i) viability of the operating arrangements devised for the program; (ii) technical-institutional viability of the municipalities and projects in the samples; and (iii) the program's financial viability.

1. Operating design

4.6 The implementation format devised for this program is innovative, entailing institutional changes and new transparent rules for allocation of Economic Development Fund resources and their use as an instrument of a uniform targeted-spending policy in municipalities. In examining this operational approach a number of strategic implementation scenarios were analyzed, giving different relative weights to criteria of horizontal equity and fiscal responsibility.

4.7 The funding apportionment formula that came out of this analysis, explained in paragraph 3.18, contains elements to reward municipalities for fiscal responsibility while addressing their residents' needs. Implementation of this formula, with due consideration to resource and time requirements for the requisite institutional adjustments, will be synchronous with the political realities in which municipal executives are operating (the Fiscal Responsibility Act) and with the need to give the community a voice in investment priority-setting in an environment of fiscal accountability—which also makes the municipalities' proposed institutional actions politically viable.

4.8 The proposed operating format is institutionally viable by virtue of the experience SEDURB has amassed, through its Management Unit, in executing urban development programs, including a Bank-funded macrodrainage project now nearing completion. But even with its experience in project implementation the Management Unit will need to bolster its capacity to be able to handle the scale of operations required by the proposed program. This will be done by hiring additional staff and engaging a management firm to provide support for project analysis, supervision, physical and financial planning, and other administrative and financial control tasks.

4.9 The State of Pará has hired Paranácidade as the management firm. That company managed the Paraná Urbano program (for which the Bank supplied funding in 1996), working with the state of Paraná's 399 municipalities. The Paraná Urbano funds were disbursed in four years, as prescribed in the contract. As part of this contract Paranácidade will implement an on-line project management and tracking system to allow real-time monitoring of the execution of each institutional or works project and of the program's status.

4.10 Paranácidade, which was created with Bank support, is viewed as a model agency by other multilateral lending organizations like the World Bank and by various Latin American, Asian and European countries which have signed cooperation agreements and sent technical missions for training and exchanges of experiences. The hiring of this firm affords assurances that the program will be institutionally viable.

2. Sample of municipalities and projects

a. Selection of municipalities and preparation of PAIIs

4.11 In order to gain a comprehensive picture of the situation of municipalities that will be taking part in the program, an assessment was done during the preparation stage of the institutional and fiscal status of a representative sample of municipalities, and their institutional development requirements were scaled in institutional action and investment plans (PAIIs). The sample consisted of 23 municipalities selected according to size, socioeconomic features, geographic location and other considerations, forming homogeneous clusters.

4.12 Thanks to the participatory methodology used to produce PAIIs, the strengthening measures are realistic, address the actual demand, and will help assure the program's institutional sustainability. The PAIIs include fiscal performance targets for four years and financing for the investment program agreed upon with civil society organizations. Funding for projects is tied to attainment of these targets, through access to the program transfers.

b. Sample of investment projects and SEDURB performance

4.13 Some projects in the program sample had been proposed by municipalities which had developed a PAII, others by municipalities not included in the municipality sample, and others by the state.[7] One object of the analysis of state projects was to assess SEDURB's performance, to gauge its technical capabilities for project appraisal, approval, and monitoring.

Table IV-1
Features of projects in the sample (US$000)

SECTOR	No.	Cost	Average cost
Urban streets and squares	4	1,414	354
Channeling and drainage	5	2,834	567
Sanitation	1	96	96
Solid waste	1	183	183
Social services	2	112	56
Culture and recreation	4	1,414	354
Education	4	3,267	817
Health	13	24,254	1,866
Productive sectors	4	2,368	592
Intermunicipal integration	2	6,110	3,055
TOTAL	**40**	**42,042**	**1,051**
- Municipal projects	29	10,001	345
- Strategic projects	11	32,041	2,913

4.14 The appraisal of projects comprising the sample indicated the success of their promotion and soundness of the technical analysis, financing and physical execution. To analyze project costs, a comparison was done of unit prices of materials, labor and equipment with SEDURB's database on different Brazilian states and regions, which is continually updated with information from projects presented and confirmed with in situ market studies.

