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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A PROPOSED LOAN

IN THE AMOUNT OF US\$150 MILLION TO

THE MUNICIPALITY OF MANAUS

WITH A GUARANTEE OF THE FEDERATIVE REPUBLIC OF BRAZIL

FOR THE

SERVICE DELIVERY AND FISCAL MANAGEMENT

DEVELOPMENT POLICY LOAN

October 20, 2015

Governance Global Practice
Latin America and the Caribbean Region

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BRAZIL GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of October 20, 2015)

Currency Unit

Currency Unit = Real (R\$)

R\$3.86 = US\$1.00

ABBREVIATIONS AND ACRONYMS

CML	Central Procurement Committee (<i>Comissão Municipal de Licitações</i>)
CRP	Pension Conformity Certificate (<i>Certificado de Regularidade Previdenciária</i>)
DPL	Development Policy Loan
FDI	Foreign Direct Investment
FRL	Fiscal Responsibility Law
GDP	Gross Domestic Product
GIDE	Integrated School Management Model (<i>Gestão Integrada da Escola</i>)
GRS	The World Bank's Grievance Redress Service
IBRD	International Bank for Reconstruction and Development
ICMS	Brazilian Value-Added Tax (<i>Imposto sobre a Circulação de Mercadorias e Serviços</i>)
IDEB	Basic Education Development Index (<i>Índice de Desenvolvimento da Educação Básica</i>)
IMF	International Monetary Fund
IPTU	Municipal Property Tax (<i>Imposto Predial e Territorial Urbano</i>)
ISS	Service Taxes (<i>Imposto Sobre Serviços</i>)
MEI	Individual Micro Entrepreneurs (<i>Micro Empreendedor Individual</i>)
MM	Municipality of Manaus
MP	Federal Government Pension Ministry (<i>Manaus Previdência</i>)
NCR	Net Current Revenues
PDCA	Plan, Do, Check and Act Methodology
PDO	Program Development Objective
PFM	Public Financial Management
PPA	Manaus' Multi-Year Plan (<i>Plano Plurianual</i>)
PSIA	Poverty and Social Impact Analysis
SEMAD	Secretariat of Administration (<i>Secretaria de Administração</i>)
SEMC	Municipal Secretariat of the City Center (<i>Secretaria Municipal do Centro</i>)
SEMED	Municipal Secretariat of Education (<i>Secretaria Municipal de Educação e Cultura</i>)
SEMEF	Municipal Secretariat of Finance (<i>Secretaria Municipal de Finanças</i>)
SWAp	Sector Wide Approach
TCE/AM	State Court of Accounts (<i>Tribunal de Contas do Estado de Amazonas</i>)
WBG	World Bank Group
ZFM	Manaus Free Trade Zone (<i>Zona Franca de Manaus</i>)

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MUNICIPALITY OF MANAUS, BRAZIL

SERVICE DELIVERY AND FISCAL MANAGEMENT DEVELOPMENT POLICY LOAN

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LOAN AND PROGRAM SUMMARY
MUNICIPALITY OF MANAUS, BRAZIL

SERVICE DELIVERY AND FISCAL MANAGEMENT DEVELOPMENT POLICY LOAN

Borrower	Municipality of Manaus with the counter-guarantee of the Federative Republic of Brazil
Implementation Agency	Secretariat of Finance (SEMEF) – Government of the Municipality of Manaus
Financing Data	IBRD Loan Terms: USD commitment linked IBRD Flexible Loan with a variable spread, with level repayments on March 15 and September 15 of each year, with 5 years Grace Period and 24 years Final Maturity, with all conversion options selected and the Front-end Fee capitalized. Amount: USD150 million
Operation Type	One-tranche stand-alone operation development policy loan
Main Policy Areas	Procurement, Tax Administration, Public Financial Management, Urban Mobility, Education
Program Development Objective(s)	To assist the Municipality of Manaus (MM) in improving the management of its finances as well as its education and transport sectors, through upgraded revenue and expenditure processes, meritocratic and results-oriented management of schools, and improved control of bus concessions.
Result Indicators	<p><i>Strengthened Public Sector and Fiscal Management</i></p> <ul style="list-style-type: none"> • Number of registered properties in the Property Tax Cadaster • Average execution time of electronic bidding processes for the purchase of goods and services • Percentage of bidding results published in the <i>Manaus Compras</i> open access website • Average reduction of unit price of supplies and contracted services • Number of non-conformities • Acquisition and maintenance of the Pension Conformity Certificate (<i>Certificado de Regularidade Previdenciária</i>), without resorting to judicial measures • Municipal tax rate compliance <p><i>Enhanced Management and Quality of the Education and Transport Sectors</i></p> <ul style="list-style-type: none"> • Number of schools that achieved at least 19 out of 24 GIDE targets • Number of schools with certified directors • Number of schools complying 100% with the Minimum Standard Framework • Number of street vendors accredited as individual micro entrepreneurs (MEI) and relocated to shopping galleries • Monthly percentage of bus trip completed • Number of licenses for moto-taxis issued
Overall risk rating	Moderate
Operation ID	P153203

**IBRD PROGRAM DOCUMENT FOR A
PROPOSED SERVICE DELIVERY AND FISCAL MANAGEMENT
DEVELOPMENT POLICY LOAN
TO THE MUNICIPALITY OF MANAUS
WITH THE GUARANTEE OF THE FEDERATIVE REPUBLIC OF BRAZIL**

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed operation is a one-tranche Development Policy Loan (DPL), in the amount of US\$150 million to the Municipality of Manaus (MM), in the State of Amazonas, Brazil.** The purpose of the operation is to assist the Municipality of Manaus in improving the management of its finances as well as its education and transport sectors, through upgraded revenue and expenditure processes, meritocratic and results-oriented management of schools, and improved control of bus concessions. By supporting the mobilization of revenues and the introduction of more modern public sector management practices, this operation will allow the Municipality to expand and upgrade public service delivery in the areas of education, transport and urban services, which benefits mostly the poor and the vulnerable and thus contributes directly to the World Bank's twin goals of ending extreme poverty and promoting shared prosperity.

2. **This is the first engagement of the Bank with the Municipality of Manaus and builds upon the recent engagement with the State of Amazonas.** The Bank has had a limited but growing engagement with the State of Amazonas, of which Manaus is the capital city. In May 2014 the Board approved the first operation to the State of Amazonas, the *Modernizing Public Sector Management, Citizen Security and Gender Policies DPL* (P147979). Part of the reforms carried out by Manaus benefit from a partnership with the State Government.

3. **Although poverty in Manaus is lower than in the rest of the State of Amazonas, it is still slightly higher than in the country.** 17 percent of the population of Manaus is poor, almost half the rate of Amazonas, and 9 percent is extreme poor, 10 percentage points less than Amazonas. The corresponding figures for Brazil are 16.7 and 8.9 percent¹. In addition, due to its large population – 2.02 million people in 2014 – Manaus concentrates one quarter of the State's population in extreme poverty and 48 percent of the population in vulnerable condition. Due to its large size - 11,401 Km² – and its location, Manaus presents a unique combination of rural and urban poverty.

4. **Manaus' average income levels are higher than those of Brazil, due to the presence of a strong industrial cluster in the city – the Manaus Free Trade Zone (*Zona Franca de Manaus – ZFM*).** In 2012, gross domestic product (GDP) per capita reached R\$26,760.96 (US\$13,695.48), 18 percent higher than the national average GDP per capita of US\$11,589. This high income level provides potential for a higher revenue base, a potential that is poorly utilized at present and together with deficient public sector management practices translates into poor public service delivery.

5. **In this context, one of the main objectives of the Municipality of Manaus is to modernize its management practices to improve service delivery.** The new administration that took office in January of 2013 is committed to eliminating the financial deficit generated in 2012 by the end of 2016. Recurrent expenditures were cut as a result of introducing routine payroll

¹ Data from the 2010 Census.

audits and a review of eligible social program beneficiaries. In addition, penalties and fines for late payment of public utilities bill in the Municipality was reduced from an average of R\$1.5 million per month to close to zero. The internal control function was strengthened, benchmarking visits to other municipalities were conducted, delayed payments to suppliers were halted and redoubled attention was given to tax arrears and taxpayers in default. Higher returns for the municipal cash balances were also sought. Overall, the MM adopted a pragmatic approach to reform which entails learning from other governments and adopting existing successful systems and procedures to save time and financial resources. For instance, the Municipality partnered with the State Government to modernize its procurement and contract management processes.

6. To achieve this goal and maintain fiscal sustainability, the Municipal Secretariat of Finance (*Secretaria Municipal de Finanças - SEMEF*) prioritized the introduction of modern management tools in public administration. In 2013, SEMEF created an undersecretary for management for results (*Gestão por Resultados*) which developed action plans, activities and goals, and provided managerial trainings to staff. These plans include revenue increasing and expenditure reduction targets and weekly monitoring of indicators. They indicate who is responsible for each activity, and when. The action plans include, for example, measures to institutionalize transparent and efficient processes for the procurement of goods and services and to control personnel expenditures.

7. Looking forward, the Government's intention is to gradually expand this methodology to other secretariats of the MM, thus enhancing its overall capacity to deliver services. To this end, Manaus requested a long-term engagement with the Bank, starting with a DPL as a means of supporting policy reforms while providing relatively rapid disbursement to assist with the process of fiscal adjustment. The modalities of future engagement would be determined on the basis of progress made in implementing reforms under the DPL, the resources available to the Bank, and the priorities of the Municipal and Federal Governments.

8. Furthermore, the Municipality is seeking to improve the quality of its education and transport sectors by improving management practices. In addition to strengthening the management of its finances and other functions such as its procurement procedures, Manaus is implementing improved management practices in crucial sectors such as education and urban mobility, as well as measures to reduce informality of economic activity in the city (e.g. moto-taxis, micro-buses, street vendors). In education, reforms include the meritocratic selection of school directors, the establishment of school-level targets and the creation of minimum standards for school staffing. In the transport sector, Manaus is strengthening its capacity to monitor the provision of services by bus operators. Reforms in this sector include the adoption of a formal agreement between bus companies to implement a management facility, which tracks bus services in real-time, curbs delays and non-conformities and balances revenues and remuneration. The technical solution adopts a state-of-the-art technology which is adopted by Curitiba, the city in Brazil known as world-wide pioneer in urban development. This is another example of Manaus' pragmatic approach to upgrading its public sector management and service delivery.

2. MACROECONOMIC POLICY FRAMEWORK AND RECENT DEVELOPMENTS

2.1 RECENT ECONOMIC DEVELOPMENTS

9. Following years of economic slowdown, Brazil is currently undergoing a deep and widespread recession. Since the start of this decade, the country's growth performance has

continually declined—from an average of 4.5 percent growth between 2006 and 2010, to 2.1 percent between 2011 and 2014. Growth in the past decade was largely based on favorable external conditions, credit-fueled consumption, and an expanding labor force. As these drivers were increasingly exhausted, structural constraints on potential growth have become binding.² Hence, while Brazil still posted reasonable growth of approximately 4 percent in 2011, growth dropped to an average of 2.3 percent in 2012–2013, and to 0.1 percent in 2014. The slowdown has been exacerbated in 2015 by the impact of the *Lava Jato* corruption investigation, a difficult political environment, and an increasingly unfavorable external environment, which have driven investment and confidence to record low levels. As a result, in the first half of 2015, the economy contracted at an annual rate of 3.3 percent (seasonally adjusted relative to the second half of 2014).

10. While the decline in economic activity has been broad based, it has been driven particularly by contractions in investment and industry. Growth of investment spending declined (from an average of 9.3 percent in 2006–2010, to 1.9 percent in 2011–2014), while private consumption growth slowed from 4.8 percent in 2011, to 0.9 percent in 2014. The initial decline in investment in 2011 and 2012 was associated with a deteriorating external backdrop and a steady loss of competitiveness. Since then, other domestic factors have become more important—notably, increased uncertainty about policies and, more recently, the ongoing investigations of corruption at Petrobras, which have paralyzed a large swath of the construction sector. Growth in the services sector cooled significantly to 0.7 percent in 2014. However, the industrial sector saw the most pronounced slowdown—moving from growth of 10.4 percent in 2010, to contracting by 1.2 percent in 2014 and another 3.0 percent in the first half of 2015. More recently, the decline in economic activity in 2015 has become broad based, affecting all major sectors of the economy. On the production side, manufacturing, construction, and services declined by 9.1, 7.6, and 6.5 percent, respectively, seasonally adjusted relative to the second half of 2014, with only the extractive and agricultural sectors growing by 9.0 and 8.7 percent.

11. Unemployment has been increasing rapidly, due primarily to job losses in a recessionary economy. Formal sector job creation has moderated from the creation of 2.5 million jobs in 2011 to 0.15 million in 2014, and to a loss of 1.1 million jobs in the 12 months preceding August 2015. Job losses are widespread among most sectors of the economy and across all demographic groups. Industry, construction, and commerce dismissed the largest numbers of workers in 2015, while the only sectors that created a modest number of jobs were agriculture, education, financial and medical services. Unemployment has remained low at around 5 percent until the end of 2014, masked by shrinking labor-force participation³ but it has surged in recent months standing at 7.6 percent in August 2015⁴.

12. Because of weak GDP growth and job creation, progress in poverty reduction has slowed. Brazil has made significant advances in poverty reduction and social development since the 1990s. Growth in employment and labor income, as well as the implementation of targeted social assistance programs, contributed to a significant reduction in the share of Brazilians living

² These include infrastructure bottlenecks, high labor costs and low skill levels, a high tax burden and onerous tax system, excessive administrative burdens, shallow credit markets, and barriers to competition and international trade.

³ Despite the slowdown in economic activity and jobs creation since 2012, the reduction in unemployment continued, reaching an historical low of 4.8 percent in 2014, and average wages also continued to rise. This was largely the result of a drop in labor force participation, which masked the impact of reduced job creation in recent years.

⁴ This is using the *PME* survey of main metropolitan areas. The unemployment rate according to the *PNAD Contínua* is slightly higher than the *PME* result and reached 8.1 percent in May 2015.

below the extreme poverty line. However, because of the economic slowdown in recent years, it is estimated that the number of Brazilians living in extreme poverty grew from 7 million in 2012 to 7.6 million in 2013, the first increase after 10 consecutive years of reductions.

13. Notwithstanding the slowdown, inflation has increased far above target and is currently close to double digits, largely driven by the realignment in administered prices. Since 2011, inflation has been at the upper limit of the 4.5 ± 2 percent target range, ending 2014 at 6.4 percent, and reaching 9.5 percent in September 2015—the highest rate since 2003. From 2010 to 2014, inflation largely reflected demand-pull pressures from fiscal expansion and high household spending, in the face of capacity constraints and low unemployment. It also reflected cost-push factors such as automatic minimum wage adjustments. In 2015, while demand pressures have subsided, the adjustment in administered prices (of fuel, energy, water, and public transport), as well as food price shocks and the sharp exchange rate depreciation, have resulted in a spike in inflation.

14. The Central Bank has significantly tightened monetary policy to control inflation. Since April 2013, the Brazilian Central Bank has tightened monetary policy, raising the policy interest rate (SELIC) by a cumulative 7 percentage points through July 2015, to 14.25 percent in October 2015. The tightening cycle has so far not brought inflation to target. Its effectiveness was to an extent reduced by significant increase in lending by state-owned banks since 2009. In 2014, the loosening of reserve requirements also counteracted the tightening. However, the Central Bank has been successful in reducing inflation expectations to within the target band, since they currently stand at about 5.9 percent for the end of 2016.

15. The fiscal stimulus introduced in 2011 in response to the deceleration in economic activity continued through 2014, resulting in a steady deterioration of fiscal balances. Combined with less favorable revenue performance, expansionary fiscal policy from 2012 to 2014 resulted in rising fiscal deficits. The primary balance declined from a surplus of 2.1 percent of GDP in 2012, to a deficit of 0.6 percent in 2014, while the overall fiscal deficit deteriorated to 6.2 percent of GDP in 2014, given the debt-interest bill of 5.6 percent of GDP. Since early 2015, the authorities have been trying to bring the deficit under control with austerity measures that have reduced expenditures, mainly in public investment, but also in discretionary and nondiscretionary current expenditures, notably through the tightening of eligibility for unemployment benefits and survivor pensions. Nonetheless, despite these efforts and a series of revenue-raising measures, the primary and overall fiscal deficits have widened to 0.8 and 9.2 percent of GDP, respectively, in the 12 months preceding August 2015. The deterioration in the primary balance is mainly because of the deterioration of tax revenues resulting from the economic recession, and the difficulty in finding significant fiscal savings given the rigid budget, and weak political support for fiscal adjustment in Congress. In addition, the bill for debt interest has increased drastically in 2015, and stands at 8.4 percent of GDP over the 12 months ending in August, because of rising interest rates and significant losses under the Central Bank's currency swap contracts (which are accounted for under interest expenditure).⁵

16. In September 2015, owing to the fiscal deterioration amidst a challenging political environment, Standard & Poor's downgraded Brazil's long-term sovereign currency rating

⁵ The cumulative losses over the 12 months through August from the dollar-swap program reached R\$112bn (2.0 percent of GDP).

to BB+ with a negative outlook, stripping Brazil of its investment grade. The severity of the fiscal challenges facing Brazil was evident in early September when the Government submitted a 2016 budget to Congress envisioning a fiscal primary deficit of 0.5 percent of GDP in 2016. This represented a departure from the primary fiscal surplus target, which had already been revised downwards from 2.0 percent of GDP to 0.7 percent in July, and triggered the downgrade by S&P. Following the downgrade in mid-September, the Government submitted an additional package of fiscal measures to achieve the 0.7 percent of GDP primary surplus target in 2016⁶. Many of these measures will require congressional approval, however, and are likely to encounter severe resistance.

17. The deterioration of fiscal policy has reversed the declining trend in public debt observed throughout the 2000s. General government gross debt rose from 51.8 percent of GDP in 2010 to 58.9 percent at the end of 2014, and further up to 65.3 percent of GDP in August 2015⁷—relatively high for an emerging market country. Net debt remains significantly lower, but has recently increased to 35.5 percent of GDP in August 2015, following a downward trend from 38.5 to 32.2 between 2010 and 2013. Nonetheless, characteristics of the debt profile limit the risks associated with the debt level. These characteristics include the low foreign-currency exposure, an increasing share of fixed-rate domestic debt, and a comparatively low share of foreign-held government debt. As of the end August 2015, foreign currency denominated debt of the nonfinancial public sector accounted for only 5 percent of the total, representing close to 4 percent of GDP. Moreover, despite a significant increase in foreign holdings of government debt since 2007, domestic investors hold most (81 percent) of the local debt.

18. In line with the deceleration of the economy and the tighter monetary policy, credit markets have slowed. Following a period of rapid credit expansion, nominal credit growth has slowed down considerably to 9.6 percent year over year in August 2015. Moderated credit growth has stabilized the ratio of credit to GDP this year, at 54.6 percent. The credit slowdown is in line with the weak evolution of domestic demand, rising interest rates (the average lending rate reached 29 percent in August, from 25 percent in January), the high degree of uncertainty, and the Government’s decision to significantly reduce the use of subsidized credit through public banks as a countercyclical mechanism. Household and corporate leverage have increased over the past decade. Household indebtedness (as a percentage of disposable income) has risen to 46 percent in mid-2015; however, households’ debt service has remained stable since 2012, on account of the rising proportion of mortgages in household borrowing, which has lengthened average maturities. Corporate debt as a share of GDP increased 15 percent since 2007, mirroring developments seen in other emerging countries. Offshore issuance by foreign-incorporated subsidiaries, thus raising foreign exchange exposure, explains a significant share of this increase. While foreign exchange debt accounts for about 30 percent of the total, it is largely hedged. However, the prospect of a rise in interest rates, potentially triggered by monetary tightening in the U.S., has raised concerns about the ability of corporates to service their debt. This vulnerability has important implications for the

⁶ The new fiscal plan announced in September 2015 includes a number of revenue raising and expenditure cutting measures. Among them, the recreation of the CPMF, tax changes for the “Sistema-S” (worker training programs), reallocation of income source for the “Sistema-S”, tax rebate in exports etc. On the expenditure side, measures include postponement of civil servants wage rises, changes to the “Minha Casa Minha Vida” (MCMV; low income housing program) funding and “Programa de Aceleração do Crescimento” (PAC; public investment program) funding.

⁷ This is in accordance with Brazilian methodology. According to IMF methodology, debt has been higher, though the two figures have converged more recently. As of end 2014, general government gross debt according to the IMF methodology stood at 65.2 percent, compared with 63 percent at end 2010.

financial system, in part because corporate debt constitutes a significant share (31 percent in 2014) of Brazilian banks' assets.

19. **The banking system's soundness indicators remain positive, but the deteriorating economic situation and the impact of the ongoing scandals on the corporate sector may affect asset quality adversely.** Despite the rapid expansion in public banks' portfolios, reported asset quality indicators have remained broadly stable. However, these indicators appear to be weakening at the margin this year, given the recessionary economy and rising interest rates. The reported average delinquency rates on all loans reached 3.1 percent in August, up from 2.9 percent on average in 2014. Nevertheless, the banking system appears to be well cushioned to withstand losses, with aggregate capital buffers comfortably above OECD averages, and loan loss provision coverage at 130 percent of nonperforming loans. Moreover, the solvency ratio remains considerably above the 11 percent minimum regulatory requirement, at 16.7 percent.

20. **Brazil's external position has undergone rapid adjustment in 2015, following a deterioration in 2014.** The current account deficit widened from 2.7 percent of GDP in 2011 to 4.4 percent in 2014 (US\$104 billion), largely reflecting worsening terms of trade and declining exports of manufactured goods (especially to Argentina). In 2015, weakening domestic demand and the exchange rate depreciation have narrowed the current account deficit to 4.1 percent of GDP (US\$46.2 billion), as of August. While the deficit remains financed largely by FDI inflows, these inflows have declined significantly this year (by 36 percent in US\$ terms over the first 8 months) while portfolio flows have been volatile, highlighting vulnerabilities to capital flow reversals. Moreover, concerns about the stability of FDI flows have risen, because of growing offshore debt issuance by foreign subsidiaries of Brazilian parent companies (mentioned above).⁸

21. **Brazil's currency depreciated sharply in 2015, especially since July, as the economic outlook deteriorated.** After weakening gradually since 2011, the Brazilian real lost about 34 percent of its value with respect to the US dollar in 2015, amid domestic uncertainties and the strengthening of the US dollar (Table 1). The depreciation accelerated in September, with the exchange rate peaking at a record low of R\$4.18 per US\$, amidst significant volatility. The depreciating real, combined with the widening current account deficit, have resulted in a steady increase in total external debt (including private sector debt and intercompany loans) to GDP from 19.6 percent in 2012 to 28.5 percent as of August 2015. However, this percentage is still relatively low in comparison to other countries. Ample international reserves, at US\$368 billion (15 months of imports) as of August 2015, continue to provide a buffer against external turbulence. However, they are partially offset by a short position in currency swaps (US\$108 billion in August 2015), which the Central Bank has been offering since May 2013 to support the real.

⁸ Intercompany loans accounted for 60 percent of total FDI in 2014. However, about 60 percent of intercompany loans reflect proceeds from overseas borrowing by foreign subsidiaries of Brazilian parent companies, which, arguably, carry a risk profile more similar to portfolio debt flows.

Table 1 Brazil: Selected Economic Indicators and Projections, 2008–2017

	2008	2009	2010	2011	2012	2013	2014	2015f	2016f	2017f
Real gross domestic product (percent change)	5.0	-0.2	7.6	3.9	1.8	2.7	0.1	-2.7	-0.7	1.4
Private consumption	6.4	4.2	6.4	4.8	3.9	2.9	0.9	-3.4	-2.3	1.1
Government consumption	2.1	2.9	3.9	2.2	3.2	2.2	1.3	-0.9	0.6	0.5
Gross fixed capital investment	12.7	-1.9	17.8	6.6	-0.6	6.1	-4.4	-11.6	-2.9	2.5
Statistical discrepancy (% GDP)	1.7	-1.0	0.8	0.7	-0.4	-0.3	-0.1	-0.1	-0.1	-0.1
Exports, goods & services	0.4	-9.2	11.7	4.8	0.5	2.1	-1.1	4.2	3.5	3.1
Imports, goods & services	17.0	-7.6	33.6	9.4	0.7	7.5	-1.0	-10.4	-5.8	1.5
Agriculture	6.3	-3.1	6.3	3.9	-2.1	7.3	0.4	3.4	4.3	3.8
Industry	4.1	-5.7	10.4	1.5	-0.8	2.2	-1.1	-6.5	-1.8	1.5
Services	4.9	2.0	5.6	2.7	1.8	2.0	0.7	-1.7	-0.7	1.2
Output Gap (percent of potential GDP)	2.7	-0.9	2.9	3.6	2.5	2.6	0.6	-2.9	-4.7	-4.7
CPI Inflation (end of period)	5.9	4.3	5.9	6.5	5.8	5.9	6.4	9.2	5.5	4.5
Current account balance, % of GDP	-2.3	-2.1	-2.8	-2.6	-2.6	-3.9	-4.4	-4.1	-3.7	-3.6
Foreign direct investment, % of GDP	1.2	1.9	1.4	2.4	2.6	2.6	3.0	3.2	3.3	3.3
Official reserves (US\$, billion)	194	239	289	352	373	359	364	...	...	...
Gross External Debt* (US\$ billion)	200	247	351	403	436	440	498	...	...	...
Average exchange rate (R\$/US\$)	1.8	2.0	1.8	1.7	2.0	2.2	2.4	...	...	...
Real effective exchange rate (2010 = 100)	86.1	86.9	100.0	104.6	94.5	90.0	89.7	...	...	...
Fiscal Indicators (% of GDP)										
General Government Revenue	36.7	34.8	37.1	36.6	37.7	37.2	34.7	34.4	35.6	36.5
General Government Expenditure	38.3	38.1	39.9	39.2	40.4	40.4	40.9	42.4	42.7	41.3
Interest Expenditure	5.5	5.3	5.2	5.7	4.6	5.0	5.6	7.7	7.8	6.0
Primary Balance	3.9	2.0	2.4	3.1	2.1	1.9	-0.6	-0.3	0.7	1.2
Fiscal balance	-1.6	-3.3	-2.8	-2.6	-2.5	-3.1	-6.2	-8.0	-7.1	-4.8
Gini coefficient of consumption										
Sources: IBGE, BCB, IMF and World Bank staff forecasts.										
Notes: e = estimate, f = forecast, * includes securities issued in Brazil, held by foreign residents										

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

22. **The short-term outlook for the Brazilian economy is challenging, with a deep contraction of GDP and above target inflation expected in 2015.** Confidence indicators have continued to decline steadily in 2015, reaching record lows and indicating further deterioration of the near-term outlook for consumption and private investment. The Government has moved to address previous policy inconsistencies, but in the short term, these necessary policy adjustments have exacerbated the widespread decline in economic activity while creating inflationary pressures. Fiscal consolidation and rising unemployment will further put the brakes on aggregate demand, while currency depreciation and realignment of administered prices are expected to continue to weigh heavily on inflation. The economy is expected to experience a severe recession in 2015, followed by a lesser contraction in 2016 as economic difficulties abate, and a modest recovery thereafter. Inflation is expected to peak at above 9 percent in 2015 and to remain above the target in 2016 despite the weak economy, as second-round effects of administered price hikes and the weakening of the currency pass through to market prices. In the medium term, inflation should gradually converge towards the target of 4.5 percent, since growth is projected to recover only slowly, leaving a negative output gap.

23. **Prospects for debt sustainability depend on the pace of fiscal consolidation.** Primary surpluses of around 2-3 percent of GDP will be needed to put the gross debt-to-GDP ratio on a downward path. On current projections for the likely path of fiscal policy public debt is expected

to increase in the next few years, with gross debt as a percent of GDP rising to above 70 percent. Public debt should stabilize and decrease gradually in the medium term in line with the authorities announced fiscal adjustment path which aims to bring the primary surplus to 1.3 percent of GDP in 2017 and to at least 2 percent of GDP in 2018 and beyond. This trajectory of gross debt is however sensitive to growth underperformance and fiscal slippage given the pressure arising from high borrowing costs.⁹

24. **The government is pursuing a coordinated macroeconomic adjustment.** Fiscal consolidation to correct the slippage of the last few years and stabilize fiscal trends is underway, although Congress has not approved all measures and the slowdown in economic activity has undermined the achievement of the targets. In parallel, the Central Bank has limited its intervention in the foreign exchange market to episodes of excessive volatility, allowing the exchange rate to play its role as shock absorber, and the convergence of the rate to levels in line with fundamentals, thus boosting competitiveness and exports. At the same time, the government has committed to strengthen the monetary policy framework and bring inflation to target by end-2016, which has been backed by monetary tightening and a reduction (effective 2017) in the target band to 4.5 ± 1.5 percent (from ± 2 percent previously). In addition, the government has moved to reverse key distortions. Among these key distortions are domestic price controls (price controls on fuel, electricity rates, and transport tariffs); credit market distortions resulting from subsidized lending by the Brazilian development bank (BNDES); and heavy exchange rate intervention. Lending by public banks has scaled down, which will help alleviate pressures on the fiscal position, while reducing financial distortions and bolstering fiscal credibility. Finally, general subsidies to consumers of electricity have been discontinued, resulting in tariff increases—a positive step for both fiscal and economic efficiency reasons.

25. **Efforts to alleviate supply-side constraints and boost the economy's productive capacity have also continued, but progress has been slower.** On the one hand, the government has focused on its program of concessions—the Logistics Investment Program—to involve the private sector in key infrastructure projects in transportation (roads and airports), energy transmission and generation, and telecommunications. In June 2015, a new phase of the program was announced with planned infrastructure investment totaling R\$198.4 billion, including R\$69.2 billion investment between 2015 and 2018. On the other hand, structural impediments to growth remain significant. In particular, Brazil remains a relatively closed economy compared to its peers, regulatory quality is weak and barriers to competition are widespread, the tax system is uncommonly complex, and unit labor costs are high. Moreover, despite recent initiatives, Brazil's infrastructure and competitiveness indicators have deteriorated in relation to its competitors.

26. **Risks to the outlook tilt significantly to the downside.** The government's fiscal consolidation effort will likely continue to face challenges from the ongoing recession. The government has already reduced its primary surplus targets for 2015 and 2016 (from 1.2 and 2 percent of GDP, respectively, to 0.15 and 0.7 percent) in response to the deterioration of revenues. Achieving even these reduced fiscal targets in a recessionary environment will require further significant spending reductions as well as revenue increases. Political gridlock and growing social discontent also threaten to derail the fiscal consolidation effort and this could have serious ramifications for investor confidence in Brazil. The ongoing investigations into corruption

⁹ World Bank staff are working on an updated Debt Sustainability Analysis, expected to be available by end 2015.

allegations at Petrobras present an additional risk of political, economic, and financial disruptions. Investment may be further hampered and insufficient access to funding by the companies under investigation may result in adverse spillovers to the banking sector. In addition, Brazil remains vulnerable to capital flow reversal. Capital outflows could result from a further deterioration of the domestic economy, further credit downgrades, and tightening of monetary policy in the U.S.¹⁰ In addition, as mentioned above, a reversal of post-crisis accommodative global financial conditions could trigger corporate distress and spill over to the financial sector. The high level of reserves and the flexible exchange rate acting as a shock absorber partially mitigate these risks. The risk of water and electricity rationing because of a prolonged drought has receded in the near term, but could return in 2016 if rainfall is insufficient.

27. Brazil's medium-term outlook will depend on the success of the ongoing macroeconomic adjustment, as well as tackling structural fiscal pressure points and the adoption of growth-enhancing reforms. In the medium term, correcting Brazil's fiscal situation will be essential to create the conditions needed to begin a new cycle of growth. The current adjustment will be pivotal to bring the deficit under control. However going forward, addressing the key sources of long-term fiscal pressure, notably the social security system, will be crucial to stabilize and reduce the debt and build fiscal space. To achieve higher growth in the medium term, raising investment and productivity is also a crucial challenge for Brazil. With the growth drivers over the past decade—credit-fueled consumption, labor expansion, and the commodity boom—exhausted, growth will need to be based on higher investment and gains in productivity. This requires policies to address the challenges to raising public and private investment in infrastructure, improve the quality of education, simplify red tape and the tax system, increase the effectiveness of public spending, and increase competition and market contestability in key sectors of the economy.

28. Brazil's overall macroeconomic framework is currently adequate for the purposes of this operation. Even though policy space has been reduced, Brazil's policy framework continues to provide some flexibility to respond to economic crises. The government has taken strong action in 2015 to address the macroeconomic imbalances. The sharp exchange-rate adjustment is forcing a rebalancing of the economy, and the ongoing fiscal consolidation—albeit subject to political risks—is addressing the fiscal imbalances that had been building up over the past few years. While the continuation of inflationary pressures and the deterioration of fiscal outturns in the low-growth environment complicate macroeconomic management, the administration remains committed to taking the necessary measures to restore a sustainable fiscal path and to keep inflation under control, while seeking to boost investment to restart growth. Under this scenario, public sector debt (gross as well as net) is expected to increase in the short term, but to remain at a manageable level. Moreover, a flexible exchange rate and large foreign reserves will continue to provide Brazil with a buffer in the face of external shocks.

Recent Economic Developments in the Municipality of Manaus

29. Manaus is the sixth largest capital city in Brazil. The Municipality is geographically the largest capital city in the country with an area of 11,401 Km². It also has the highest population growth

¹⁰ S&P was the first to downgrade Brazil's sovereign debt to non-investment grade status; other rating agencies may likely follow suit, triggering "forced selling" of Brazilian assets.

rate of all capital cities. Its GDP amounted to R\$50 billion (US\$25.5 billion) in 2012. GDP per capita stands at R\$26,761 (US\$13,695), 18 percent higher than the national average GDP per capita of US\$11,589. Manaus accounts for 52.2 percent of the State's population and 78 percent of the State's GDP.

30. **In the past Manaus flourished as a result of the rubber trade, but today its economy is closely linked to the ZFM.** The ZFM was created in 1957, but took off in 1967 when the military regime expanded the tax incentives scheme for companies located there, with the aim of developing an industrial, trade and agribusiness cluster in the Amazon region. Currently, companies located in the ZFM enjoy federal and state tax incentives. There are no municipal tax incentives specific to the companies located at the ZFM. The total amount of revenue forgone from the federal and state level at the ZFM is estimated at 0.6 percent of the national GDP. Its privileged legal status is granted in the Constitution and although originally set to end in 1997, it has been extended more than once and now it is set to last until 2073.

31. **The economic performance of the Municipality is closely linked to the performance of the ZFM.** The companies located at the ZFM had a combined revenue of R\$97.1 billion in 2014 and, as of 2014, employed 120,089 workers, out of which 32.4 percent are female. The jobs generated at ZFM accounted for 27 percent of all formal jobs in the Municipality. As with the Brazilian economy, growth in the ZFM has declined throughout 2014. The main industries at ZFM are electronics, electro-domestic goods, information technology and bicycles and motorbikes. Total revenues grew by 4.7 percent in 2014, down from the 13.31 percent registered in 2013.

32. **The current administration took office in 2013 with a legacy of a fiscal deficit, but acted promptly to revert it.** By the end of 2012, the Municipality had a financial deficit – committed expenditures without corresponding cash resources – of R\$347 million, including R\$81 million of expenditures that were done outside of the budget. The Municipality took several measures to curb expenditures, increase revenues and modernize internal processes. These measures included setting agreements to pay arrears gradually, monitor timely payment of utility bills to avoid late penalties, introduction of results-based management with revenue and expenditure targets, creation of a central fiscal committee to approve larger expenditures, among others. By the end of 2013, the outstanding financial deficit was reduced to R\$214 million.

33. **In 2014, a combination of external and internal factors caused the financial deficit to widen again.** Lower economic activity which translated into lower transfers than budgeted and the non-realization of capital transfers from the Federal Government to pay for World Cup-related public works were the external drivers of the deterioration. In addition to that, the obligation to segregate the civil servants pension contributors and beneficiaries into two funds, known as '*segregação de massas*' generated an extra expenditure of R\$100 million to the Municipality to fund the financial fund deficit. Lack of control in some line agencies caused expenditures to be contracted out of the budget again. All these factors caused the deficit to increase by R\$228 million in 2014.

34. **The Municipality acknowledged the fiscal slippage in 2014 and took drastic measures to put fiscal accounts back on track.** The mayor dismissed secretaries that were causing fiscal problems to the Municipality and approved a plan to increase revenues and cut expenditures amounting to R\$569 million in 2015. This plan includes measures such as payroll audits, reduction of personnel, standardization of automobile fleet, sale of unused building and real estate and reduction in utility bills, among others. Lastly, longer term initiatives initiated in 2014, especially on tax administration, will start to pay-off and generate extra revenues in the short and medium term.

35. **Manaus is highly dependent on transfers from the Federal and the State Governments.** In 2014, transfers accounted for 64 percent of the Municipality's current revenues, a ratio larger than comparable capital cities such as Recife (52.8 percent), Fortaleza (63 percent) and Belém (61.4 percent). Transfers from the State Government accounted for more than 50 percent of the transfers. The largest transfer is from the Value-Added Tax (*Imposto sobre a Circulação de Mercadorias e Serviços* - ICMS) that in 2014 accounted for 30 percent of all current revenues of the Municipality. This large share of the ICMS transfers in Manaus' budget is a reflection of the dependence on the ZFM, since the industries located there are large ICMS taxpayers and the main criteria for sharing the ICMS is the value added in the Municipality. State transfers to municipalities are rule-based (see Annex 4 for more details about the distribution of taxes across levels of governments); only a decline in economic activity and thus in ICMS collection could potentially lower the amount transferred. The State's GDP grew 8 percent in nominal terms in 2011 and dropped 0.7 percent in 2012, a reflection of the significant deterioration in the industrial sector (Table 2).

36. **Local taxes are an underutilized source of revenues in Manaus.** Tax revenues represent less than 25 percent of the Municipality's revenues, with property tax (*Imposto Predial e Territorial Urbano* - IPTU) generating less than R\$130 million in 2014 and the tax on services (*Imposto Sobre Serviços* - ISS) accounting for R\$575.5 million worth of revenues. In relation to a set of comparable capital cities¹¹, Manaus has the lowest IPTU revenue per capita (R\$40.2) and the second lowest tax on services (R\$207), also in per capita terms. The IPTU is the least utilized tax base: it is estimated that Manaus has approximately 550,000 properties, out of which only 150,000 are included in the IPTU cadaster and only half of it pays the IPTU regularly. In addition, the property value for tax purposes is outdated and Manaus grants a 15 percent discount for immediate payments of the tax, a large discount compared to other cities such as Belo Horizonte and Fortaleza that grants 7 and 10 percent discount, respectively.

37. **Nevertheless, in the last four years, tax revenues have grown faster than transfers.** From 2011 to 2014, taxes have grown 11.3 percent in real terms on average, while transfers posted a 7.8 percent growth. IPTU was the fastest growing tax with a 25 percent real average growth rate. This performance can be credited to changes in the IPTU legislation that is gradually reducing the discount given to immediate payments (from 20 to 15 percent) and also closing the gap between the real property value and its values for tax purposes. These effects will last until 2016. Several measures are being implemented to boost tax collection including a full revision and modernization of the taxpayer cadaster, negotiation with large non-compliant taxpayers, implementation of routines to collect tax in arrears and provision of several tax services through electronic channels. Other taxes such as ISS showed good performance as well, growing by 9.3 percent real growth rate.

38. **The largest municipal expenditures are on payroll and goods and services.** The first amounted to R\$1,821 million, while the second one totaled R\$1,489 million in 2014. Debt service payments are very low – R\$72 million in 2013 or 2.1 percent of Net Current Revenues (NCR), a reflection of the low debt levels. In terms of functional classification: health, education and urban services accounted for 74 percent of expenditures. Investment levels in Manaus are not low compared to other capital cities. In 2013, investments reached 11.1 percent of NCR (12.5 percent in 2014), placing it in third place after Belo Horizonte (19.8 percent) and Recife (17.3 percent).

39. **Total workforce has remained roughly stable, but public sector wages have increased in real terms every year since 2008 causing the payroll to increase in real terms, but still**

¹¹ Curitiba, Belo Horizonte, Fortaleza, Salvador, Recife and Belém.

within Fiscal Responsibility Law (FRL) limits. The total workforce for the Municipal Government was 33,605 workers in 2014, a 4.6 percent increase from 2008. The average wage in the Municipality has grown by 3.8 percent annually in real terms since 2008. Pressures for wage increases come from the federally instituted minimum wage for teachers¹² that have grown above inflation in the past three years and from local laws that guarantee at least yearly inflation increases and automatic pay rises linked to seniority.

40. **The Municipality of Manaus is in compliance with all limits of the FRL.** The most recent figures for August 2015 show that payroll expenditures are at 4,545.7 percent¹³ of NCR against a limit of 60 percent; guarantees are at 1,212.2 vis-à-vis a limit of 22 percent; loan proceeds stood at 1.1 percent when the limit is set at 16 percent and the Net Consolidated Debt over NCR stood at 88.2 percent for a 120 percent limit, showing that the Municipality has accumulated more assets than debt, even though these assets might not be freely disposable.