(i) Technical viability

4.15 The project team reviewed the designs of the sample of projects and found them to meet the standards and specifications of municipal and state agencies in charge of the various infrastructure services required. The projects were considered technically viable, presenting least-cost solutions and complying with the pertinent laws and standards. Unit costs of materials and labor were computed through

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7 Projects in the sample were selected from state and municipal project proposals. The municipalities were invited to submit their priority projects. Forty projects were selected, involving a total investment cost of US$42 million.

indices estimated on the basis of market prices. Accordingly, the projects analyzed constitute solutions that qualify for funding under the program.

(ii) Economic viability

4.16 According to the economic analysis of the sample of projects in the main program-funded sectors, projects would yield economic internal rates of return exceeding 12% in sectors in which benefits could be calculated, as Table IV-2 illustrates. For other sectors the maximum cost per beneficiary was calculated by reference to cost-efficiency criteria.

4.17 Two noteworthy factors here are the satisfactory caliber of SEDURB's economic analysis and the need for effective monitoring of contractual covenants relating to tariffs and to the operation and maintenance of services—issues that come in for special attention in the program's General Operating Regulations and Specific Operating Regulations. Indeed, some projects in the sample are investments to replace urban equipment that had a short service life because of problems in continuity of funding available for maintenance.

Table IV-2
Economic return of projects

SECTOR	COST/ BENEFICIARY (US$)	EIRR (%)
Urban streets and squares	840	33 to 14
Drainage	670	32 to 20
Sanitation	1,200	24
Social services-Daycares- Multi-sport facilities	4,183 250	
Education-school Supplemental education and meal program	1,900 1,050	
Health hospital emergency Indigenous health Neonatal ICU Oncology and necrology	380 465 8,800 120	
Intermunicipal integration		21 and 14

3. Financial viability

4.18 The State of Pará will furnish counterpart resources for the program and will channel the loan proceeds through SEDURB. The State also is to repay the Bank's loan. The counterpart requirement for the program will come to about US$8 million a year over its first four years. Since this is equal to 40% of the roughly US$20 million the Economic Development Fund has been transferring to municipalities in recent years, there would be no problems in counterpart fund availability.

4.19 The state government has made a resolute fiscal effort not just by containing growth in current spending—in payroll costs particularly—but also by generating fresh funds through a major overhaul of state finances. As part of this adjustment process the state rescheduled its largest debts with the federal government. This helped dispel the previous uncertainty regarding annual debt-service amounts, the state's debt-service payments having been capped at 13% of its net revenues. The agreement signed with the federal government sets mandatory fiscal targets for the state, including ratios of debt stock to net revenues and personnel costs to net revenues and primary-surplus requirements.

4.20 The state government has made satisfactory progress toward these targets and in fact has exceeded some of them thanks to its fiscal effort and economic conditions in the past two years. Some of this can be attributed to the implementation of a project to strengthen its financial management, funded in part by the Bank.[8]

4.21 The operation proposed here would fit within the state's borrowing and debt-service ceilings prescribed in the above-mentioned debt rescheduling agreement. Accordingly, the state will be in a financial position to honor its counterpart-funding commitments for this program and to service its debt.