41. **Debt levels are low and manageable, but costly.** Total gross debt stands at R\$845 billion, less than one percent of GDP, or 2,323.8 percent of NCR. 33 percent of this debt is external, while the rest is domestic. All debt is contractual, since the Municipality is not allowed to issue bonds (as is the case with all other municipalities and states). The largest debt contract, which is also the most costly - with real interest rates of 1 percent monthly, is with the Federal Government relating to unpaid social contributions in past municipal administrations and accounts for one third of the total debt. The debt renegotiation contract relating to the third bail-out promoted by the Federal Government (Law 9.496/97 and MP 2.185) to all states and municipalities was paid out in May of 2014. The average time to maturity is 15.6 years, with the domestic debt showing slightly longer term (16.7) than the external one (13.9). On the other hand, the domestic debt is more costly - with interest rates ranging from nominal 4.31 percent to real 12 percent yearly - than the external debt, in which interest rates are set at Libor plus spreads of at most 1.35 percentage points.

42. **Despite slight deterioration in 2014, budget results have improved since 2012.** The primary balance deficit of 5 percent of NCR in 2011 was turned into a surplus of 3.9 percent in 2013, slipping to a small deficit of 1.7 in 2014. The overall balance was also negative in 2011 (R\$ 103.8 million) and was turned into a surplus of R\$121.1 million in 2013, but returned to deficit level – R\$40.3 million - albeit smaller in 2014. By the same token, the Gross Financing Needs of the Municipality declined from 6.3 percent of NCR in 2011 to 0.5 in 2014.

43. **Manaus does not face significant fiscal risk in the short or medium term.** *Precatórios*¹⁴ are paid in accordance with legislation and amount to R\$212.6 million. The main fiscal risk relates to public employees with temporary contracts. The Municipality has not paid the social security contribution for these employees, causing a legal action from the Federal Government. At the same time, the Municipality is facing legal action from Public Prosecutors to incorporate these temporary workers as permanent civil servants. The MM is not hiring anyone else under this contract and is gradually dismissing the current temporary workers hired under temporary contracts. Manaus has only one Public Private Partnership (PPP) which is not performing well (under an old and poorly structured contract) and if it is terminated early will generate fiscal impact.

¹² The Municipality is in strict observance of the law and therefore is not expected to face any immediate fiscal risk relating to the non-observance of the minimum wage for teachers.

¹³ The payroll expenditures currently do not include expenditures with retired personnel, which would add around R\$150 million to the reported figure. The Municipality would still be in compliance with the legislation.

¹⁴ *Precatórios* are judicial claims filed against governments where a judgment was issued against it.

44. **Despite significant achievements in the past two years, structural challenges remain.** The Municipality needs to revise its budget and financial execution process to avoid future out-of-budget expenditures, as well as to improve allocative and technical efficiency. A sustainable source of revenues must be established to fund the cost of the pension regime transition which is expected to increase until 2035. Considerable thought should be given to the institutionalization of good practices and procedures already implemented in order to avoid the reversal of the gains obtained so far and consequently the deterioration of the fiscal stance of the Municipality. In addition, these changes have to be executed and the budget must be balanced in a negative growth environment, with direct effects on revenues – both transfers and own-source.

Figure 1 – Revenues: 2011-2014
(values in nominal R\$ million)

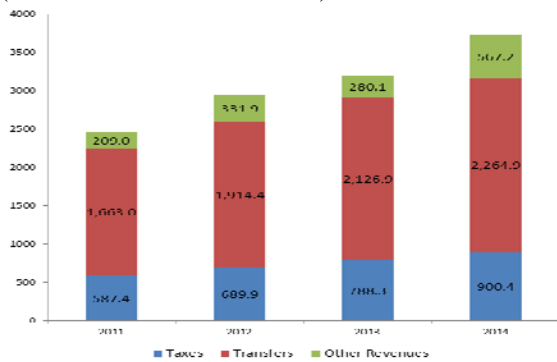


Figure 2 – Tax Property per Capita Revenue: 2013
(values in nominal R\$)

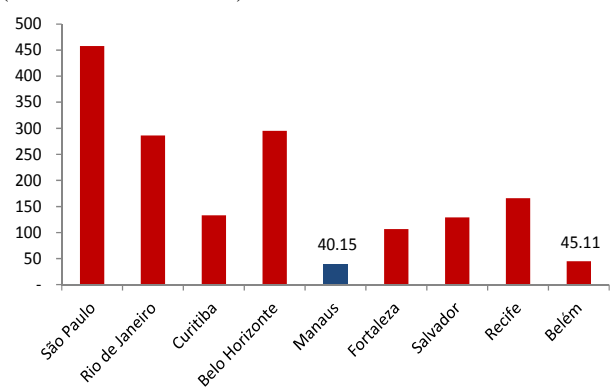


Figure 3 – Expenditures: 2011-2014
(values in nominal R\$ million)

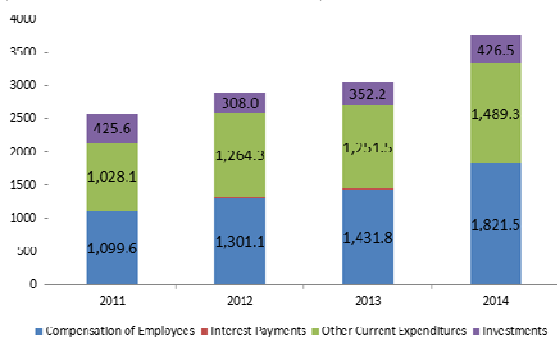


Figure 4 – Debt to Revenue Ratios: 2011-2014
(% of NCR)

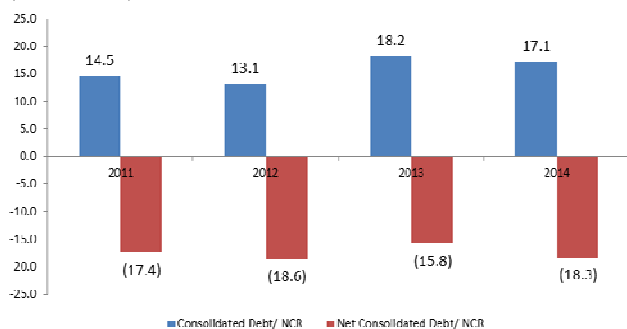


Figure 5 – Payroll Expenditures: 2011-2014 (% of NCR)

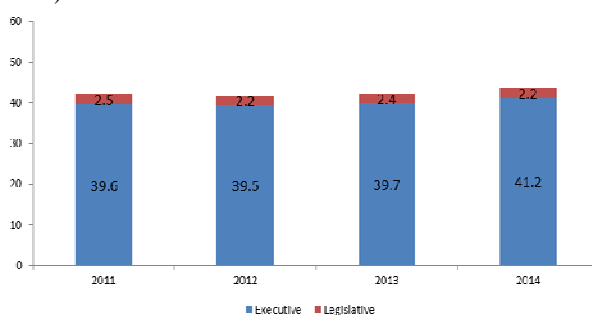
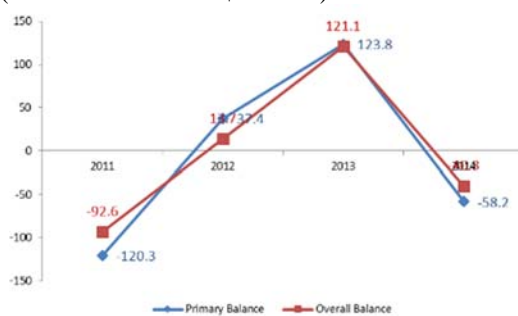


Figure 6 – Budget Balances: 2011-2014
(values in nominal R\$ million)



Source: Municipality of Manaus, National Treasury Secretariat and WB Calculations. * 2014 figures are from the month of August.

45. **Intergovernmental fiscal relations are adequate.** Transfers are mostly rule-based, with the rules being written in the Constitution or laws. Transfers from the State of Amazonas are entirely rule based, and not affected by the fiscal situation of the State, except to the extent that the State and the Municipality are affected by national levels of economic activity. The rules are public and known in advance, and their application is overseen by the State Court of Accounts (*Tribunal de Contas do Estado de Amazonas - TCE/AM*). Under the FRL and complementary Senate resolutions borrowing by sub-nationals is prohibited if: (i) the Net Consolidated Debt twice exceeds NCR in the case of states or 120 percent in the case of municipalities; (ii) new credit operations exceed 16 percent of NCR; or (iii) debt service exceeds 11.5 percent of NCR. Borrowing is also prohibited if it violates the debt reduction schedules. Finally, bail-outs of subnational governments are prohibited and none has been registered in the last 15 years. The current debate over intergovernmental finance reforms is not expected to change these characteristics in the next few years. See Annex 4 for more details about the FRL and Brazil's fiscal framework.

Economic Outlook and Debt Sustainability in the Municipality of Manaus

46. **Fiscal and debt projections show a sustainable path for the Municipality.** Two alternative scenarios were constructed. The assumptions for each scenario are described in Annex 5. Overall, taxes are mostly expected to grow in line with inflation and GDP growth; however, in the first years some efficiency gains are expected from IPTU and ISS tax collection. Payroll is expected to grow 3.8 percent in real terms, in line with the historical growth rate. Recurrent expenditures are also expected to grow with inflation and GDP. Investments are projected to increase by 1.1 percentage points of NCR every year until 2020, starting from 12.4 percent in 2014. Lastly, debt stock and the corresponding debt service were projected taking into consideration the existing debt contracts, also the ones in the pipeline and assuming a constant borrowing level thereafter.

47. **The baseline scenario shows balanced budget and increased room for investment on the back of growing revenues.** The MM will enjoy higher revenues due to the catch-up process with best practices that it is developing. Debt service is expected to increase, although from a very low level, due to the new loans that the Municipality is contracting.

48. **An alternative worst case scenario was developed.** This scenario considers Manaus' budget and debt path under a more constrained economic environment. Both scenarios consider a 2.7 percent GDP contraction in 2015. In the worst case scenario, GDP is expected to contract 2 percent in 2016 and report zero growth in the following year. Later, it is assumed that GDP growth will stabilize around 1.5 percent until 2020 and 2.5 percent afterwards. Inflation is also expected to be higher at 6.5 and 5.5 percent in 2016 and 2017, stabilizing at 5.5 percent until 2020 and at 4.5 percent afterwards. It is also assumed that there will be no efficiency gains in tax collection and ICMS transfers report a more pessimistic projection. Additionally, a more ambitious investment plan in 2015 is projected (24.5 percent of NCR), which will then deteriorate afterwards, reaching 11.5 percent of NCR in 2020. Furthermore, the Municipality is expected to hire R\$80 million in new loans annually from 2017 onwards.

Table 2 - Manaus Statement of Government Operations: 2014-2020 (R\$ million)¹⁵

	2012	2013	2014	2015	2016	2017	2018	2019	2020
I. REVENUE	3,309.0	3,400.0	3,732.5	4,477.4	4,900.2	5,289.6	5,636.0	6,028.0	6,447.9
Taxes	777.5	838.8	900.4	1,008.7	1,122.1	1,191.8	1,272.2	1,363.7	1,461.8
ISS	523.0	546.2	575.5	626.8	673.0	713.2	760.2	814.2	872.1
IPTU	84.6	105.9	127.0	163.1	213.7	226.5	241.4	258.6	277.0
Others	169.9	186.7	197.9	218.9	235.3	252.1	270.6	290.9	312.7
Social and Economic Contributions	84.6	108.0	214.2	536.0	582.0	626.1	673.8	725.2	780.8
Social Contributions	101.5	101.5	101.5	412.9	452.2	490.5	532.1	577.1	626.0
Economic Contributions	-16.9	6.5	112.7	123.0	129.8	135.6	141.7	148.1	154.8
Transfers	2,157.5	2,263.1	2,264.9	2,547.2	2,789.3	3,046.7	3,245.8	3,474.9	3,720.3
Current Transfers	2,107.0	2,241.0	2,206.9	2,522.2	2,764.3	3,021.7	3,220.8	3,449.9	3,695.3
FPM	307.8	350.2	364.1	408.8	459.6	503.8	537.0	575.2	616.1
Share of State ICMS	1,162.8	1,247.8	1,211.5	1,419.7	1,562.2	1,719.1	1,832.4	1,962.7	2,102.3
FUNDEB Net Gain	233.1	234.8	234.1	271.7	300.4	330.3	352.1	377.1	403.9
Other Current Transfers	403.3	408.2	397.2	422.0	442.1	468.5	499.3	534.9	572.9
Capital Transfers	50.5	22.1	58.0	25.0	25.0	25.0	25.0	25.0	25.0
Other Current Revenues	289.4	190.1	353.0	385.5	406.7	425.0	444.2	464.1	485.0
II. EXPENSE	2,909.5	2,871.7	3,328.1	3,846.5	3,990.7	4,291.6	4,621.0	4,981.6	5,367.6
Compensation of Employees	1,466.3	1,523.5	1,821.5	2,064.7	2,261.0	2,452.5	2,660.3	2,885.6	3,130.1
Interest Payments	18.4	16.4	17.3	49.4	71.9	82.4	88.3	90.3	89.3
Other Current Expenditures	1,424.8	1,331.7	1,489.3	1,732.5	1,657.8	1,756.7	1,872.4	2,005.6	2,148.2
Contracted Services (Third-parties)	863.4	809.3	902.2	958.6	1,004.2	1,064.1	1,134.2	1,214.9	1,301.3
Other Goods and Services	561.4	522.4	587.2	773.9	653.6	692.5	738.2	790.7	846.9
III. GROSS OPERATING BALANCE (I - II)	399.5	528.4	404.4	630.9	909.5	998.1	1,014.9	1,046.4	1,080.3
% of NCR	12.3	15.7	11.8	15.3	20.2	20.5	19.6	18.9	19.0
IV. TRANSACTIONS IN NON-FINANCIAL ASSETS	353.0	374.8	427.0	559.9	662.0	767.8	874.8	996.3	1,088.2
Investment in Non-Financial Assets	347.1	374.8	426.5	556.9	659.0	764.8	871.8	993.3	1,085.2
Investment in Financial Assets	5.9	0.0	0.4	3.0	3.0	3.0	3.0	3.0	3.0
V. NET LENDING / BORROWING (III - IV)	46.5	153.6	-22.6	71.0	247.5	230.3	140.2	50.1	-7.8
VI. PRIMARY BALANCE (V + Net Interest Payments)	42.1	131.8	-58.2	62.6	258.4	248.9	161.9	70.8	8.7
% of NCR	1.3	3.9	-1.7	1.5	5.7	5.1	3.1	1.3	0.2
VII. TRANSACTIONS IN FINANCIAL ASSETS AND LIABILITIES	-26.6	-2.9	18.0	501.7	-12.6	-19.0	-28.6	-72.0	-87.5
New Loans	46.1	67.4	71.4	540.7	39.9	38.9	38.9	0.0	0.0
Amortizations, net	(74.0)	(70.9)	(54.3)	(39.5)	(53.0)	(58.4)	(68.0)	(72.5)	(88.0)
Amortizations received	1.6	1.0	0.5	1.0	1.0	1.0	1.0	1.0	1.0
Amortizations paid	75.6	71.9	54.8	40.5	54.0	59.4	69.0	73.5	89.0
Asset sales	1.3	0.5	0.9	0.5	0.5	0.5	0.5	0.5	0.5
VIII. GROSS FINANCING NEEDS (Net Debt Service - VI)	27.5	-82.7	76.9	-31.6	-194.5	-171.9	-72.1	22.5	95.8
% of NCR	0.8	-2.5	2.2	-0.8	-4.3	-3.5	-1.4	0.4	1.7
VIII. OVERALL BALANCE (VI + VII)	15.5	128.8	-40.3	564.3	245.8	229.9	133.3	-1.2	-78.8
<i>Memo Items:</i>									
Net Current Revenue (NCR)	3,254.0	3,372.7	3,427.7	4,111.7	4,499.9	4,857.6	5,175.6	5,535.6	5,698.2
Non-Financial Investment / NCR	10.7	11.1	12.4	13.5	14.6	15.7	16.8	17.9	19.0

Source: Municipality of Manaus, National Treasury Secretariat and WB Calculations

49. **Under the worst case scenario, Manaus still reports a balanced budget, but investment levels deteriorate given the lower gross operating balance.** Debt is expected to increase up to 31.5 percent of NCR in 2018 and then follows a descending trajectory, reaching 17.8 percent of NCR by 2030, which characterizes a low debt level for FRL purposes. Debt service would reach 4.1 percent of

¹⁵ Figures for 2012-2014 are in R\$ million as of 2014. Projections for 2015-2020 are in nominal prices. Figures exclude past expenditures outside of the budget. Including these expenditures the Municipality would have shown an overall budget deficit of R\$75.8 and R\$268.3 in 2012 and 2014 respectively.

NCR in 2020, significantly higher than the 2.8 percent recorded under the baseline scenario, but still manageable and with a favorable outlook given the descending trajectory observed going forward.

Figure 7 – Consolidated Debt to NCR: 2014-2030

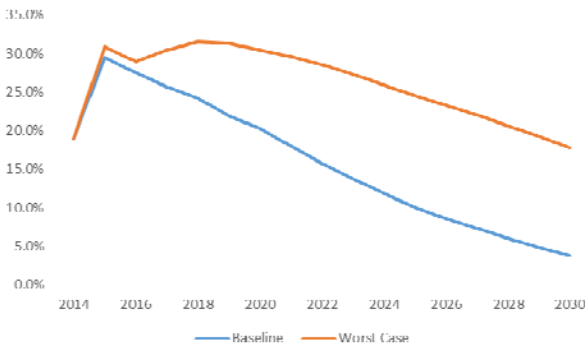
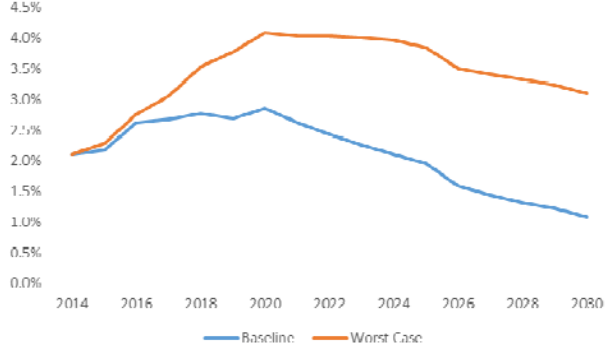


Figure 8 – Debt Service to NCR: 2014-2030



Source: World Bank

50. **In conclusion, Manaus’ fiscal stance is considered adequate for the purpose of this operation.** Debt levels are low and are expected to continue dropping in the long term despite sizable loans contracted in the past years and the impact of this operation. Budget balances are also projected to follow a sound path, but the Municipality should see its investment capacity decrease in case the harsher economic environment prolongs itself. Under the baseline scenario, investments are projected to grow from 12.4 percent of NCR to 19 percent in 2020. Meanwhile, the worst-case scenario reports investments at 10.8 percent of NCR in 2020.

2.3 IMF RELATIONS

51. **This DPL complies with the guidelines for coordinating with the International Monetary Fund (IMF) on development policy financing.** The IMF has not had a program with Brazil since 2005. Annual Article IV missions have been held since then. The Executive Board of the IMF concluded the latest Article IV Consultation with Brazil on September 16, 2015 (annex 3). The Bank and Fund work closely on the overall Brazil program. This is consistent with the Joint Management Action Plan (JMAP), which requires Bank and Fund staff to consult at least annually in the preparation of their work programs. However, since the IMF does not work directly with state governments, there has been no direct collaboration with the IMF on this specific operation.

3. THE GOVERNMENT’S PROGRAM

52. **The Government of Manaus’ program is established in its Multi-year Plan (*Plano Plurianual – PPA*) for 2015-2017.** This plan reflects the strategic alignment of state and municipal priorities in terms of programs that seek to modernize municipal capacity, improve service delivery, and reduce inequality. The PPA is divided into five different thematic objectives: (i) City Organization; (ii) Service Quality; (iii) Social Protection Guarantees; (iv) Creation of New Opportunities; and (v) Achievement of Fiscal Balance and Strategic Development of Public Human Resource Management. Each municipal program included in the PPA, and the institution to which it corresponds, is mapped to one of the five thematic objectives. Each program also

includes indicators to monitor program results and progress towards the thematic objectives. In addition, the PPA includes annual budget estimates for each program from 2014 to 2017.

53. **This proposed DPL is directly linked with the PPA thematic objectives of “City Organization”, “Service Quality” and “Achievement of Fiscal Balance and of Strategic Development of Public Human Resource Management”.** To support Manaus’ urban development, the first thematic objective includes programs dedicated to improving urban transport and infrastructure as well as restoring Manaus’ center and historic areas to improve efficiency and strengthening security. To improve the quality of municipal services, the second thematic objective focuses on reforms within the social sectors (i.e. education and health) which are critical for enhancing equality. In the last thematic objective, the MM prioritizes programs supporting the technological modernization of SEMEF allowing for improvements in resource management, procurement and payroll and pension management, as well as programs to increase citizen access to information on municipal services.