Table IV-3
State of Pará: Fiscal situation 1998-1999 and 2000-2010 program
(US$ million)

	1998	1999	2000	2005	2010
1. Gross revenues	1,487	1,024	1,351	1,549	2,222
1.1 Transfers to municipalities	150	111	165	199	296
2. Net revenues (1-1.1)	1,337	913	1,186	1,350	1,926
3. Current expenditure	1,532	894	1,126	1,287	1,830
3.1 Payroll	733	502	660	705	976
4. **Primary surplus(deficit) (2-3)**	**(195)**	**19**	**60**	**63**	**96**
5. Debt service	84	91	88	63	47
6. Borrowing requirement	278	72	28	-	-
Targets and results in percentages:					
- Primary result/Net revenues > 0%	**(15.0)**	**2.1**	**5.6**	**5.0**	**5.0**
- Payroll costs/Net revenues < 60%	**54.8**	**55.0**	**55.6**	**52.2**	**50.7**
- Debt service/Net revenues <13%	**6.3**	**10.0**	**7.4**	**4.7**	**2.4**

4.22 The following conclusions can be drawn from the analysis: (i) counterpart funding for the program described here will not be a problem, since sufficient resources are available from increases in state revenues from the ICMS tax and constitutionally mandated federal transfers; and (ii) improvements achieved through adjustment measures and reforms of the state finances afford assurances that the Pará state government will be able to service its debt to the Bank.

C. Environmental and social viability

4.23 During the preparation of this program an environmental impact assessment (EIA) was performed as directed by the Committee on Environment and Social Impact at its meeting on 29 June 2001. SEDURB gave public notice of the existence of the first version of the EIA on 17 August 2001. Subsequently, meetings were held with representatives of civil society in the main municipalities in the sample to discuss the PAIIs and investment projects in detail. An important feature of the proposed

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[8] National Program for State Fiscal Management (PNAF), loan 980/OC-BR.

program is the participatory process devised for its execution, culminating in a meeting of local stakeholders to prioritize and approve institutional and works projects. The program's Operating Regulations explain this methodology.

4.24 The EIA contains: (i) a description of environmental features and social conditions of the state of Pará and its municipalities; (ii) information on environmental laws and technical-environmental standards relevant to the program and an evaluation of environmental management and the environmental permit procedure for projects in Pará; (iii) an evaluation of each project in the sample with the respective environmental protection measures; and (iv) environmental and social eligibility criteria and project approval, supervision, inspection, and monitoring procedures. Environmental requirements and procedures are itemized in the General Operating Regulations.

4.25 The program will have positive environmental and social impacts, including: (i) improvements in quality of life and health indicators following the execution of storm drainage, slaughterhouse, integrated solid waste management, sanitation, indigenous health, and health center projects; and (ii) improved environmental conditions in the state, thanks to amelioration of degraded areas, control of erosion and silting, elimination of environmental liabilities, and new parks and green spaces. The program will give priority to projects of this kind, requiring a counterpart of only 10% of the project cost.

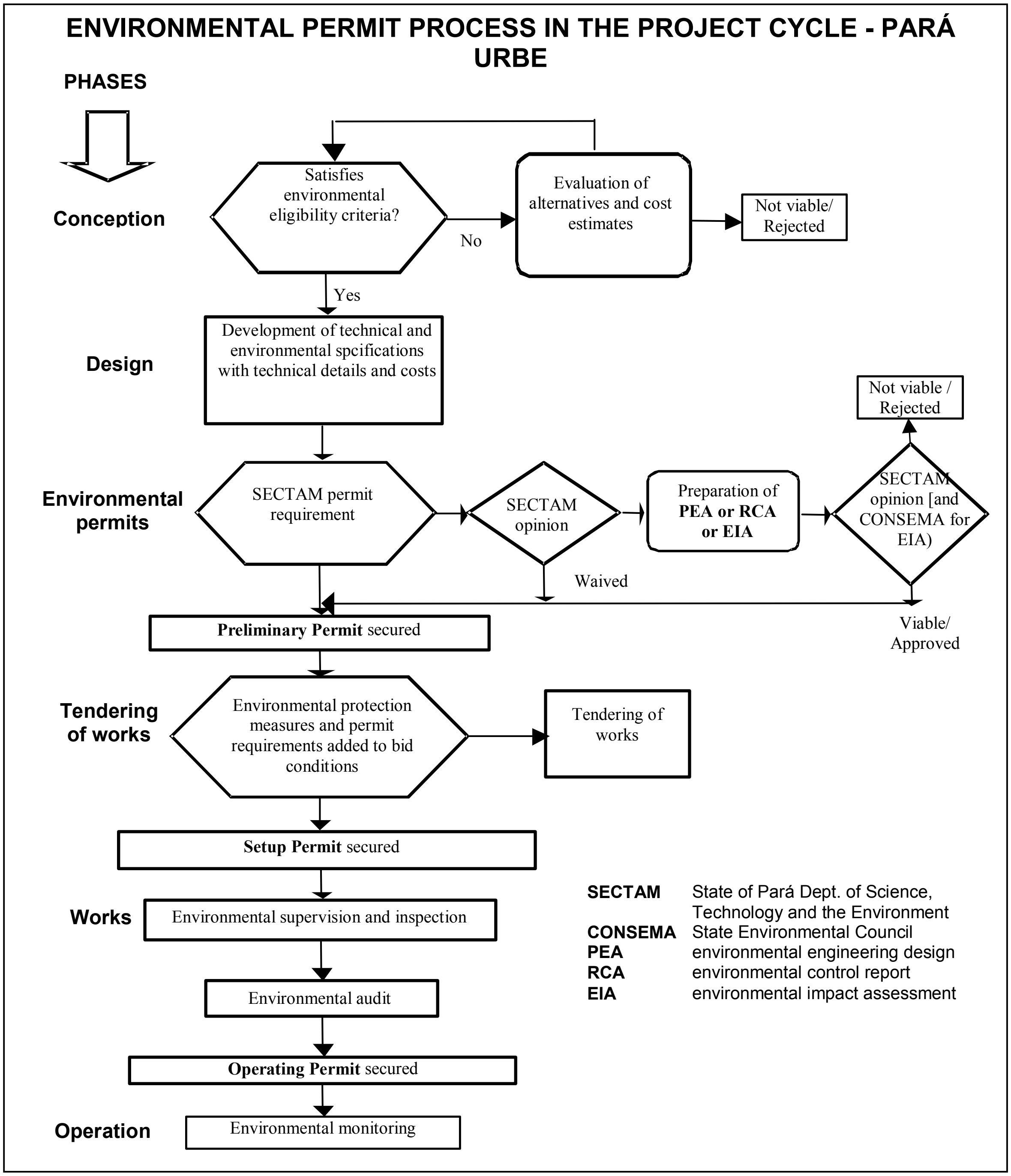
4.26 The program also will contribute to sustainable management of the state's natural resources and its balanced social and environmental development. This is a vision enshrined in state and federal environmental protection legislation, the State of Pará Environmental Protection Act (Law 887 of 9 May 1995), the state's "Environmentally Friendly Development" policy, and the State of Pará Integrated Environmental Management Project. In addition, the Pará development plan divides the state into four ecological/economic zones, described in the following table.

Table IV-4

Ecological/ economic zone	Features	% of state surface area	% of zone with original vegetation to recover
Specially Protected Zones	Indigenous Areas and Conservation Units.	32%	100%
Zones with Future Potential	Conservation and amelioration areas, ecotourism and social infrastructure, sustainable forest use.	25%	80%
Priority Investment Zones (ZOPI)	Established urban areas; the aim is to improve and verticalize the state's economy.	32%	15% - 30% (green spaces for public use)
Transition Zones	Areas adjacent to ZOPIs; the aim is to keep these sparsely occupied and make sustainable use of forests. Transportation infrastructure permitted.	11%	50%- 80%

4.27 The evaluation of projects in the sample revealed the possibility, during the construction period, of the kind of adverse impacts inherent in urban development projects. Even small-scale projects can cause negative impacts in the operating phase, such as: (i) environmental pollution, particularly of water, if there are shortcomings in operation or maintenance, and (ii) unsustainable changes in land use and in natural resources in a project's area of influence. To attenuate these impacts, Brazilian technical standards were applied, these forming part of the bid conditions in accordance with the environmental clearance procedure illustrated in Figure IV-1. According to this procedure, projects were classified as follows: for ten projects the environmental permit requirement was waived; nine required environmental engineering designs; three required environmental control reports; none required an environmental impact assessment/report. Six of the projects requiring permits obtained a setup permit and six are being reviewed by the State of Pará Department of Science, Technology and the Environment (SECTAM).