54. **Policy reforms under this DPL have been discussed within Municipal Councils and responded to feedback provided by Manaus’ citizens.** In compliance with the Access to Information Law (Federal Law 12,527/2011), in 2013, the MM has revamped Municipal Councils and its Ombudsman Office. As an integral part of the PPA preparation process, the MM conducted consultations with the local population to present program proposals and collect feedback from the public. Every year in September the MM holds public meetings over the period of a week, including first readings on the budget and then public hearings to promote citizen participation in drafting the budget proposal for the coming year. These meetings are widely announced through print and radio media two weeks prior to the consultations. For the social sectors - health, education and social assistance – consultations are carried out by the Municipal Councils responsible for these programs.

4. THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

55. **The Program Development Objective (PDO) of this proposed operation is** to assist the Municipality of Manaus (MM) in improving the management of its finances as well as its education and transport sectors, through upgraded revenue and expenditure processes, meritocratic and results-oriented management of schools, and improved control of bus concessions. The PDO is, therefore, fully aligned with the Government’s longer-term development goals as outlined in the previous section.

56. **The proposed DPL builds on the experience of other Bank operations with Brazilian state and municipal governments.** Among these lessons learned is the importance of putting arrangements in place to assist the implementation over the medium-term. Previous experience has also shown that prior actions should be limited to a few key policy and institutional reforms. Without such a focus, implementation by the Government and supervision by the Bank risk losing sight of the operation’s priorities. Analytical work has proven to be a critical tool for project preparation. It helps to identify gaps in specific sectors, inform stakeholders, build consensus around important development issues, and prepare the groundwork for future engagement and dialogue. Previous Bank analytical work provides support for this proposed operation (see Table 3).

4.2 PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

57. **The two pillars that underpin this proposed operation are aligned with the PDO and the MM's overall goal of improving public sector management and the quality and management of its educational system and transport sector.** The pillars are: (i) Strengthened Public Sector and Fiscal Management and (ii) Enhanced Management and Quality of the Education and Transport Sectors. The first pillar includes actions that support the achievement of the PDO by increasing tax collection, strengthening expenditure controls and increasing transparency. The prior actions will foster the institutionalization of transparent and efficient mechanisms for the procurement of goods and services, for controlling personnel expenditures, raising revenues and curbing expenses through a closely monitored action plan. The second pillar includes actions that aim to improve the management and quality of the municipal service delivery in the education and transport sectors. In the area of education, this objective will be achieved through meritocratic selection of school directors, establishment of school-level targets and the creation of minimum standards for school staffing. The expected result is an increase in the proficiency levels of students. Policy actions to be supported in the area of urban transport aim at improving the mobility of passengers in Manaus.

58. **The new administration that took office in January of 2013 is committed to eliminating the financial deficit generated in 2012 by the end of 2016, despite the setbacks faced and the revenue losses brought by the worse economic scenario.** SEMEF is taking the lead in all efforts to rebalance the budget and modernize the Municipal Government, and has been implementing several measures to bring back the municipal budget into equilibrium and eliminate the financial deficit. In order to achieve this goal, SEMEF has introduced modern management techniques, trained staff, and developed action plans that include revenue increasing and expenditure reduction targets and weekly monitoring of indicators. Individuals are held accountable for specific activities, and at this stage no monetary bonus is distributed for reaching targets. The internal control function was strengthened, benchmarking visits to other municipalities were conducted, delayed payments to suppliers were halted and redoubled attention was given to tax arrears and taxpayers in default.

59. **The Municipality partnered with the State Government to modernize its procurement and contract management processes and introduced sector ceilings for the preparation of the 2015 budget.** Higher returns for the municipal cash balances were also sought. Recurrent expenditures were cut as a result of introducing routine payroll audits and a review of eligible social program beneficiaries. In addition, penalties and fines for late payment of public utilities bills in the Municipality were reduced from an average of R\$1.5 million per month to close to zero. Overall, the MM has adopted a pragmatic approach to reform which entails learning from other governments and adopting existing successful systems and procedures in order to save time and financial resources.

Pillar I. Strengthened Public Sector and Fiscal Management

60. **The main objective of this first pillar is to improve public and fiscal management in the Municipality, starting with SEMEF.** The main reforms aim to control expenditures, improve efficiency, savings and transparency in procurement procedures, and increase tax collection.

Improved management of SEMEF

61. **The introduction of modern management techniques at SEMEF has already generated positive results.** In the area of public spending, strong contingency spending was deployed in 2013 and 2014 along with other more structural measures such as a review of the

registry of beneficiaries of social programs and all procurement procedures of the Municipality. An administrative reform was also carried out, which reduced the number of government agencies from 36 to 23. This number was reduced further to 17 in 2014. In addition, the 2015 budget was prepared for the first time with the introduction of ex-ante sector ceilings for budget units.

62. **Due to expenditure arrears and lack of financial backing, the Municipality ended the year of 2012 with a deficit of R\$360 million.** This situation began to be reversed in 2013 as a result of a thorough expenditure review and limits on spending, along with measures to increase revenues. These measures increased revenue by approximately 14 percent in 2013, while at the same time capped spending growth to only 4 percent. In order to achieve fiscal sustainability, the SEMEF prioritized the introduction of modern management tools in public administration. This included the creation of an undersecretary for management for results (*Gestão por Resultados*) in 2013, which developed indicators, targets and action plans, and trained employees in the PDCA (Plan, Do, Check and Act) methodology¹⁶. In total, approximately 30 indicators and targets are monitored. Each target is substantiated by a working plan, and each activity is assigned to an individual, with deadlines. The 20 financial indicators and 10 operational indicators are listed in the legal evidence, and include for example targets for raising own revenue collection (e.g. property tax) and the elimination of fees for late payment of utilities. The Government's intention is to gradually expand this methodology to other secretariats of the MM, thus enhancing its overall capacity to deliver services and meet fiscal targets.

- **Prior Action #1:** The Secretariat of Finance (SEMEF) has adopted a management model following the PDCA methodology, an integrated electronic document management system and monitored the achievement of selected indicators.
- **Results:** Improved management of SEMEF and its fiscal accounts.

Procurement Reforms

63. **The MM is making strides to become more efficient, economical and transparent in its purchases of goods and services.** Good public procurement practices are a major determinant of effective public expenditure and improved development outcomes, through the timely and cost-effective purchase of goods and services (IEG World Bank, 2013). The MM is embarking on a major reform of its public procurement system, which encompasses a complete overhaul of the processes and procedures to plan and implement procurement, manage and monitor contract implementation, and inspect the delivery of goods and services to beneficiaries. This comprehensive program was initiated in March 2014 and is expected to conclude in June 2016. The accelerated pace of reform is made possible because of a close cooperation with the Government of the State of Amazonas.

64. **The administrations of Manaus and Amazonas signed a technical cooperation agreement for the State to transfer knowledge, systems and procedures to the Municipality.** This knowledge transfer is expected to advance the reforms in Manaus by several years. The Municipality is benefiting from information systems already developed and tested by the State, legal documents designed to reengineer processes and procedures, and the vast knowledge accumulated by the State following the recent implementation of its own procurement reform

¹⁶ PDCA is an iterative four-step management method used in business for the control and continuous improvement of processes and products.

program. The MM will also replicate the processes put in place at the State level to plan its purchases and to inspect the delivery of goods and services.

65. **The backbone of the new *Compras Manaus* system is formed broadly by the following elements:** (i) implementation of a transactional electronic procurement system to carry out reverse auctions (*pregão*) for goods and services; (ii) creation of a database of suppliers and a catalogue with specifications of goods and services; (iii) development of framework agreements for goods (*Registro de Preços*); (iv) creation of the central procurement committee (*Comissão Municipal de Licitações* - CML) located at the Secretariat of Administration (*Secretaria de Administração* – SEMAD); (v) creation of a central database of prices for goods and services, maintained by SEMAD; (vi) creation of a committee at SEMAD in charge of standardizing and procuring outsourced services; (vii) creation of the commission for inspection of delivery of goods and services, comprised by SEMAD, the beneficiary agency, and the Controller General (*Controladoria Geral do Município* - CGM); and (viii) implementation of a business intelligence solution to support the monitoring and evaluation of results based on data mining of all above mentioned information systems.

66. **The procurement reform program is expected to generate savings, increase transparency in procurement and accelerate bidding processes.** The main goal of the reform is to generate savings for the Municipality, both in terms of price reductions as well as through efficiency gains. Analysis using data from tax receipts showed that the Municipality pays on average 42-49 percent more than the private sector does for the same goods and services. Comparatively, the State pays on average 22-27 percent more and the Federal Government of Brazil pays on average 14-16 percent more compared to private companies. The Municipality aims to reduce this gap with the State. Manaus spends around R\$1.2 billion/year in the procurement of goods and services and they plan to reduce this amount by 10 percent (or around R\$120 million) by 2016 through a 5 percent reduction on unit prices paid and an additional 5 percent through reducing waste and quantities purchased.

67. **To achieve the goal of R\$120 million savings in its purchases of goods and services, the Municipality is implementing a set of strategies that include consolidating demand, instituting more open and competitive bidding procedures, and reducing waste.** Manaus will implement framework agreements for bulk purchase of high volume and off-the-shelf goods. These framework agreements will be bid centrally by SEMAD and all sector agencies will be required to purchase from these agreements. In addition, the Municipality will use open and competitive electronic reverse auctions as the default method for procurement of goods and services. The use of electronic bidding saves money, both for bidders and for the Government, who benefit from improved competition and better prices. Another important aspect of this reform includes the use of the database of sales tax invoices (*Nota Fiscal do Consumidor Eletrônica* - NFC-e) which will provide better information and benchmarking for the Municipality to budget funds for specific purchases. Finally, Manaus will standardize and centralize the procurement of select outsourced services at SEMAD, thereby minimizing waste and building scale.

68. **To promote greater transparency in public procurement, the Municipality will publish all contract awards on the *Compras Manaus* website and carry out 95 percent of the bidding processes through electronic reverse auction or *pregão*.** Prior to the reform, invitations for bids were published in newspapers and the official gazette and contract awards only in the official gazette. The reform will improve transparency substantially by requiring the disclosure of 100 percent of all contract awards on an easy, publicly accessible website (*compras.manaus.am.gov.br*). In addition, the use of electronic reverse auctions published on the same website is expected to attract more competition for the MM's contracts. Bidding processes will be accelerated through the use of

modern electronic tools to facilitate bidding and speed up internal workflows through the use of digital signature. Timely procurement of inputs necessary for public service delivery is a core measure of success of the procurement function. The MM will be monitoring and measuring the impact of the reform on lead times for bidding processes. Their goal is to carry out electronic reverse auctions in an average of 45 days for contracts of goods and services over R\$8,000.¹⁷

- **Prior Action #2:** The Municipality has implemented an integrated supply management system and processes for procuring goods and services, including electronic bidding and inspection of goods delivery, and adopted the legal framework for binding selected vendors registering prices for the provision of services and goods through the signing of *Ata de Registro de Preços*.
- **Results:** Faster, more transparent and economical procurement, and data collection to inform procurement strategy and policy.

Payroll

69. **In alignment with the objective of structurally improving the Government's finances and management, SEMEF has been addressing three key issues at the Municipality: payroll expenditures, the retirement system for municipal civil servants and tax arrears.** An important source of savings is expected to come from the introduction of routines for auditing the payroll system across all secretariats. The largest municipal expenditures are on payroll and while the total workforce has remained roughly stable, public sector wages have increased in real terms every year since 2008. SEMEF created an Undersecretariat for Internal Control (*Subsecretaria de Controle Interno*) which is responsible for designing the necessary regulations and procedures to routinely conduct payroll audits. With this, the SEMEF will be able to improve the conformity of payments, as well as improve existing control tools to ensure correct payments. SEMEF has started to disclose data on audit findings including the inconsistencies and irregularities found.

70. **The introduction of routine audits of the payroll is supported by knowledge transfer from the Federal Government.** The Controller's Office at the Federal Government has been very successful in introducing this routine and non-conformities have been reduced to a residual number. The Municipality has already carried out the first municipal-wide payroll audit covering the first quarter of 2014. The first findings were released to the governmental agencies and irregularities are being investigated further. The Municipality expects to save around 2 percent of the payroll expenditures (or R\$36.4 million in 2014) after the audit routine is fully implemented.

- **Prior Action #3:** The Municipality has adopted the legal framework for auditing its payroll system and carried out a payroll audit in all of its secretariats.
- **Results:** Promotion of regularity and conformity of personnel expenses.

Retirement System

71. **Like many capital cities in Brazil, Manaus is responsible for the retirement payments of its civil servants.** This is done through a dedicated retirement fund and a specialized Government agency, known as *Manaus Previdência* (MP). This agency was created in 2013 as part of a policy to adjust the finances and improve governance and management of the retirement fund. During the

¹⁷ This period corresponds to the time taken by the CML to prepare bidding documents, advertise the invitation for bids, open and evaluate bids, and award contract(s). The Municipality also aims at implementing small procurement and direct contracting in 10 days on average.

previous administration, the Government agency in charge of managing the retirement plan had the legal status of a private company. A capitalization fund was created in 2006 separating old (financial fund) and new (capitalization fund) civil servants, ensuring fiscal sustainability in the long run, but was never effectively implemented. Therefore, the administrator was using resources from the capitalization fund to pay for benefits of the financial fund, assuming a responsibility that should be borne by the Municipal Treasury. This in turn, created a debt from the Municipal Treasury with the retirement fund. In addition, the fund's administrator lacked a clear and accountable decision making process for investment decisions, which led the fund to incur significant losses in some investments¹⁸.

72. **The MM acted promptly to deal with the financial and management problems encountered at the retirement fund.** It created the new Government agency responsible for administering the retirement plan, with a legal status that was deemed acceptable by the controlling authorities. It implemented the capitalization fund, stopped the use of its resources to pay for the benefits of the financial fund by having the Municipal Treasury paying for the deficit of the financial fund and also recognized the debt between the Municipal Treasury and the retirement fund. This debt is being paid out gradually through monthly payments in an agreement overseen by the MP. Manaus has also instituted a formal process for approving investment allocations with the creation of an investment committee, required its employees to become certified in financial planning by an external organization, and included a third party assessment for the proposed investment. The process is also overseen by the Fiscal Committee and the Municipal Pension Council. With these changes, Manaus acquired the CRP (Pension Conformity Certificate - *Certificado de Regularidade Previdenciária*¹⁹), a certificate issued by an external agency (the Ministry of Pensions) that certifies that the Municipality is in compliance with more than 40 items of the federal legislation for the civil servants pension regime. The CRP also gives some comfort of fiscal sustainability since one of the items assessed is the observance of financial and actuarial equilibrium. The *de facto* implementation of the capitalization fund, the payment of arrears between MP and the municipal Treasury as well as the governance reforms implemented show a clear commitment of the municipality to address the current imbalance and to prevent its reoccurrence in the future.

- **Prior Action #4:** The Municipality has established Manaus Previdência which includes the establishment of clear and accountable rules for investing its resources.
- **Results:** Improved governance of Manaus' retirement system (measured by the acquisition and maintenance of the Pension Conformity Certificate (*Certificado de Regularidade Previdenciária*), without resorting to judicial measures.

Tax Administration

73. **Regarding tax administration, practices in Manaus are catching up with national best practices.** SEMEF is revising its taxpayer cadaster to include all properties and create a multipurpose cadaster. It is revising the tax legislation in order to consolidate and simplify it. New IT systems are being procured. The Secretariat is upgrading its facilities to offer better services for taxpayers, and more importantly is creating several online services for taxpayers and allowing them to contact SEMEF also by phone and internet through call centers and *webchats*.

¹⁸ Formal charges were presented against the previous administrators of the retirement fund after an investigation carried out by the Federal Police found evidence that they were receiving corrupt payments for allocating the fund resources into alternative investment options.

¹⁹ The Municipality obtained the CRP on Nov 30, 2014.

74. **However, part of the weak revenue collection at the municipal level is a reflection of the low priority given to collection of tax arrears.** In fact, the Municipality did not have any structured routine to monitor payments from taxpayers and had very generous options for consolidating tax arrears and becoming compliant again²⁰. In addition, other structural tax administration problems such as a faulty taxpayer cadaster and limited channels for servicing taxpayers are reflected in this poor performance. As a result, the delinquency rate on the tax property stood at 57 percent and the combined rate for all taxes was at 52 percent in 2013. The overall stock of tax arrears was at R\$3.2 billion in 2013, almost 100 percent of that same year's current revenues or four times the amount collected as tax revenues.

75. **As part of a larger reform plan in tax administration, the Municipality has implemented a structured routine to recover tax arrears and reduced the options for payment of arrears on favorable conditions.** SEMEF prioritized the recovery of arrears from large taxpayers and adopted alternative mechanisms for small taxpayers, such as resorting to credit bureaus. It has also formally implemented a procedure to send email and SMS notifications to taxpayers to remind them of the upcoming payment dates as well as to call taxpayers soon after they have missed payments. The tax legislation was also changed to prohibit consolidation of debts from the current year, demand an initial payment of at least 10 percent and limit the number of concurrent consolidations to six.

- **Prior Action #5:** The Municipality has adopted administrative procedures to enable taxpayers to pay their respective tax arrears in instalments and established a system of communicating with taxpayers in arrears through various channels.
- **Results:** Increase in municipal tax compliance rates.

In addition to strengthening management of its finances and other functions such as its procurement procedures, Manaus is implementing improved management practices in crucial sectors such as Education and urban mobility, as well as measures to increase the formalization of economic activity in the City (e.g. moto-taxis, micro-buses, street vendors).

Pillar II. Enhanced Management and Quality of the Education and Transport Sectors

76. **Policy actions to be supported under this pillar aim at improving the quality of the municipal educational system and urban mobility via enhanced management practices.** In education, this objective will be achieved through the meritocratic selection of school directors, the establishment of school-level targets and the creation of minimum standards for school staffing. The expected result is an increase in the proficiency levels of students. To improve urban mobility, Manaus is upgrading its capacity to monitor and control public concessions, and regulating certain transportations, such as microbuses and moto-taxis.

Education Sector

77. **The main objective of the Municipal Secretariat of Education (Secretaria Municipal de Educação e Cultura - SEMED) is to improve the quality of the municipal educational system.** The municipal school system is lagging behind other capital cities according to the results of the Basic Education Development Index (*Índice de Desenvolvimento da Educação Básica* –

²⁰ The previous tax legislation allowed taxpayers in arrears to negotiate several and concurrent payment plans for the unpaid taxes.

IDEA).²¹ Although the IDEB has improved in the early primary education –from 3.5 in 2005 to 4.6 in 2013– and for upper primary education from 2.6 in 2005 to 3.4 in 2013, Manaus remained as the 20th ranked capital of Brazil (out of 27). The objective of the SEMED is to achieve the 10th position in the IDEB performance in 2015. Since there is evidence that improvements in school management lead to improvements in students’ proficiency, the expected long-term result of this policy is the improvement in IDEB scores of Manaus’ municipal schools (Bloom et al, 2014).

78. **Age-grade distortion, repetition and dropout rates are also high.** The primary education age-grade distortion is the fourth worst among the state capitals in Brazil, at 34.2 percent in 2013. The repetition rate of 11.8 percent is the highest and significantly different from the Northern Region average of 7.1 percent in the same year (2013). At this same education level, the dropout rate of 4.6 percent in 2013 was higher than other Northern state capitals such as Belém (3.3 percent) and Palmas (0.5 percent). The main challenges identified in schools were lack of teachers, inadequate infrastructure, excess enrolment and low quality of teachers’ education.

79. **SEMED is implementing a new Integrated School Management (*Gestão Integrada da Escola - GIDE*) model.** This reform has already been implemented in other educational systems that have significantly improved the proficiency levels of its students, such as Minas Gerais, Rio de Janeiro, Pernambuco and Ceará²². GIDE's methodology is based on the method of Management for Results and PDCA. SEMED and regional directors were trained on how to use an online monitoring system that has clear targets for schools, and on how to find objective solutions when challenges are identified. Two pedagogical activities were redesigned: (i) the bimonthly student assessments (*Avaliação de Desempenho Individual - ADI*); and (ii) the definition of the Core Curriculum for the elementary school, which is reviewed every two months. Management contracts have also been signed by the school directors with SEMED to increase accountability. This model is aligned with two policies implemented in 2012: the Secretariat’s and schools’ targets plan, and the school-level bonus pay program to achieve IDEB targets. The latter incentive mechanism provides one or two extra salaries for all staff members of schools that reach the IDEB targets at the end of the year.

- **Prior Action #6:** The Municipality, through the Education Secretariat (SEMED), has implemented an integrated school management model, including the establishment of school-level targets and pedagogical planning.²³
- **Results:** Improvement in school management capacity.

80. **SEMED aims to strengthen the management of municipal schools through an accreditation process of teachers as potential school directors and a new merit-based selection of school directors.** Currently, school directors with little experience in management are politically appointed to the position. The SEMED team understands that a more technical and transparent approach is needed for a more effective selection of key school administrators. The accreditation process will be carried out in four stages: (i) through an exam testing school management knowledge; (ii) an analysis of professional experience; (iii) an assessment of education achievement; and (iv) an appraisal interview of managerial profile. Two consulting firms have been hired to coordinate the general accreditation process and carry out the appraisal interview of managerial profile. The

²¹ IDEB is the national quality-driven basic education development index of education. It is measured every two years, in a scale that varies from 0 to 10.

²² Vieira (2007) discusses the effect of GIDE in the education system of the State of Ceará.

²³ The school targets include 6 indicators related to school environment, 10 indicators of teaching quality, and 8 indicators of students’ achievement.

interview methodology will use the KSA tool (knowledge, skills and attitudes), which is widely used in the private sector. SEMED intends to appoint the school directors in a transparent manner, based on their performance in the accreditation process. Appointed school directors will be nominated by the Secretary for a three-year period contract, renewable for another three years. If the appointed directors do not achieve the IDEB targets, they can be replaced by other certified teachers.

- **Prior Action #7:** The Municipality, through the Education Secretariat (SEMED), has implemented a certification program on school management skills for school directors and adopted a meritocratic selection process for school directors.
- **Results:** Improvement in school directors' management skills (measured by the number of schools with directors selected through meritocratic process).

81. **Additionally, SEMED is defining clear and objective rules for the allocation of school staff to support the continuity of pedagogical programs.** To this end, SEMED created a minimum standard framework for the composition of school staff of *crèches*, municipal early childhood education centers (*Centro Municipal de Educação Infantil - CMEI*), and early grades of primary education. The number of staff was set in a transparent manner, taking into account the number of classrooms in schools. The number of teachers assigned for *crèches* is double. Also, the standard defines the number of teachers for each subject. This policy not only lays down rules that prevent an inefficient allocation of teachers and support staff in schools, but also allows parents and the controlling institutions to monitor and check the compliance with the standard allocation. If these standards are not followed, the local Public Prosecutor Office can issue notifications and impose fines on SEMED. This policy is associated with a school-based management reform because it establishes a more accountable system and empowers the community to play a larger role in school decisions²⁴.

- **Prior Action #8:** The Municipality, through the Education Secretariat (SEMED), has established the procedures and criteria for appointment and relocation of public servants serving SEMED.
- **Results:** Improved allocation of SEMED's public servants through the observation of the minimum standard framework (measured by the number of schools complying with the minimum standard framework).

Urban Restoration and Transport Sector

82. **The Municipality has created a Secretariat (*Secretaria do Centro - SEMC*) to coordinate all efforts to rejuvenate Manaus' city center.** The strategy of this Secretariat is to create a business-friendly environment at the city center, to attract and maintain private investment reconciling at the same time these investments with the preservation of historical and cultural landmarks. This strategy is aligned with the idea that it is more cost-efficient to rejuvenate central areas of a city, attracting people back to it than to expand the urban footprint, especially in a city surrounded by a preserved ecosystem. Together with the recovery of degraded public areas in the city center, the transfer of street vendors to formal commerce areas is one of the cornerstone policies of SEMC. The streets of the city center of Manaus were taken by vendors, preventing the circulation of pedestrians, harming formal retail shops and contributing for urban disorder. Moreover, informal street vendors worked in a vulnerable situation.

²⁴ Patrinos, Harry (2007). What Is School-Based Management? World Bank Report.

83. **The Municipality adopted an innovative policy to relocate and integrate street vendors into the formal sector of the economy.** SEMC started out by mapping the main areas occupied by street vendors, and conducted a census of this population: 45.4 percent are women and 48 percent had gross monthly income of less than 1.5 times the minimum wage. SEMC's policy approach is based on a tripod of urban upgrading, social inclusion and income generation. Street vendors were taken off the streets and relocated to temporary spaces, while at the same time empty historical buildings were identified and refurbished into shopping malls to host the vendors. In order to generate pedestrian traffic, public service outlets were also relocated to these shopping malls. While the buildings were being renovated, street vendors underwent training on entrepreneurship and were registered under the category of Individual Micro Entrepreneurs (*Micro Empreendedor Individual* - MEI). The Municipality also extended loans on preferential terms to vendors. The process of relocation was a voluntary one, following consultations with all those involved.

- **Prior Action #9:** The Municipality has adopted an integrated urban regeneration policy for the city center, including licensing, retraining and relocating street vendors to selected venues.
- **Results:** The upgrading of Manaus' city center.

84. **Manaus has undergone major demographic growth and urban expansion in recent years, which has generated excess demand for public transportation.** Presently, the fleet of 1,620 buses, distributed in 244 bus lines, often follow similar routes in a radial system, in which most of the lines start or end at downtown Manaus. Poor urban planning is also reflected in the absence of planning of new bus lines to meet this growing demand. The bus system is organized through public concessions to ten private operators, and is funded by fare revenues paid by users and partly by the Municipality that subsidizes exemptions for the elderly and students. Part of the Municipality's challenge is to properly monitor the operation and quality of its concessions; for example, overcrowding of buses is common and trips are not always completed. Urban mobility is also challenged by a growing number of motorbikes and cars, which increased 382 and 142 percent, respectively from 2001 to 2011. Consequently, traffic congestion is constant and the average speed of the collective transportation system is 12 kilometers per hour, leading to long commuting times for lower-income residents (who rely on the public transport system).

85. **The Municipality is implementing policies and investments to improve public transport accessibility.** These measures are designed to improve bus flow, reduce travel time and decrease average bus occupancy. Infrastructure interventions include the construction of integrated terminals connecting low capacity bus lines with higher capacity BRT (Bus Rapid Transit²⁵) lines operating along the North-South and East-West corridors²⁶. Moreover, the Municipality is implementing upgrading traffic lights' coordination and interaction with the bus system operation in order to prioritize bus movement around Manaus. This is accomplished through the implementation of a new traffic command and control center designed to strengthen the management of public transportation by increasing information and interaction with individual

²⁵ BRT is a public transport system typically using high capacity articulated buses, with intermediary stations for boarding, disembarking and ticketing, running in segregate lanes, apart from the general traffic.

²⁶ The North and East corridors are the backbone of a trunk-feeder transport system, in which low capacity feeding routes connect to high capacity BRT corridors and provide balanced level of service such as speed, comfort and waiting times to the users.

buses which will allow for intelligent traffic coordination. For instance, the Municipality will be able to monitor the length and the number of trips completed, among other key variables.

86. **These policies and investments are being consolidated as a part of a City Mobility Plan**, which is expected to become a City Law by 2016. The Mobility Plan contains the guidelines and related (physical, operational, institutional) measures which must be implemented at short, mid and long-run to meet transport demand growth and increase service efficiency.

87. **Since 2013, the MM has also pursued policies aimed at promoting cost sustainability, economic regulation and inclusion of informal transport services.** In order to improve public transport services, the Municipality has implemented policies to enhance and upgrade bus services coordination and effectiveness of services rendered by the bus companies. The objective of this activity is to promote integrated management of the bus services and monitor the implementation of contracted services, providing information for a clearing system²⁷ (*câmara de compensação tarifária*), which balances costs of services rendered, revenues and gratuities established by law. Components under this activity include the adoption of a formal agreement between bus companies to implement a management facility, which tracks bus services in real-time, curbs delays and non-conformities and balances revenues and remuneration. This central operational control facility oversees the services of ten bus operators through an advanced computerized system. The technical solution adopts a state-of-the-art technology which is used by Curitiba, the city in Brazil known as world-wide pioneer in urban development.

88. **Moreover, the Municipality is implementing policies to increase public control over informal services provided to the low-income population.** The objectives of these policies is to improve the mobility of the population in areas where access to transportation services are more limited, while also increasing quality of the service through strengthening control over vehicle maintenance and driver ability. Specific interventions include formalizing other public transport services by awarding municipal service provider permits to 200 minibuses and 3,303 moto-taxis through a public bidding process. These regulatory measures will establish formal control over vehicles and transport workforce, which will permit further control on vehicle quality, workforce accreditation and pollutant and noise emission.

- **Prior Action #10:** The Municipality has adopted processes for managing the concession of bus services in the Municipality’s territory (including real-time tracking and control of the bus fleet) and policies to license selected public transport in selected areas of the Municipality’s territory.
- **Results:** Increased service compliance and control of bus concessions and mototaxi services.

Table 3: DPL Prior Actions and Analytical Underpinnings

Prior Actions	Analytical Underpinnings
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²⁷ It involves the use of a clearing house which collects revenues, accounts and compensates unbalanced performance among the bus operators. In Manaus, operators carry out contracted services at rates varying from 98.5 to 100 percent. Under that procedure, the underperforming companies must pay compensations corresponding to incomplete service in order to stimulate schedule compliance.

Pillar I: Strengthened Public Sector and Fiscal Management	
Prior Action 1: Improved management of the Secretariat of Finance (SEMEF)	Viñuela and Zoratto (2013). "Performance Gains in Results-Based Management in Brazil". World Bank. <i>This piece describes the experiences of states in adopting performance-based management to improve outcomes in service delivery. Results suggest that the implementation of team level results agreements and performance-related pay is associated with significant and positive changes in outcomes in the education and security sectors (and less so in the health sector).</i>
Prior Action 2 and 3: Implementation of an integrated supply management system and framework agreements	<p>Tridapalli, Juarez P. <i>et al.</i> "Gestão da cadeia de suprimento do setor público: uma alternativa para controle de gastos correntes no Brasil." <i>Revista de Administração Pública – RAP</i>, March-April 2011: 401-433. Print. <i>This article presents the results of research that highlights the importance of a strategic approach to the entire governmental supply chain (from planning to inventory and asset management) as a way to increase operational efficiency, reduce costs and generate savings. It also shows that the uses of electronic systems are fundamental enablers of an effective integrated supply management framework.</i></p> <p>Faria, Evandro R. <i>et al.</i> (2008) "Estudo Comparativo de Redução de Custos e Tempo nas Modalidades de Licitação por Pregão Eletrônico e Presencial." <i>This paper presents the conclusions of research that shows that electronic reverse auction is faster and more cost-efficient than its equivalent offline version.</i></p> <p>Moreira Silva, Alessandro (2013). "Improvement in Public Procurement Management Process with an Emphasis on the Effectiveness of Planning and Execution." Amazonas Government Technical Note. <i>This technical note details the problems the GoAM faces with their current procurement framework and their progress in establishing a price registration allowing to plan and implement public bidding process more efficiently and transparently.</i></p> <p>World Bank (2013). "The World Bank and Public Procurement." Independent Evaluation Group Report. <i>This IEG report emphasizes the importance of good public procurement as a major determinant of effective public expenditure and, in turn, for development outcomes</i></p> <p>McKinsey (2009) "Improving public sector purchasing." <i>McKinsey on Government</i>, Summer 2009: 18-25.</p> <p>UK Government Cabinet Office (2013). "Efficiency and Reform 2012/13 summary report". Efficiency and Reform Group report (ERG). <i>These pieces argue that a strategic approach to procurement of high volume items can unlock savings, streamline processes and strengthen purchasing organizations. Particularly in the case of the UK, £ 3.8 billion in savings were achieved by the Government through a strategic approach to procurement that relied heavily on framework agreements and centralized purchasing of bulk items.</i></p>
Prior Action 4: Establishment of a management unit for municipal employee pension	Implementation and Completion Results Report for the State System Pension Reform Technical Assistance Project II (2012) – Report No. ICR-2225 Rofman, Apella and Vezza (2013). <i>Más allá de las Pensiones Contributivas en América Latina.</i> World Bank.
Prior Action 5: Implementation of new procedures for collection of overdue taxes, communication system, and payment installment criteria	Reform Priorities for Subnational Revenues in Brazil. (Ter-Minassian, T., Inter-American Development Bank Policy Brief IDB-PB-157, 2012). Handbook on Best Practices on Tax Expenditures Measurement (CIAT 2011)
Pillar II: Enhanced Management and Quality of the Education and Transport Sectors	
Prior Action 6: Implementation of new GIDE model	<p>Vieira, S. L. (2007). <i>Gestão, avaliação e sucesso escolar: recortes da trajetória cearense. estudos avançados</i>, 21(60), 45-60.</p> <p>Bruns, Evans and Luque (2011). <i>Achieving World-Class Education in Brazil.</i> World Bank report.</p> <p>Viñuela and Zoratto (2013). "Performance Gains in Results-Based Management in Brazil". World Bank report.</p> <p>Patrinos, Harry (2007). <i>What Is School-Based Management? The World Bank report</i> <i>These pieces describe the experiences of Brazilian states in implementing result-based management reforms that improve education outcomes. These sources indicate that the</i></p>

	<i>establishment of results agreements and school-level bonus pay program is associated with significant and positive changes in education indicators.</i>
Prior Action 7 and 8: Implementation of certification program and meritocratic selection for school directors and Establishment of Minimum Standard Framework for appointment and dismissal of faculty and staff	Bruns, Filmer and Patrinos (2011). “Making schools work: New evidence on accountability reforms”. World Bank (2011). <i>In this piece the authors outline how school-based management reforms can contribute to promoting greater accountability and improving results within the education system, such as through empowering parents to play a larger role in school decisions. These reforms can also increase schools’ autonomy to make key management reforms and implement new pedagogical policies.</i> <i>Bloom, Lemos, Sadun, and Reenen (2014)</i> ”Does management matter in schools? Working paper. <i>This study found a strong and significant correlation between school directors managerial capacity and learning outcomes.</i>
Prior Action 9: Implementation of an integrated urban regeneration policy for the City Center	“Cities and Social Equity – Detailed Report.” Urban Age Programme, The London School of Economics. (2009). “Mobility for Development – Sao Paulo, Brazil.” Engenharia de Tráfego e de Transportes Ltda., Conselho Empresarial Brasileiro para o Desenvolvimento Sustentável, and World Business Council for Sustainable Development.
Prior Actions 10: Implementation new processes for management of urban transport and formalization of mototaxis and others	<i>These pieces, which both focus on aspects of urban development in Sao Paulo, found that investments in urban regeneration, enhanced management of urban transport as well as adoption of policies that promote optimal traffic flows can help improve efficiency in transportation, increase security and safety, and impact justice and equity in urban areas.</i>

4.3 LINK TO CPS, OTHER BANK OPERATIONS AND THE WBG STRATEGY

89. **The proposed DPL operation is fully consistent and closely aligned with the objectives of the World Bank Group’s Country Partnership Strategy (CPS) for Brazil for the period 2012-2015 (Report No. 63731-BR) discussed by the Executive Directors on November 1, 2011.** The strategy is focused on second-generation development problems that require innovative solutions in terms of improving national policy frameworks and finding ways to implement programs with sub-national governments. This is one of several DPLs and Sector-Wide Approaches (SWAp) designed to strengthen public sector management and service delivery as an integral part of the Bank’s CPS for Brazil.

90. **The PDO and the policy focus of the operation are hence closely aligned with the strategic objectives of:** (i) increasing the efficiency of public and private investments, thus boosting growth capacity with job and income generation, and (ii) improving the quality of public services for low income households and expand their provision through public and private channels. Within the first strategic objective, this operation is directly linked with several results areas, including reducing taxpayer’s default rates, increasing the quality of expenditures, and promoting modern performance management techniques. The operation directly supports the second strategic objective through its focus on inclusive development, with special consideration to the formalization of informal street vendors and the upgrade of quality of municipal schools.

91. **This is the first engagement of the Bank with the Municipality of Manaus and results from the recent dialogue with the State of Amazonas.** The Bank so far has had a limited but growing engagement with the State of Amazonas, of which Manaus is the capital city. In May 2014, the Board approved the first loan operation to the State of Amazonas, the *Modernizing*

Public Sector Management, Citizen Security and Gender Policies DPL (P147979). Part of the reforms now being carried out by Manaus are the result of a partnership with the State Government, which is transferring knowledge and systems to Manaus, notably for the procurement of goods and services. Prior to that, the *Alto Solimões Basic Services and Sustainable Development Project* (P083997) was approved in 2008 and involved institutional strengthening for regional development, sustainable production, and water and sanitation in the region of *Alto Solimões*.

92. **In recent years, the Bank has increased its engagement with municipalities in Brazil** focusing on policy initiatives similar to those supported in this proposed DPL, such as through the *Upgrading and Greening the Rio de Janeiro Urban Rail System Additional Financing* (P125630) approved in January 2012, *the Recife SWAp Education and Public Management* (P126372) approved in May 2012, *the Belo Horizonte Urban DPL* (P126749) approved in June 2013, and the pipeline *Fortaleza Sustainable Urban Development Project* (P153012). These operations support diverse reforms including the adoption of results-based management and improvements to the civil servant retirement system to ensure long-term fiscal sustainability as well as the establishment of single access points for delivery of municipal services, the strengthening of transportation safety, and the restoration of degraded urban areas.

4.4 CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

Consultations and Citizen Engagement

93. **Policy reforms under this DPL have been discussed within Municipal Councils and answer to feedback provided by Manaus' citizens.** In compliance with the Access to Information Law (Federal Law 12,527/2011), in 2013, Manaus has revamped Municipal Councils and the City's Ombudsman Office. Additionally, the Municipal Secretariat of Communication has expanded the use of several social media (Facebook, Twitter, Instagram, Soundcloud, and website) to obtain citizens' feedback and increase transparency and accountability of its actions. In the first year of operation, the Ombudsman Office received 3,274 people, including 1,644 complaints. In 2014, the office received 8,075 people, who filed 1,075 complaints. The Ombudsman Office has twenty days to reply. The office operates with 32 servants and makes yearly reports available to the public. As of January 2015, the Manaus' Facebook page is second only to Curitiba (among the state capitals) in number of followers, which rose from 7,359 in 2012 up to 192,926 in early 2015. The number of followers at Twitter rose from 11,808 in 2012 up to 24,500 in January 2015; at Instagram, there were 989 followers in 2013 and now there are 3,405. Finally, at SoundCloud, there were 592 podcasts (with total plays reaching 15,594) in 2013 and these figures went up to 1,264 and 69,863, respectively, in 2014.

94. **Moreover, the MM has been upgrading its points of contacts with citizens via internet, call centers and service stations.** Citizens of Manaus have access to 150 online services through the Municipality's WebPortal²⁸. A Call Center with *WebChat* is also available in addition to several service stations (PAC, "*Pronto Atendimento ao Cidadão*") spread across Manaus.

95. **These changes were implemented in addition to the PPA elaboration process.** As an integral part of the PPA preparation process, the MM conducted consultations with the local population to present program proposals and collect feedback from the public. Every year in September the MM holds public meetings over the period of a week, including first readings on

²⁸ <http://semefatende.manaus.am.gov.br>

the budget and then public hearings to promote citizen participation in drafting the budget proposal for the coming year. These meetings are widely announced through print and radio media two weeks prior to the consultations. For the social sectors - health, education and social assistance – consultations are carried out by the Municipal Councils responsible for these programs. On average 400 people participate in these annual public consultations.

Collaboration with Other Development Partners

96. **This operation is not being carried out in partnership with other development partners.** The IADB is supporting the MM through an investment lending operation to SEMED, aiming at building new schools to substitute the currently rented buildings.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

97. **Distributional impacts of the prior actions have been considered in the scope of a Poverty and Social Impact Analysis (PSIA).** The Bank carried out a desk review of census data and other secondary sources as well as primary consultations with key stakeholders – including: representative organizations of school teachers and principals, street vendors and commercial associations, civil servants unions and retirees, representatives of users, providers and regulating agencies of public transportation in Manaus. These consultations focused on their views of the policies proposed to be supported by this operation, aiming to understand how they will affect different social groups as well as to assess the potential distributional impacts (in the short, medium, and long-term) that these policies may cause. The meetings have been held in the period of January 13-16, 2015. A full report of the PSIA is included in the project files. Its main conclusions are summarized below.

98. **Overall the policy changes supported by this operation are expected to have positive impacts for the Manauara society and particularly the low-income population.** Improved public management through a results-based approach may benefit society by increasing efficiency and the value-for-money of public services, enhancing accountability and transparency, reducing risks of collusion and corruption, rendering public biddings more attractive for local small and medium enterprises and, consequently, contributing for an enabling business environment and private sector-led growth. Better delivery of public services, such as education and public transport supported under this operation, may have the most positive impact upon the poor, because they are the ones that most rely on public services in the most diverse sectors to carry out their lives. A strengthened public pension management increases trust and provides incentives for better performance among public servants (who count for more than 30,000 people) insofar as ensures their labor rights as well as the wellbeing of the elderly and their families are protected. As a requisite for ensuring the maintenance of the transference of federal funds to the Municipality, improvements in the public pension system are also a pre-condition for providing and ameliorating public service delivery.