Figure IV-1



4.28 The program's environmental evaluation was done in close coordination with SECTAM because of that agency's environmental policy and environmental permit mandate. Prior to the analysis mission SEDURB and SECTAM signed a technical cooperation agreement specifying each agency's responsibilities in the proposed program. The municipalities and communities also pledge their efforts, via the social participation mechanism, to see projects properly implemented and operated. However, SEDURB is accountable to the Bank for the projects' environmental quality, suspending disbursements to any municipality that fails to satisfy the program's operating requirements. As noted above, SEDURB will be assisted by a management firm that gained a wealth of experience in implementing the Paraná Urbano program. The project management system developed by that firm, which is to be implemented in SEDURB, contains information on project environmental requirements and environmentally relevant links (to access technical standards and environmental legislation, for example).

D. Gender and ethnic group considerations

4.29 During the preparation of the program an assessment was done of the situation of women and indigenous groups as regards their involvement in municipal investment projects. Women accounted for a large share (over half) of those attending the participatory workshops. Some of the civil society groups were women's organizations, among them the Organization of Amazonian Women. Though the program is gender neutral, it contains provisions for: (i) gender indicators for beneficiaries; (ii) a social specialist in the Management Unit to evaluate projects; and (iii) periodic training courses for municipal government employees on these issues. Indigenous people will benefit directly through indigenous health projects to be executed directly by the State of Pará in partnership with the federal government. These projects, which will respect indigenous customs, will be accompanied by investments to provide potable water, environmental education, and waste management.

E. Impact on poverty

4.30 The proposed program qualifies as a social equity enhancing operation as described in indicative targets for Bank activity mandated in the Eighth Replenishment report (document AB-1704). It also qualifies as a poverty-targeted initiative (PTI) because it supports local services to benefit mostly (73% of the population of the state of Pará) low-income groups. The borrower will not be using the 10 percentage points in additional financing. The project specifies explicit performance indicators to measure poverty reduction and social equity gains (see Annex II-1).

4.31 The PTI classification is warranted because the program targets the delivery of urban services benefiting primarily low-income groups. Thirty percent of the program projects are located in rural areas where an estimated 80% of the population is poor, measured by income level. Furthermore, all the projects in the sample indicate that over 50% of the benefits will accrue to people living below the poverty line.

F. Risks

4.32 **Institutional weaknesses of municipalities**. Institutional and operational weaknesses of Pará municipalities and their structural and staffing shortcomings are an obstacle to efficient municipal administration and operations. To attenuate this risk the program will develop, by way of Institutional Action and Investment Plans (PAIIs), institution-strengthening and adjustment actions to equip municipalities to improve their workings and the efficiency of service delivery to local residents. The monitoring and evaluation actions planned in the multiphase program format being proposed will allow for close, frequent monitoring of the municipal strengthening process. This will make it easy to adjust the PAIIs as needed, offering the necessary technical support.

4.33 **Achievement of the program's development objectives**. The program's achievement of its objectives will depend in large measure on the effective implementation and operation of the policy of dialogue and consensus-seeking between the state government and municipal governments and civic organizations. The challenge lies in the responsiveness of small communities and state agents' willingness to support them. The program has sought to mitigate risks in this regard by creating avenues for consultation and consensus-building as part of the PAII preparation and approval process, and by funding promotional and information activities to help the community understand the commitments adopted by the state and municipal governments under the Pará Urbe program, and the benefits this will entail.