99. **Policy changes supported on the education, urban upgrading and urban mobility sectors are expected to have direct and positive pro-poor impacts.** As evidenced by outcomes achieved in other Brazilian states, the introduction of policies related with results-based school management may contribute to improve the quality of education provided by the municipal schools where most of the children enrolled come from low-income families (among the children living in families at the bottom quintile of *per capita* income up to 95 percent are enrolled in public schools). In the short and medium-term, these poor children will benefit through better learning, access to

knowledge and enhanced endowments. In a society in which school attainment has a huge influence on economic activity and earnings, these poor children will benefit at the medium and long-term from more opportunities at the formal job market and get out of chronic poverty.

100. **The rationalization of operation of the bus transport system in the Municipality of Manaus benefits the low-income population the most.** Low income people are the majority of the users of this modal of transportation. Positive impacts are expected because the policy contributes to reduce commuting time, to improve coverage on under-served areas as well as to increase comfort, accessibility and affordability. Broader and more general environmental and social co-benefits (GHG emissions may be reduced and may have positive effects on health conditions in Manaus) are also expected from the rationalization and increased efficiency of the bus transport modal.

101. **Street vendors (of whom women count for 45.4 percent) get the most benefits from the prior action related with their relocation, retraining and formalization.** These benefits are achieved through improved access to social protection and retirement policies, enhanced skills and access to credit lines, safer and healthier working places, heightened social status and self-esteem. Other stakeholders – formal shopkeepers and merchants as well as owners of premises located at the city center – will also benefit from this policy. The commercial enterprises already reported growths in their sales during the holiday season, because more consumers have visited the revamped and safer central areas. From the perspective of urban managers, the policy is one critical step to recover the touristic potential of the historical center of Manaus, to protect the historical and cultural heritage, and to create a business environment more conducive to attract and keep investments.

102. **Income in Manaus is strongly related to school attainment, formalization, gender, and ethnicity.** Thus, the average earning of individuals with undergraduate degrees (R\$4,372) equals 5.3 times the average earning of people without school education or incomplete fundamental education (R\$822). Urban dwellers earn 3.3 times the wages of rural dwellers. Laborers with formal jobs earn in average 51.9 percent more than laborers in the informal labor market. Women's average earnings correspond to 70.9 percent of their male counterparts. The graph below shows the gaps in average earnings by self-ascribed skin color. School attainment is strongly correlated with ethnicity Indigenous peoples and people from Afro-descent origins are overrepresented among the lower levels of school attainment.

103. **Access to some basic services is a major issue in Manaus.** Over 10 percent of the population lives in households which lack access to sanitation and water and have children who are not enrolled in school. Inadequate water and sanitation is a major issue, with almost 20 percent of the population deprived in the former and 40 percent deprived in the latter. The moderate poor have less access to services than any other income group, including the extreme poor people. Up to 49 percent of the moderate poor have no access to sanitation and less than 20 percent of them have attained secondary education. Meanwhile the extreme poor people face the severest hurdles in the labor market with high levels of unemployment (74 percent) and informality (89 percent). Thus, while access to services should be expanded especially to the moderate poor, facilitating a more permanent inclusion of the extreme poor in labor markets is crucial to tackling poverty in the city.

Figure 9 – Comparative average earnings

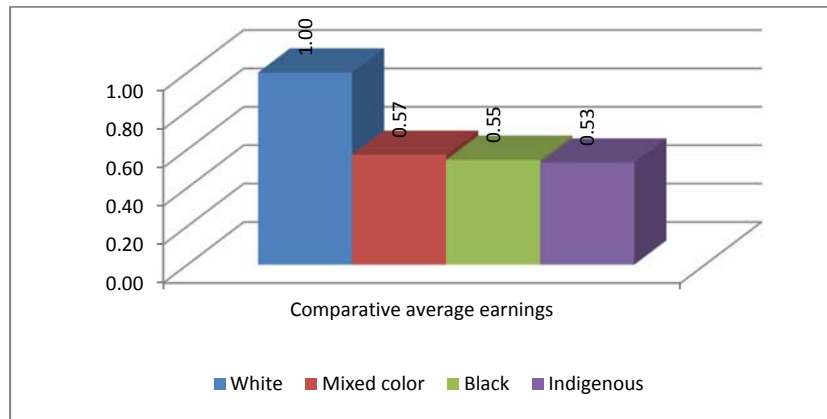
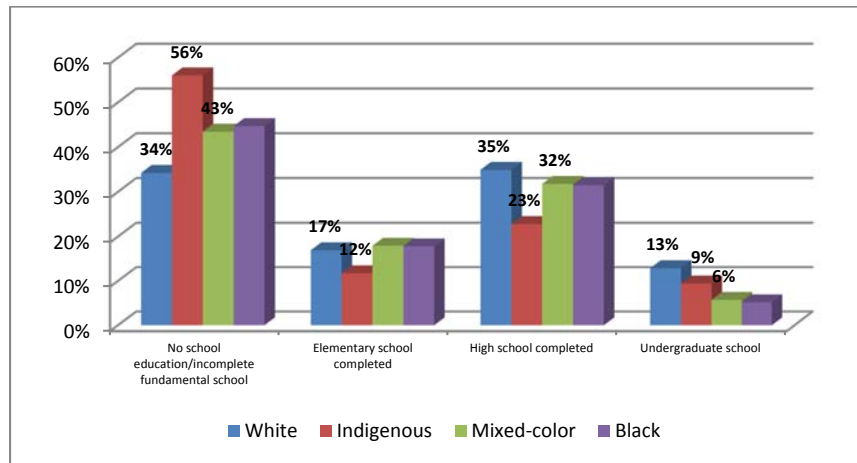


Figure 10 –School Attainment by ethnicity, Manaus (2010)



Source: Municipality of Manaus, National Treasury Secretariat and WB Calculations

5.2 ENVIRONMENTAL ASPECTS

104. **The policy reforms supported by the prior actions of this operation are expected to have positive effects on Manaus’ environment, forest, and other natural resources.** Prior actions under the first pillar, Strengthened Public Sector and Fiscal Management, will help to increase tax collection, strengthen expenditure controls and increase transparency. These objectives could potentially free up resources and improve the institutional management that might have positive spillovers on the environmental management. The education-related prior actions under the second pillar, Enhanced Management and Quality of the Education and Transport Sectors, will have no impact on the environment, forests, and natural resources. Prior actions related to transport and urban mobility will improve the coordination, traffic and control of public transportation, reduce travel time and increase control of vehicle maintenance. These prior actions can generate environmentally- friendly effects through the potential reduction of emissions and pollution. Table 4 summarizes these potential effects.

Table 4 - Analysis of Environmental Aspects

<i>Prior Actions</i>	<i>Environmental Effects</i>		
	<i>Positive</i>	<i>Negative</i>	<i>Neutral</i>
Improved management of the Secretariat of Finance (SEMEF)	X		
Implementation of an integrated supply management systems and framework agreements for procuring goods and services	X		
Payroll audits	X		
Establishment of Manaus Previdência	X		
Implementation of new procedures for collection of overdue taxes and improved communication with taxpayers in arrears	X		
Implementation of an integrated school management model including school-level targets and pedagogical planning			X
Implementation of certification program and meritocratic selection for school directors			X
Establishment of a minimum standard framework for the appointment and relocation of civil servants of the Education Secretariat (SEMED)			X
Adoption of an integrated urban regeneration policy for the city center including licensing, retraining and relocating street vendors to selected venues	X		
Implementation of new processes for management of urban transport and formalization selected transport providers	X		

5.3 FIDUCIARY, DISBURSEMENT AND AUDITING ASPECTS

105. **The Constitution of the Federative Republic of Brazil and a well-developed legal framework underpin the management of public finances at all levels of government.** Recently the Federal and Subnational Governments have embarked on an initiative to adopt international public sector accounting standards (IPSAS). This reform is not only intended to improve financial reporting and accountability at all levels in Brazil, but also the quality and relevance of financial information available for decisions making by public sector managers. This would enhance transparency and accountability in the management of public resources.

106. **The public financial management (PFM) system of the Municipality of Manaus features strong internal rules and controls and a clear definition of responsibilities and institutional arrangements.** There is generally a high level of transparency with respect to financial information in Brazil. This is made possible through the use of the internet and other public media channels to disseminate information on plans and budgets, regular financial reports and annual financial statements. The obligations relating to the preparation of these annual financial statements

are clearly described in relevant laws and regulations, and the Municipality's internal controls generally ensure that these are adhered to.

107. **The internal audit function is carried out by the internal audit department of the Municipality (*Subsecretaria de Controle Interno*).** The department (with approximately 26 staff members) is split into two separate units, with each unit assigned responsibility for specific secretaries of the Municipality, with a set frequency/schedule of review. Its strategic plan includes actions that are aimed at developing its capacity to ensure continuing adequacy of its internal control environment and to contribute to the efficiency and effectiveness of public expenditures in the Municipality.

108. **The TCE/AM is constitutionally mandated to audit all municipal resources.** However, it faces some challenges in meeting this responsibility. It has a limited number of staff, and its methodologies need to be strengthened and modernized. The TCE/AM's strategy for improvement and strengthening its capacity is documented in the Plano Estrategico for 2012-2016. The key actions in the strategy include the modernization of its methodologies and its processes.

109. **The control environment governing the Central Bank's operations within which the loan's foreign exchange would flow continue to be adequate.** This conclusion is based on reviews undertaken by both the IMF and the World Bank. The IMF's Safeguards Assessment of the Central Bank of Brazil concluded that it does not present any widespread vulnerability that could compromise the safeguarding of Fund resources. The Bank also undertook a review of the financial statements of the Central Bank to assess the extent to which the foreign exchange control environment continued to be adequate. The Bank examined the audited financial statements for the years ended December 31, 2006 to 2014, and a report of the independent audit carried out by an international firm of auditors. The latter contained an unqualified opinion on the financial statements for all years.

110. **The proceeds of the loan will be disbursed against satisfactory implementation of the Development Policy lending program and will not be tied to any specific purchases.** Once effective, disbursements of the loan will be made by the World Bank into an account maintained by the Municipality at the Banco do Brasil, a commercial bank, deemed an acceptable financial institution to the World Bank as it is: (i) financially sound; (ii) authorized to maintain the account in the currency agreed between the World Bank and the Municipality; (iii) audited regularly, and has received satisfactory audit reports; (iv) able to execute a large number of transactions promptly; (v) able to perform a wide range of banking services satisfactorily; (vi) able to provide a detailed statement of the account; (vii) part of a satisfactory correspondent banking network; and (viii) charging reasonable fees for its services. The account will be denominated in foreign currency and will not form part of the country's foreign exchange reserves. However, the Central Bank will be informed of the deposit of this amount. The Municipality will ensure that upon the deposit of the loan proceeds into said account, an equivalent amount will be credited in the Municipality's budget management system. The Municipality will provide a confirmation to the Bank that: (i) the loan proceeds were received into the foreign currency denominated account, and (ii) an equivalent amount was credited to the account that finances budgeted expenditures. Such a confirmation will be sent to the Bank within 30 days after payment. If the proceeds of the loan are used for ineligible purposes as defined in the Loan Agreement, the Bank would require the Municipality to refund the amount. Due to the conclusions related to the adequacy of the Municipality's PFM environment, no additional fiduciary arrangements will be required.

Procurement

111. **As is the case for all subnational governments in Brazil, procurement in the MM follows federal laws for bidding procedures.** These include procurement methods, implementation procedures, thresholds, and contract provisions. Municipal legislation mainly regulates operational procedures and sets up the workings of the municipal system. A detailed review of the federal procurement legal framework can be found at the report “Assessment of the Procurement Systems of the Brazilian Federal Government and the Brazilian State of São Paulo” published in December 2010 by the procurement team in the Latin America and Caribbean Region.

112. **Procurement of goods and services in the MM is centralized at the CML.** The CML is responsible, among others, for advertising bidding processes, receiving, opening and evaluating bids, preparing a recommendation of award and publishing the award decision. Small purchases -below R\$8,000- are carried out by line secretariats. The MM carries out live reverse auctions, or “*pregão presencial*”, for the procurement of off-the-shelf goods and non-consulting services. With the reform, reverse auctions will be carried out electronically and rely on digital signature for a full online and more transparent process. The MM uses framework agreements, or “*atas de registro de preço*”, for high volume items that fit bulk-purchasing. The reform will make framework agreements a strategic process with better cost-efficiency results by centralizing its design and management at SEMAD. Procurement of common non-consulting services, such as cleaning and security services will follow standardized specifications and reference prices prepared by SEMAD. Procurement of works is done by the Municipal Secretariat for Infrastructure (*Secretaria Municipal de Infraestrutura - SEMINF*) and they follow procedures of federal procurement laws.

5.4 MONITORING, EVALUATION AND ACCOUNTABILITY

113. **The M&E of this operation will combine impact evaluation elements and monitoring of system-generated indicators when possible.** SEMEF will be responsible for the consolidation of information necessary to monitor the progress of the program, and will keep the Bank informed on the main achievements. For that purpose, it will coordinate with the other governmental entities involved in the implementation of policies supported under this operation, such as Manaus’ SEMED, SEMAD, Secretariat of Traffic (*Manaustrans*), SEMC, Urban Planning Institute (*Instituto Municipal de Planejamento Urbano*) and the Secretariat of Transport (*Secretaria de Transportes*).

114. **The progress of the program will mainly be monitored through outcome and/or results indicators linked to each of the prior actions** (see Annex 1). Data will be collected, whenever possible, from new systems that the Municipality is putting in place, such as the new procurement systems. The Bank will carry out continuous implementation support to monitor and document the progress towards the established results indicators. After closing of the operation, the MM, through SEMEF, and the Bank will each prepare a project completion report, which will describe the results accomplished and impacts achieved by the operation and report on the status of the results indicators described in the policy and results matrix in Annex 1.

115. **The Municipality is also currently working with the Bank team in the design of an Impact Evaluation that will seek to measure effect of the procurement reforms on savings, timeliness, and transparency of procurement.** The evaluation will be designed during project preparation and interventions will be executed during DPL implementation. Such an intervention would help establish the causal effects of the procurement reforms.

116. **Grievance Redress.** Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns.

117. **Affected communities and individuals may submit their complaint to the Bank's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of Bank non-compliance with its policies and procedures.** Complaints may be submitted at any time after concerns have been brought directly to the Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the Bank's GRS, please visit <http://www.worldbank.org/GRS>. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

6. SUMMARY OF RISKS AND MITIGATION

118. **Overall risk.** Based on the assessment of the different risk categories, the proposed operation is considered to have an overall Moderate risk.

119. **Political and governance.** Given that the program is widely supported among the Government and the participating entities, the political context for the operation is favorable. The upcoming elections are in October 2016 and the new administration takes office in January 2017 by which time reforms will have been implemented and results measured. Indicator targets will be measured by December 2016. Consequently, no major issues regarding the implementation of the policies supported under this operation are expected to occur. While there are no specific local governance risks, at the national level the ongoing political and governance crisis around *Petrobras* may contribute to macroeconomic risks.

120. **Sector policies and stakeholders.** Reforms under Pillar I such as the introduction of management based on results and the routine of payroll auditing depend on the continued support of the Mayor to SEMEF, which is championing such reforms. Reforms in the education sector were discussed with teacher's union during the PSIA elaboration, and teachers are supportive of such reforms.

121. **Operational design, implementation and sustainability.** The policies supported are implemented by several institutions. A lack of coordination or a decrease in the priority of the policies in one or several institutions might slow down the implementation process. In the medium or long term, a change in the Government priorities might occur, which could lead to the discontinuation of policies. However, the program is fully supported by the current Government, and the MM's technical teams and all participating entities have been involved in the preparation of this operation. As this operation is the first development policy lending operation between the World Bank and the MM, the team will maintain continuous communication with the Government to ensure close coordination and to facilitate implementation. The MM has requested continuous engagement with the Bank to follow up the work under the DPL.

122. **Fiduciary.** The Municipality is in the process of adopting international accounting standards and the *Tribunal de Contas* of the State of Amazonas, the entity responsible for auditing the accounts of the Municipality, has a limited number of staff, and its methodologies need to be strengthened and modernized. The team will follow up with the Municipality, to ensure they

provide a confirmation to the Bank that: (i) the loan proceeds were received into the foreign currency denominated account, and (ii) an equivalent amount was credited to the account that finances budgeted expenditures and (iii) that this confirmation is sent to the Bank within 30 days after payment.

123. **Macroeconomic Risks at the Country Level.** In 2015, Brazil’s macroeconomic environment deteriorated due to weaker than expected growth, inflationary pressures, and the weakening of the Real. Nonetheless, levels of public debt remain sustainable. The principal macroeconomic risk is a prolonged stagnation of the economy which could lead to lower ICMS, part of which the State of Amazonas transfers to Manaus, and ISS collected by Manaus. In addition political uncertainty and the growing external deficit increase the possibilities of an external crisis in the medium term if corrective measures are not taken by the end of 2015.

Systematic Operations Risk-rating (SORT)

<i>Risk Categories</i>	<i>Rating (H, S, M or L)</i>
1. Political and governance	M
2. Macroeconomic	M
3. Sector strategies and policies	M
4. Technical design of project or program	L
5. Institutional capacity for implementation and sustainability	M
6. Fiduciary	M
7. Environment and social	L
8. Stakeholders	L
9. Other	L
Overall	M

ANNEX 1: POLICY AND RESULTS MATRIX

Policy Development Objective: To assist the Municipality of Manaus (MM) in improving the management of its finances as well as its education and transport sectors, through upgraded revenue and expenditure processes, meritocratic and results-oriented management of schools, and improved control of bus concessions.		
OBJECTIVE	PRIOR ACTIONS	RESULTS INDICATORS (2016)
Pillar I – Strengthened Public Sector and Fiscal Management		
To improve fiscal and public sector management at SEMEF via upgraded procurement procedures and systems, tax collection procedures, and payroll audits.	Prior Action #1: The Secretariat of Finance (SEMEF) has adopted a management model following the PDCA methodology, an integrated electronic document management system and monitored the achievement of selected indicators. ²⁹ Evidence: (i) Reports from SEMEF’s Business Intelligence tool as stated in SEMEF’s Ofício nr. 253, of March 9, 2015 ³⁰ (ii) Portaria No. 022/2015 da SEMEF published January 29, 2015. (iii) Decree nr. 2,796 published May 21, 2014, establishing the use of the integrated electronic system of management (SIGED) at SEMEF	Expected Result: Improved management of SEMEF and of its fiscal accounts. Indicators: Number of registered properties in the Property Tax Cadaster: Baseline (2013): 214,914 Target (2016): 560,000

²⁹ This prior action refers to SEMEF only. Through the creation of an Undersecretariat for Results-based management (*Subsecretaria de Gestão por Resultados*), SEMEF has provided training to staff in other secretariats, which are expected to adopt this management methodology in late 2015/2016.

³⁰ The 20 financial indicators and 10 operational indicators are listed in evidence (i) SEMEF’s Ofício nr.253, of March 9, 2015. Examples include the increase of own revenue collection (e.g. property tax) and the elimination of fees for late payment of utilities.

<p>Prior Action #2: The Municipality has implemented an integrated supply management system and processes for procuring goods and services, including electronic bidding and inspection of goods delivery, and adopted the legal framework for binding selected vendors registering prices for the provision of services and goods through the signing of <i>Ata de Registro de Preços</i>.</p> <p>Evidence:</p> <p>(i) Executive Decree No. 3.009 published January 26, 2015 that regulates that organization, maintenance and functioning of the Central Suppliers' Registry.</p> <p>(ii) Executive Decree No. 3.011 published January 26, 2015 that regulates the delivery of procured materials and institutes the Electronic Stock Management System.</p> <p>(iii) Executive Decree No. 3.012 published January 26, 2015 that establishes the contract management system (SIGEC) and regulates the procurement of services and the management of contracts.</p> <p>(iv) Executive Decree No 3.013 published January 26, 2015 regulating the Price Registration System.</p> <p>(v) Executive Decree No. 3.014 published January 26, 2015 that adopts the Integrated Procurement and Contract Management System of the Municipality of Manaus.</p>	<p>Expected Result³¹: Faster, more transparent and economical procurement, and data collection to inform procurement strategy and policy.</p> <p>Indicators:</p> <p>Average execution time of electronic bidding processes for the purchase of goods and services</p> <p>Baseline (2013): There was no electronic bidding (the average time for other methods was 120 days). Target (2016): 50 days for bids between R\$8 thousand and R\$1 million.</p> <p>Percentage of bidding results published in the <i>Manaus Compras</i> open access website: Baseline (2013): 0% Target (2016): 90%</p> <p>Average reduction of unit price of supplies and contracted services³²: Baseline (2013): 0% Target (2016): 5%</p>
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³¹ An Impact Evaluation (IE) is currently being designed with assistance from the Bank team to capture the impact of the procurement reforms on savings, timeliness and transparency of procurement, which are priorities for the Municipality.

³² This indicator is calculated using a pre-defined basket of 35 items that will be purchased using framework agreements after the reform is implemented. The 35 items were strategically chosen as they are high-volume, low-risk items that are suitable for framework agreements. The list of items include powder chocolate milk, air conditioning, gravel, notebooks, coffee, bread, pipes, mops and others. These items added up to expenses of R\$ 61 million in 2014. This is around 5 percent of what the Municipality spends in the procurement of goods, approximately R\$ 1.2 billion.

<p>Prior Action #3: The Municipality has adopted the legal framework for auditing the Borrower's payroll system and carried out an audit of the Borrower's payroll in all of its secretariats.</p> <p>Evidence: (i) the Borrower's Decree No. 2.683, dated and published in the Borrower's Official Gazette on December 27, 2013, (ii) the Borrower's <i>Programa de Auditoria Especial</i> – PAE No. 001/2014, dated April 28, 2014, and (c) the Borrower's service order OS 2014 n° 001, dated April 28, 2014 .</p>	<p>Expected Result: The promotion of regularity and conformity of personnel expenses.</p> <p>Indicators: Number of non-conformities: Baseline (2013): 54,222 Target (2016): 1,000</p>
<p>Prior Action #4: The Municipality has established <i>Manaus Previdência</i> which includes the establishment of clear and accountable rules for investing its resources.</p> <p>Evidence: (i) Law 1.803, published on November 29, 2013, creating Manaus Previdência. (ii) Decree 2.714, published on January 29, 2014, establishing the internal organization of Manaus Previdência,</p>	<p>Expected Result: Improved governance and transparency of Manaus' retirement system.</p> <p>Indicators: Acquisition and maintenance of the Pension Conformity Certificate (<i>Certificado de Regularidade Previdenciária</i>), without resorting to judicial measures. Baseline (2013):no Target (2016): yes</p>
<p>Prior Action #5: The Municipality has adopted administrative procedures to enable taxpayers to pay their respective tax arrears in instalments and established a system of communicating with taxpayers in arrears through various channels.</p> <p>Evidence: (i) <i>Service Order (Ordem de Serviço)</i> DECOB/SUBREC/SEMEF01/2013 (ii) Lei 1.792, published on November 12, 2013</p>	<p>Expected Result: Increase in municipal tax compliance rates</p> <p>Indicator: Municipal tax rate compliance: Baseline (2013): 54.49% Target (2016): 57.9%</p>

Pillar II – Enhanced Management and Quality the Education and Transport Sectors		
<p>i) To improve management at the Education secretariat (SEMED) and school levels, through meritocratic selection of school directors, establishment of targets and minimum standards.</p> <p>ii) To improve management of Manaus' transport sector, through the formalization of moto-taxis, upgraded monitoring of bus operators, and an overhaul of the city center.</p>	<p>Prior Action #6:</p> <p>The Municipality, through the Education Secretariat (SEMED), has implemented an integrated school management model, including the establishment of school-level targets and pedagogical planning.</p> <p>Evidence:</p> <p>(i) Portaria 0145/2014 published January 31, 2014 defining the internal selection of the implementers of the GIDE and the list of those selected</p> <p>(ii) Copies of two commitment letters between SEMED and school directors, both dated April 15, 2014.</p>	<p>Expected Result: Improvement in school management capacity</p> <p>Indicators: Number of schools that achieved at least 19 out of 24 GIDE targets³³:</p> <p>Baseline (2013): 0</p> <p>Target (2016): 278 (out of 400)</p>
	<p>Prior Action #7:</p> <p>The Municipality, through the Education Secretariat (SEMED), has implemented a certification program on school management skills for school directors and adopted a meritocratic selection process for school directors.</p> <p>Evidence:</p> <p>(i) Decree 3.022 published in March 5, 2015</p> <p>(ii) <i>Edital</i> N°001/2015 – SEMED/GS, dated and published in the Borrower's Official Gazette on March 6, 2015.</p>	<p>Expected Result: Improvement of school directors' management skills</p> <p>Indicators:</p> <p>Number of schools with certified directors:</p> <p>Baseline (2013): 0</p> <p>Target (2016): 150 (out of 400)</p>

³³ The GIDE indicators include 6 indicators related to school environment, 10 indicators of teaching quality, and 8 indicators of students' achievement (24 indicators in total).

	<p>Prior Action #8: The Municipality, through the Education Secretariat (SEMED), has adopted the procedures and criteria for appointment and relocation of its teaching and other staff.</p> <p>Evidence: (i) Portaria N. 0570/2014, published on May 9, 2014 establishing the minimum standards to regulate the school staff appointment</p> <p>(ii) Executive Decree published July 10, 2014 with the names of the new professors that allowed the SEMED to comply with the minimum standards of teachers.</p>	<p>Expected Result: Improved allocation of SEMED's public servants through the observation of the minimum standard framework</p> <p>Indicator: Number of schools complying 100% with the Minimum Standard Framework: Baseline (2013): 0 Target (2016): 150 (out of 400)</p>
	<p>Prior Action #9: The Municipality has adopted an integrated urban regeneration policy for the city center, including licensing, retraining and relocating street vendors to selected venues.</p> <p>Evidence: (i) Law 1780, published on October 30, 2013 (ii) Decree 3.008, published on January 23, 2015, regulates the functioning of the selected venues.</p>	<p>Expected Result: The upgrading of Manaus' city center</p> <p>Indicator: Number of street vendors accredited as individual micro entrepreneurs (MEI) and relocated to shopping galleries: Baseline (2013): 0 Target (2016): 1,642</p>

<p>Prior Action #10: The Municipality has adopted processes for managing the concession of bus services in the Municipality’s territory (including real-time tracking and control of the bus fleet) and policies license selected public transport in selected areas of the Municipality’s territory.</p> <p>Evidence:</p> <ul style="list-style-type: none"> (i) Decree No 2.566, dated and published in the Borrower’s Official Gazette on October 11, 2013, (ii) (b) the Ofício ACOP No 012/2015, issued by ACOP, dated February 9, 2015, (iii) (c) the Borrower’s Edital Concorrência Pública No 001/2014 – CEL/SMTU, dated February 27, 2014, and (iv) (d) the Borrower’s Despacho de Homologação e de Adjudicação Concorrência Pública No 001/2013 – CEL/SMTU, dated April 23, 2014, and published in the Borrower’s Official Gazette on April 24, 2014 	<p>Expected Result: Increased service compliance and control of bus concessions and mototaxi services.</p> <p>Indicators:</p> <p>Monthly percentage of bus trips completed³⁴</p> <p>Baseline (2013): 88%</p> <p>Target (2016): 97%</p> <p>Number of licenses for moto-taxis issued³⁵</p> <p>Baseline (2013): 0</p> <p>Target (2016): 3303</p>
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³⁴ A completed trip is defined as a scheduled bus trip performed by a vehicle, according to a route and time specified in compliance with a public contract of service concession. Its operational purpose is to carry passengers and charge a fare established by a public administration act. In the event of non-conformity to any of the requirements above, the indicator considers the trip as not completed. Monthly target, average for all 10 bus operators.

³⁵ The term formalized generically signifies being under permission or under concession contract. In Brazil the term licensed refers to the assignment of a vehicle identification into the National Transport Registration Office. The number 3203 represents the ratio of 1 mototaxi per 6000 inhabitants, as established by law.

ANNEX 2: LETTER OF DEVELOPMENT POLICY



Ofício nº 014/2015 - Gabinete do Prefeito

Manaus, 10 de março de 2015.

Senhor Presidente,

Com meus cumprimentos, dirijo-me a Vossa Excelência para apresentar as premissas e as condições que objetivam acessar o empréstimo de Política de Desenvolvimento do Banco Mundial para este Município de Manaus.

O Programa de Consolidação do Equilíbrio Fiscal para a Melhoria da Prestação de Serviços Públicos (PROCONFINS-MANAUS) contribuirá para a consolidação e o fortalecimento do equilíbrio fiscal, melhorando a prestação de serviços públicos do Município de Manaus, através da profissionalização, racionalização e melhor aplicação dos recursos públicos. Esses desafios exigem, acima de tudo, a modernização da capacidade de gestão e de instrumentos que possibilitem o aumento da arrecadação e a eficiência no controle da despesa pública.

Pretende-se a colaboração do Banco Mundial para as políticas do Município de Manaus direcionadas a contribuir com a instituição de uma gestão fiscal focada em resultados para incremento da receita e otimização das despesas, fortalecer o planejamento urbano e melhorar a gestão da educação, proporcionando uma melhora nos fluxos financeiros do município no curto e médio prazo, possibilitando o direcionamento de mais recursos financeiros para investimentos públicos, visando tornar a gestão pública mais eficiente.

A Sua Excelência o Senhor
JIM YONG KIM
Presidente do Banco Mundial
1818 H Street, NW
Washington, DC 20433 USA

PERFIL ECONÔMICO DO MUNICÍPIO

Em 2011 o Produto Interno Bruto de Manaus foi o 6º maior do Brasil, no valor de R\$ 51,025 bilhões, 1,23% do PIB Nacional e PIB per capita de R\$ 27.846,00. E isto se dá, principalmente, em função da implantação de um dos mais importantes pólos industriais da América Latina, abrigando mais de 400 empresas com elevados índices de inovação tecnológica, automação, competitividade e produtividade. O Polo Industrial de Manaus (PIM) apresentou um faturamento superior a US\$ 38,5 bilhões em 2013 e, atualmente, gera mais de 115,893 mil empregos diretos (2014), segundo dados Indicadores de Desempenho do Polo Industrial de Manaus atualizado em 07 de março de 2014 e divulgado pela Superintendência Regional da Zona Franca de Manaus (SUFRAMA).

SITUAÇÃO FISCAL

No exercício de 2012, em função do crescimento desenfreado dos gastos correntes houve um comprometimento da gestão fiscal. Em termos nominais, esse crescimento foi de 20,6%.

Nesse período os grupos de despesa que mais cresceram foram: Pessoal e Encargos Sociais, que cresceu 18,3%, juros e encargos GM 21,51% e Outras Despesas Correntes que teve um crescimento de 23,0%. Por outro lado, a receita corrente do município cresceu 19%, em termos nominais.

No início de 2013, o resultado fiscal apresentava um déficit financeiro da ordem de R\$ 346,3 milhões, comprometendo a capacidade de investimento do Município.

A partir de janeiro de 2013, deu-se início a medidas saneadoras das contas públicas através de controle rigoroso dos gastos correntes por meio do recadastramento dos programas sociais do Município, do estabelecimento de metas para cada secretaria para os serviços de utilidade pública, da criação de uma Comissão de Gestão Orçamentária e Financeira (CGOF) para a criação de novas despesas, inclusive de Pessoal e Encargos Sociais, do contingenciamento do orçamento das despesas de custeio administrativo, dentre outras.

Com essas medidas, o crescimento dos gastos correntes, que anteriormente era de 20,60%, caiu para 4,41%, em termos nominais, permitindo o aumento da poupança corrente do Município, possibilitando o aumento da capacidade de investimento.

Paralelamente, as receitas correntes alcançaram, no exercício de 2013, um crescimento de 10,27% em termos nominais.

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A partir de 2013, o Município de Manaus alcançou o significativo superávit orçamentário de R\$ 136,6 milhões. A receita total do exercício alcançou R\$ 3,255 bilhões, representando um crescimento de 9,5% em comparação ao ano de 2012. A despesa empenhada totalizou R\$ 3,118 bilhões, apresentando um crescimento de 5,29%.

Os setores que receberam as maiores alocações de recursos orçamentários em 2013 foram Educação, Saúde, Infraestrutura e Assistência Social. Importante salientar que em razão da precariedade das vias urbanas, tornou-se imperativo realizar investimentos emergenciais em infraestrutura urbana. Esses investimentos foram suportados pela economia na gestão dos gastos e possibilitou um início de transformação da qualidade de vida da população.

Paralelamente, os investimentos em Saúde exigem um volume de recursos que ultrapassa em 6,81% a aplicação mínima constitucional. Da mesma forma, o investimento no setor de Educação vem apresentando crescimento, em razão da necessidade de ampliação da rede municipal de ensino, tanto na área urbana e rural, da ampliação de assistência às famílias, através de construção de creches, para atender a demanda local.

Essas medidas geram impactos nos gastos públicos e se constituem em um grande desafio para sua sustentabilidade.

POLÍTICAS A SEREM APOIADAS PELO DPL

Diante do cenário fiscal apresentado anteriormente, os gestores do Município de Manaus identificaram um conjunto de problemas que poderiam ser objeto de ações específicas, agrupadas em três pilares, conforme segue:

- 1 - Instituir uma gestão pública fiscal focada em resultados para incremento da receita e otimização das despesas, implementar um modelo integrado de compras;
- 2 - Fortalecer o planejamento urbano; e
- 3 - Melhorar a gestão da educação.

Há de se observar que o alcance dos objetivos de cada área de intervenção, deverá constituir um círculo virtuoso no qual cada área, objeto do presente projeto, auxilia a alimentação das demais. Nesse sentido, a transformação do ambiente da gestão pública, bem como a adoção de políticas inovadoras de desenvolvimento, deverá orientar o Município de Manaus na direção do desenvolvimento sustentável.

1 - Gestão Pública Fiscal Focada em Resultados para Incremento da Receita e Otimização das Despesas, Implementação um Modelo Integrado de Compras

Para melhorar a situação fiscal de qualquer município, torna-se necessário investir no fortalecimento do aparelho arrecadador e na gestão do controle da despesa pública, considerando que todos os ganhos anuais das receitas podem ser absorvidos pelas despesas correntes, sem gerar melhoria da qualidade de vida da população.

Nesse sentido, na busca de racionalizar a expansão dos gastos correntes, o controle da despesa abrangerá dois mecanismos que permitirão: 1) o controle da expansão da despesa pública, onde ficará claro que as exigências dispostas nos artigos 16 e 17 da lei de responsabilidade fiscal (lei complementar nº 101/2000) estarão sendo cumpridos; 2) a melhoria contínua da qualidade do gasto público na busca da eficiência na utilização dos recursos públicos, que significará fazer mais com menos sem prejudicar a qualidade dos serviços prestados. Essas melhorias contínuas só serão possíveis mediante a implantação de um modelo de gestão centrado em metas e em resultados.

Dessa forma, considerando que a Cidade de Manaus ainda carece de grandes investimentos para a melhoria da infraestrutura urbana e para a melhoria contínua dos serviços prestados, temos de racionalizar a alocação dos recursos orçamentários para permitir o aumento da capacidade de investimentos do município e a melhoria contínua da qualidade do gasto público.

A fim de termos aumento de arrecadação, equilíbrio fiscal, incrementando a capacidade de investimento do Município, sem aumentar os impostos, superando a reta de crescimento normal da receita e controlar as despesas de custeio, desenvolvem-se na área de Gestão Pública, seis ações a seguir elencadas:

- a) A Secretaria de Finanças adotou um Modelo de Gestão por Resultados, que compreende um conjunto de metas financeiras e operacionais negociadas com os responsáveis pelas respectivas áreas e utiliza-se para sua execução, a elaboração de planos de ação através da ferramenta 5W1H. Esse modelo de gestão permite considerar todas as tarefas a serem executadas ou selecionadas, de forma cuidadosa e objetiva, assegurando sua implementação de forma organizada, com indicadores de resultados, monitoramento semanal e sistema eletrônico de acompanhamento de indicadores, através do sistema Business Intelligence (BI), da Oracle, para o monitoramento online das metas. Busca-se, com a adoção dessa metodologia, aumento da arrecadação e o equilíbrio fiscal;
- b) A Prefeitura implementou um sistema integrado de gestão de suprimentos que compreende a adoção de:
 - (i) um sistema eletrônico integrado de compras de bens e serviços que viabilizará a execução e gestão de processos, controle de estoque, acompanhamento de

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fornecedores, controle do banco de preços de referência e padronização do catálogo de materiais e serviços;

(ii) um sistema eletrônico integrado de gerenciamento de contratos de bens e serviços que permitirá o controle da liquidação de pagamentos através do cadastro dos contratos que deverão ter cumprido os processos licitatório cabíveis. Como consequência da implementação do sistema integrado de gestão de suprimentos, a Prefeitura de Manaus busca ter mais agilidade, transparência e economia nas aquisições, além da coleta de dados e informações essenciais para o gerenciamento e planejamento estratégico das compras e contratos;

- c) A Prefeitura de Manaus adotou um sistema de gestão centralizada de atas de registro de preço na Secretaria Municipal de Administração, Planejamento e Gestão – SEMAD, para compras de materiais comuns e licitados competitivamente e de prestação de serviços; tendo o uso das atas existentes na Prefeitura de uso obrigatório para os órgãos da administração direta a menos que consigam obter melhores preços fora das atas. Com o uso do sistema, busca-se economia, padronização e agilidade na compra de materiais comuns e licitados competitivamente para toda Prefeitura;
- d) A Prefeitura de Manaus instituiu uma rotina de auditoria no sistema de folha de pagamentos em toda administração direta e indireta, a fim de obter a redução do custo da folha de pagamentos, com a promoção da regularidade e qualidade de gastos com pessoal;
- e) A Prefeitura de Manaus instituiu o Órgão Gestor da Previdência dos Servidores Municipais (Manaus Previdência), efetivando a segregação de massas, na qual se faz a separação dos servidores efetivos mais antigos dos mais novos vinculados ao regime, separando em dois fundos previdenciários, equacionando a dívida da previdência com o Tesouro Municipal, cujo objetivo é a contenção do déficit atuarial e equilíbrio financeiro;
- f) A Prefeitura estruturou os procedimentos de cobrança de impostos em atraso, instituiu uma sistemática de comunicação com contribuintes através de vários canais, e reviu critérios para parcelamentos, visando à redução da inadimplência dos tributos municipais (IPTU, ALVARÁS E ISS) e o conseqüente aumento da arrecadação.

2 - Fortalecer o planejamento urbano

O planejamento urbano é um instrumento essencial para a gestão de uma cidade e age diretamente no ordenamento físico da mesma, trabalhando basicamente com os processos de produção, estruturação e apropriação do espaço urbano. Assim, o Município de Manaus busca fortalecer o planejamento através do desenvolvimento de políticas públicas para a solução dos problemas existentes na cidade, dentre eles, destacamos as seguintes:

- a) Na busca de desenvolver e acompanhar planos estratégicos para requalificação da área central da cidade, com estabelecimento de prioridades e definição de mecanismos de implantação de atividades afins, articulando ações próprias e em conjunto com demais órgãos e entidades municipais, estaduais, federais, privadas e representativas de classe, visando melhorar a qualidade de vida da população, a Prefeitura de Manaus instituiu uma política integrada de requalificação urbana do centro da cidade, e formalização, requalificação e realocação de vendedores ambulantes para galerias de comércio, buscando a reorganização urbana, inclusão social e geração de renda;
- b) Um dos desafios dos gestores de toda metrópole é a busca incessante da gestão de um transporte público urbano de passageiros mais eficiente e visa sempre a melhora do nível de serviço e a mobilidade nos sistemas de transporte. Dessa forma, o Município de Manaus instituiu novo processo para gerenciamento de ônibus urbano, visando mobilidade para transporte público, redução do tempo de viagens e aumento do cumprimento das viagens contratadas;
- c) A implantação de políticas para formalização do transporte público em áreas remotas da cidade, com outorga de permissão de serviço público para exploração de Transporte público coletivo de Passageiros nos Modais Executivo, Alternativo, bem como o Transporte Individual de Passageiros por Mototáxi. Com essa ação, o Município de Manaus pretende a formalização de 90% dos Micro-ônibus e 80% dos mototaxistas.

3 - Melhorar a gestão da educação.

O Município deve propiciar as condições acessórias de atendimento das demandas no campo educacional, cumprindo o preceito constitucional da eficiência na prestação de serviços públicos pela municipalidade, notadamente no campo da Educação Infantil e Fundamental. Dessa forma, o Município de Manaus, através da Secretaria de Educação está comprometido com o fortalecimento e o desenvolvimento educacional do município e para tanto, faz uso de algumas ferramentas:

- a) Implementação do Novo Modelo de Gestão Integrada na Escola – GIDE, modelo de gestão por resultados na secretaria, coordenadorias regionais e nas escolas, e é uma ferramenta desenvolvida para facilitar o gerenciamento dos processos e resultados da rede, pois utiliza um banco de dados centralizado para o acompanhamento das informações, reduzindo consideravelmente a utilização de planilhas e sistemas paralelos de informação não integrados. Busca-se com a utilização deste modelo, a melhoria da qualidade do ensino das escolas municipais;
- b) Tendo a necessidade de estabelecer critérios e mecanismos destinados ao realinhamento da gestão pedagógica nas unidades educacionais de responsabilidade da Secretaria Municipal de Educação, foi implementado o

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programa de certificação e seleção meritocrática dos Diretores Escolares, no qual participam do programa professores e pedagogos efetivos da Rede Pública Municipal de Manaus através de normas específicas, destinadas à composição de Banco de Gestores Escolares para provimento da função de Diretor das Unidades de Ensino da rede pública municipal de Manaus. Com a implementação deste Programa, o Município busca a melhoria da eficiência da gestão das escolas;

- c) As unidades de ensino da Rede Pública Municipal de Manaus devem assegurar o cumprimento do currículo da Educação Infantil, currículo dos Anos Iniciais - Bloco Pedagógico, currículo do Ensino Fundamental Anos Finais e Educação de Jovens e Adultos – EJA que estão contidos nas propostas Curriculares de cada ensino. Visando isso, a Secretaria Municipal de Educação instituiu o Quadro de Padrão Mínimo para regulamentar a lotação e remoção dos servidores da secretaria a fim de alocar de forma eficiente os servidores lotados nas escolas.