PROGRAM TO SUPPORT PARÁ URBE
LOGICAL FRAMEWORK

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
GOAL Expand and improve the quality of services that local governments deliver to their communities.	Quality and coverage of services delivered by municipal governments. Quality and coverage of services delivered by state agencies that propel municipal investments.	• Surveys and participatory monitoring of the program. • Progress reports. • Inspection visit. • Index of Supply of Public Services (IOSP).	• The country's economy is stable.
PURPOSE Increase the efficiency of municipal administration, provide incentives for local resource mobilization by overhauling the transfers system and creating an enabling environment for local economic development, to ultimately reduce poverty and smooth interregional disparities.	• Discretionary transfers system implemented. • New ICMS tax distribution formula implemented. • Economic Development Fund institutionalized in SEDURB. • Municipal projects being privately funded. • Regional disparities lessened. • Municipalities have made adjustments to comply with Fiscal Responsibility Act.	• Reports from SEDURB and the Accounting Office of State of Pará Municipalities. • Inspection visits. • Program progress reports. • Official Gazette. • Gini coefficient of the IOSP.	• Municipalities are capable of sustainable growth. • The community continues to participate in local decision-making.

COMPONENTS	PHASE I	PHASE II	MEANS OF VERIFICATION	ASSUMPTIONS
1. Municipal sector development				
(a) Financing for the sector • Funding of studies intended to spur new modes of financing for municipalities and improve the discretionary transfers and ICMS system.	• Studies produced and proposed legal changes in process. • New ICMS distribution formula implemented.	• Proposals implemented.	• Program execution reports. • Progress reports. • Implementation reports.	• Knowledge of local and state authorities' commitments.
(b) Participation and privatization • Funding of studies to increase the participation of civil society and the private sector in local service delivery and management.	• Studies presented and proposals discussed.	• Proposals implemented.	• Program execution reports.	
(c) Fiscal management • Funding for preparation and implementation of systems to monitor municipal fiscal management and municipal service performance.	• Systems implemented in SEDURB.	• Systems still current.	• Program execution reports.	
(d) Strengthening of SEDURB • Project monitoring system.	• System developed and implemented in SEDURB.	• System still current.	• Project execution reports.	

COMPONENTS	PHASE I	PHASE II	MEANS OF VERIFICATION	ASSUMPTIONS
2. Institutional strengthening of municipalities, consulting services and equipment				
(a) Municipal adjustment projects • Funding for preparation and implementation of PAIIs, approved by civil society.	• 142 municipalities have a PAII agreement and 50% present satisfactory fiscal indicators.	• 142 municipalities have a PAII agreement and 90% present satisfactory fiscal indicators.	• Program execution reports. • Progress reports.	• A formula for apportioning funds to municipalities is worked out in the dialogue with municipalities.
(b) Municipal fiscal management system • Funding for activities complementing the Program for Modernization of Municipal Fiscal Management (PNAFM).	• Systems implemented and operating in 70 municipalities.	• Systems implemented and operating in 90% of the municipalities.		• The PNAFM is being fully implemented in the state.
3. Funding of Investment projects				
(a) Municipal investments • Funding of productive and social projects	• Municipalities are executing projects with program resources.	• Another 72 municipalities are executing projects with program resources.	• Inspection visits. • Program execution reports.	• Municipal governments are providing their share of the funding.
(b) Regional investments • Funding of state projects that enable municipal development.	• 10 state projects have been executed.	• Another 10 state projects have been executed.		

PROCUREMENT PLAN

Principal procurement items for the program	Funding		Tendering method	Year
	IDB (%)	Local (%)		
Infrastructure and equipment (US$71.1 million)	50	50	ICB (60%) LCB (40%)	2002-2005
Consulting services (US$8.4 million)	58	42	ICB (40%) LCB (60%)	2002-2005

ICB international competitive bidding
LCB local competitive bidding