PROJETO

A grande finalidade do PROCONFIS Manaus é a reestruturação das finanças do município, sem prejudicar a população, a um custo financeiro relativamente baixo, o qual decorre do fato de que o Banco Mundial não tem como objetivo o lucro, mas sim, o combate à pobreza e o fomento da prosperidade compartilhada.

Nas regras atuais das operações de crédito, os recursos são vinculados aos produtos especificados no Projeto. Na modalidade Development Policy Loans (DPL), os recursos podem ser alocados em investimentos previstos na Lei Orçamentária, e em seus créditos adicionais, permitindo que os recursos do Tesouro Municipal sejam direcionados para o custeio operacional e para o equacionamento de dívidas pré-existentes.

Além disso, para a realização da operação de crédito, o Banco Mundial reconheceu a importância do modelo de gestão de resultados implantado na Secretaria Municipal de Finanças, Tecnologia da Informação e Controle Interno (SEMEF) e que está sendo espraído para todo o Município, sob a coordenação da SEMEF. O modelo de gestão, com foco em resultados, tem como fundamento o equilíbrio fiscal e o alcance da meta de déficit financeiro zero em 2016. Dessa forma, com aumento das receitas próprias e com maior controle da expansão e da qualidade da despesa, mais recursos serão aplicados para atender às demandas da população, objetivando a melhora da qualidade de vida do Município.

O DPL (Política de Desenvolvimento de Empréstimo) foi desenvolvido em conformidade com o Plano Plurianual do Município, o qual relaciona os programas prioritários e investimentos, no que tange a Consolidação do Equilíbrio Fiscal para o desenvolvimento da prestação de Serviços Públicos do Município de Manaus, enfocando a implementação de políticas de combate às vulnerabilidades sociais.

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Devido à própria natureza do programa proposto, este não necessita de execução de obras civis ou serviços de infraestrutura, desapropriações ou contratação de pessoal.

As ações de políticas públicas apoiadas por esta operação deverão repercutir positivamente sobre toda a população manauara, elevando a capacidade do Município de Manaus em avançar na prestação dos serviços públicos, culminando com a boa governança e sustentabilidade fiscal, melhorando a qualidade dos gastos públicos associado a diferentes grupos socioeconômicos, especialmente os vulneráveis, tendo em vista que proporcionará o saneamento das finanças do Município e, por sua vez, permitirá que o Município de Manaus aporte US\$ 150 milhões de dólares em investimentos que atendam as crescentes demandas da população, sem prejudicar a meta de equilíbrio fiscal sustentável.

Com a reestruturação das finanças municipais, um dos objetivos da contratação da operação de crédito pleiteada, o Município poderá arcar de forma mais sustentada com o crescimento das despesas de custeio, administrativo e operacional, e da folha de pessoal decorrentes das ações de expansão dos serviços de educação, saúde e assistência social, principalmente em relação ao primeiro. Além disso, o modelo de gestão implantado na Secretaria Municipal de Finanças, Tecnologia da Informação e Controle Interno (SEMEF), com apoio de ferramentas de gestão que buscam o alcance de resultados, será implantado em todos os órgãos e entidades do Poder Público Municipal. Dessa forma, trabalhando fortemente no aumento das receitas próprias e no controle sustentado das despesas correntes, a repetição da boa performance orçamentária de 2013 permitirá a geração de poupança corrente que, por sua vez, garantirá o pagamento da amortização da dívida contratada e a realização dos investimentos, inclusive da contrapartida necessária do Tesouro Municipal para a viabilização dos projetos originados de contratações de operações ou de termos de convênios.

PEDIDO DE APOIO FINANCEIRO

Com o aumento das demandas do atendimento primário ao cidadão, além dos graves problemas de mobilidade, infraestrutura e a degradação das vias públicas, a Prefeitura precisa ter seu aparelho arrecadador fortalecido e com um processo de gestão eficiente que garanta aumentar as receitas próprias, objetivando suportar a estratégia de crescimento voltado para tornar Manaus umas das melhores cidades para se viver e se trabalhar no Brasil.

O fortalecimento da Gestão no Setor Público, por meio de um melhor planejamento financeiro, propiciará à sociedade manauara benefícios inestimáveis e essenciais à prestação de serviços públicos mais eficazes, através de políticas que garantam a equidade, beneficiando especialmente os segmentos mais vulneráveis da população.




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O Município de Manaus, através das políticas descritas acima, demonstra uma coerente e sustentável forma de apoiar o desenvolvimento econômico e social e está profundamente comprometido com a continuação e expansão de desenvolvimento e com as políticas específicas apoiadas pela DPL.

Com esta carta, o Município de Manaus está solicitando a assistência financeira do Banco Mundial no valor de US\$ 150.000.000,00 (cento e cinquenta milhões de dólares norte americanos) relativo ao empréstimo à Política de Desenvolvimento (DPL).

Atenciosamente,


Arthur Virgílio do Carmo Ribeiro Neto
Prefeito de Manaus

Office of the Prefect

His Excellency **JIM YONG KIM**
President of the World Bank
1818 H Street, NW
Washington, DC 20433
United States of America

Mr. President,

I am writing to you to outline the circumstances and conditions for seeking the World Bank Development Policy Loan for the Municipality of Manaus.

The Program for Fiscal Balance Consolidation to Improve Public Service Delivery (PROCONFINS-MANAUS) will help consolidate and strengthen fiscal balance, thus improving the delivery of public services in the Municipality of Manaus, by enhancing professionalism and streamlining and improving the use of public services. These challenges require, first and foremost, the modernization of management capacity and tools that facilitate higher revenue collection and efficient public expenditure oversight.

World Bank support is being sought for the policies of the Municipality of Manaus that seek to contribute to establishing results-based fiscal management aimed at boosting revenue and optimizing expenditure, strengthening urban planning and improving education management, increasing financial flows into the municipality in the short and medium term, and paving the way for the channeling of greater financial resources toward public investment, with a view to enhancing the efficiency of public management.

ECONOMIC PROFILE OF THE MUNICIPALITY

In 2011, the Gross Domestic Product (GDP) of Manaus, which stood at R\$51.025 billion, was the sixth biggest in the Brazil, representing 1.23 percent of the country's GDP and a per capita GDP of R\$27,846.00. This is largely attributable to the presence of one of the biggest industrial clusters in Latin America, which houses more than 400 enterprises with high rates of technological innovation, automation, competitiveness, and productivity. The Manaus industrial cluster generated US\$38.5 billion in revenue in 2013 and currently creates more than 115,893 direct jobs (2014), according to performance indicator data from the Manaus industrial cluster, updated as of March 7, 2014 and disseminated by the Office of the Regional Superintendent of the Manaus Free Trade Zone (SUFRAMA).

FISCAL SITUATION

In FY 2012, fiscal management was compromised by the sharp increase in current expenditure. In nominal terms, that increase stood at 20.6 percent.

During this period, the expenditure groups with the biggest increases were the following: personnel and social security expenditure, which increased by 18.3 percent, interests and fees (GM), which rose by 21.51 percent, and other current expenditure, which increased by 23 percent. However, current revenue of the Municipality increased by 19 percent, in nominal terms.

In early 2013, fiscal results pointed to a financial deficit of R\$346.3 million, which negatively impacted the Municipality's investment capacity.

Starting in January 2013, public account corrective measures were implemented through the rigorous control of current expenditure by reregistering the Municipality's social programs, setting goals for each department with respect to public utility services, creating a Budget and Financial Management Commission (CGOF) to handle new expenditure, including personnel and social security expenditure, and establishing budgetary allocations for administrative costs, among others.

With these measures, the increase in current expenditure, which previously stood at 20.6 percent, fell to 4.41 percent in nominal terms, thus paving the way for an increase in the current savings of the Municipality and for greater investment capacity.

At the same time, current revenue increased by 10.27 percent in nominal terms in FY 2013.

Beginning in 2013, the Municipality of Manaus posted a big budget surplus of R\$136.6 million. Total revenue for the fiscal year stood at R\$3.255 billion, representing an increase of 9.5 percent relative to 2012. Expenditure committed totaled R\$3.118 billion, reflecting a 5.29 percent increase.

The sectors that received the biggest budget allocations in 2013 were education, health, infrastructure, and social assistance. It is important to note that the poor condition of urban roads made emergency investments in urban infrastructure imperative. These investments were supported by the savings in expenditure management and facilitated initial efforts to improve the quality of life of the population.

At the same time, investments in health call for resources that exceed the minimum constitutional investment by 6.81 percent. Similarly, the investment in the education sector has been rising, owing to the need to expand the urban and rural municipal teaching network and assistance to families by establishing daycare centers to meet local demand.

The measures are impacting public expenditure and are posing a major challenge in terms of their sustainability.

POLICIES TO BE SUPPORTED BY THE DPL

In light of the fiscal picture presented above, managers in the Municipality of Manaus identified a series of problems that could be tackled through specific measures. These have been grouped into the following three pillars:

- 1 – Introduce results-based public fiscal management to boost revenue and optimize expenditure and implement an integrated procurement model;
- 2 – Strengthen urban planning; and
- 3 – Improve education management.

It should be noted that the scope of objectives in each intervention area should form a virtuous circle so that each area identified in this project helps provide support to the others. In this regard, the change in the public management environment and the adoption of innovative development policies should place the Municipality of Manaus on a path to sustainable development.

1 - Results-Based Public Fiscal Management to Boost Revenue and Optimize Expenditure and Implement an Integrated Procurement Model

To improve the fiscal situation in any municipality, investments must be made in strengthening the collection mechanism and managing the control of public expenditure, given that all annual revenue increases can be entirely absorbed by current expenditure without improving the quality of life of the people.

In this regard and in an effort to streamline the growth in current expenditure, expenditure control will cover two mechanisms that will facilitate: (1) curbing the increase in public expenditure, in a context where there is clear compliance with the provisions of Articles 16 and 17 of the Law on Fiscal Accountability (supplementary law No. 101/2000); (2) continuously improving the quality of public expenditure in a bid to achieve the efficient use of public

resources, which will entail doing more with less, without adversely affecting the quality of the services provided. These ongoing improvements will be possible only through the establishment of a target- and results-based management model.

In so doing, and bearing in mind that the City of Manaus still lacks large-scale investments to improve urban infrastructure and upgrade the services provided on an ongoing basis, we must streamline the allocation of budgetary resources so as to facilitate an increase in the investment capacity of the Municipality and ongoing improvement in the quality of public expenditure.

In order to boost revenue collection, improve fiscal balance, and increase the Municipality's investment capacity without increasing taxes, the following six public management measures are being adopted to address the challenge of normal growth in revenue and to control expenditure:

- a) The Finance Department introduced a results-based management model that includes a series of financial and operational goals negotiated with the officials in their respective areas. For execution purposes, action plans were prepared based on the 5W1H tool. This management model facilitates consideration of all the tasks to be carried out or chosen in a careful and objective manner, thus ensuring their implementation in an organized manner, with results-based indicators, weekly monitoring, and an electronic system to support the indicators via Oracle's Business Intelligence (BI) system, so that goals can be tracked online. The goal sought in adopting this methodology is to increase revenue and fiscal balance;
- b) The Municipality implemented an integrated system for managing supplies that includes the adoption of:
 - (i) An integrated electronic procurement system for goods and services that will facilitate the execution and management of processes, the control of inventory, assistance to vendors, monitoring of benchmark prices, and the standardization of the list of materials and services.
 - (ii) An integrated electronic system for managing goods and services contracts that will allow for oversight of payments through the registration of contracts, which must be subject to the applicable bidding processes.As a result of the implementation of the integrated system for managing supplies, the Municipality of Manaus is seeking greater flexibility, transparency, and savings in the procurement process, in addition to compiling essential data and information for the strategic management of and planning for procurement and contracts.
- c) The Municipality of Manaus adopted a management system focused on the price registration records in the Municipal Department of Administration, Planning, and Management (SEMAD) for the procurement of joint materials subject to competitive bidding and the provision of services, utilizing existing records in the Municipality, which must be used by administrative entities directly discharging functions, unless they obtain better prices externally. The goal sought in using the system is savings, standardization, and flexibility in the procurement of joint materials, subject to competitive bidding, for the entire municipality.

- d) The Municipality of Manaus instituted routine payroll audits in all government offices directly discharging or delegating services, so as to reduce this payroll while encouraging regularity in and the quality of personnel expenditure;
- e) The Municipality of Manaus introduced the Management Entity for Municipal Pensioners (Manaus Pension System) by separating the groups, making a distinction between those in the system for the longest and the shortest periods, and creating two separate groups of pension funds, thereby addressing the pension debt to the Municipal Treasury, with the aim of containing the actuarial deficit and achieving financial balance;
- f) The Municipality arranged for proceedings related to the collection of back taxes, instituted systematic communication with taxpayers through various channels, and reviewed the criteria for installment payments, with the aim of reducing the non-payment of municipal taxes (IPTU, ALVARÁS, and ISS) and thus boosting collection rates.

2 – Strengthen Urban Planning

Urban planning is a key instrument for managing a city and has a direct impact on its physical layout. The process essentially entails working with production, layout, and appropriation of urban space. The Municipality of Manaus is therefore seeking to strengthen planning by formulating public policies to solve the city's current problems. These include:

- a) With the aim of developing and supporting strategic plans to revive the city center, setting priorities and identifying the mechanisms for the establishment of related activities, and coordinating internal actions and those with the other municipal, state, and federal organs and entities, as well as private and trade associations, all in the interest of improving the quality of life of residents, the Municipality of Manaus introduced an integrated policy for the urban revival of the city center and for formalizing, retraining, and relocating street vendors to commercial galleries, in a bid to achieve urban reorganization, social inclusion, and income generation;
- b) One of the challenges facing managers of the entire metropolitan area is the unending quest for more efficient urban public passenger transport management, which always focuses on improving the level of service and the mobility of transport systems. Consequently, the Municipality of Manaus introduced a new process for managing urban buses, which targets public transport mobility, reduction of travel times, and greater compliance with the terms of contract-related transport;
- c) The introduction of policies for the formalization of public transport in remote areas of the city, which entails the granting of permission, in a public service context, for the possibility of collective public passenger transport using the executive and alternative models, as well as the individual passenger transport via moto taxis. Under this plan, the Municipality is seeking to formalize 90 percent of the minibuses and 80 percent of the moto taxis.

3 – Improve Education Management

The Municipality must find additional ways to meet educational needs, in keeping with the constitutional provision of efficiency in the public services provided by the Municipality, particularly in the field of pre-school and elementary education. Consequently, the Municipality of Manaus, through the Department of Education, is committed to the strengthening and development of education in the Municipality. To this end, it is using the following tools:

- a) Implementation of a new Integrated School Management Model (*Gestão Integrada na Escola* GIDE), a results-based management model in the department, regional coordination offices, and schools. This tool has been developed to facilitate the management of the network's processes and results, as it uses a centralized database for data support, thus considerably reducing the use of spreadsheets and parallel systems of non-integrated information. The objective sought in using this model is improvement in the quality of instruction in municipal schools;
- b) Given the need to establish criteria and mechanisms aimed at realigning the pedagogical management of the educational units under the oversight of the Municipal Education Department, the certification and merit-based selection program of school directors was introduced with the participation of professors and educators from the Manaus Municipal Public Network in the program, using specific standards in order to create a pool of school managers to fill the position of Director of Schools in the Manaus municipal public network. With the implementation of this Program, the Municipality is seeking to enhance the efficiency of school management;
- c) The schools in the Manaus Municipal Public Network are required to ensure compliance with the pre-school curriculum, the early childhood curriculum—pedagogical unit, the curriculum corresponding to the latter years of elementary education, and youth and adult education, which are contained in the curriculum proposals for each educational level. With this in mind, the Municipal Education Department instituted the Minimum Standard Framework to govern the appointment and dismissal of civil servants working in the Department, with a view to efficient teacher assignment to schools.

PROJECT

The main goal of PROCONFIS Manaus is the restructuring of the Municipality's finances, without any adverse effect on residents, at a relatively low cost, given that the World Bank is a non-profit institution that seeks to combat poverty and boost shared prosperity.

In accordance with current rules pertaining to lending operations, the resources are linked to the products specified in the project. Under the terms of Development Policy Loans (DPLs), resources may be allocated to investments provided for in the Budget Law and its additional appropriations. Consequently, Municipal Treasury resources can be used for operational costs and to cover pre-existing debt.

Furthermore, the World Bank acknowledged, for the purpose of carrying out this lending operation, the importance of the results-based management model in the Municipal Department

of Finance, Information Technology, and Internal Oversight (SEMEF), which is being extended throughout the Municipality, with the assistance of SEMEF. The underlying principle of the results-based management model is fiscal balance and achieving the goal of a zero financial deficit in 2016. With the increase in internal revenue and greater control over the increase in and quality of expenditure, more resources will be channeled toward meeting the needs of the population, with the aim of improving the quality of life in the Municipality.

The Development Policy Loan (DPL) was developed in accordance with the Municipality's multi-year plan, which links priority and investment programs as they relate to the strengthening of fiscal balance to develop public service delivery in the Municipality of Manaus, with emphasis on implementing policies to combat social vulnerabilities.

Owing to the actual nature of the proposed program, it does not entail the execution of civil works or infrastructure services, expropriations, or the contracting of personnel.

The public policies supported by this operation should have a positive impact on the entire population of Manaus, thus enhancing the Municipality's capacity to achieve progress in the area of public service delivery, the culmination of which is good governance and fiscal sustainability and improving the quality of public expenditure on different socioeconomic groups, particularly the poor, taking into account that this will improve the Municipality's finances and in turn will enable the Municipality of Manaus to make investments of US\$150 million to meet the growing needs of the population, without jeopardizing the goal of sustainable fiscal balance.

With the restructuring of municipal finances—one of the objectives of the lending operation requested—the Municipality will be able to handle, in a more sustainable manner, the increase in administrative and operational costs and in payroll stemming from efforts to expand health, social assistance and, in particular, education services. Furthermore, the management model introduced in the Municipal Department of Finance, Information Technology, and Internal Oversight (SEMEF), with the support of results-based management tools, will be extended to all municipal government organs and entities. Consequently, by working diligently on increasing internal revenue and sustainably curbing current expenditure, the repetition of the sound budget performance in 2013 will lead to current savings that will in turn guarantee that debts are paid and investments are made, including the Municipal Treasury counterpart amounts necessary for the viability of projects linked to operations contracted or agreements concluded.

REQUEST FOR FINANCIAL ASSISTANCE

With the increase in basic service needs of citizens, in addition to the serious problems tied to mobility, infrastructure, and the deterioration of public roads, the Municipality needs to strengthen its collection mechanism and to have an efficient management process in place that can guarantee an increase in its internal revenue, with the aim of supporting the growth strategy that seeks to make Manaus one of the best cities in Brazil in which to live and work.

The strengthening of public sector management through better financial planning will bring measurable benefits to the people of Manaus that are essential for the provision of more efficient public services, through policies that guarantee equity and are especially favorable to the most vulnerable population groups.

Through the policies described above, the Municipality of Manaus is proposing a coherent and sustainable way to support economic and social development and is deeply committed to continuing and expanding development as well as the specific policies supported by the DPL.

By means of this letter, the Municipality of Manaus is requesting financial assistance from the World Bank in the amount of R\$150,000,000.00 (one hundred and fifty million dollars) related to the Development Policy Loan (DPL).

Sincerely,

Arthur Virgílio do Carmo Ribeiro Neto
Mayor of Manaus

ANNEX 3: FUND RELATIONS ANNEX

A satisfactory letter of assessment, dated November 2, 2015, has been received from the IMF, and it is circulated separately.

ANNEX 4: INTERGOVERNMENTAL FISCAL ARRANGEMENTS IN BRAZIL

Brazil is a federative country composed of 26 states, plus the Federal District, and 5,564 municipalities. Each government level is allowed to raise its own revenue by exploring specific tax base. Distribution of tax collection responsibilities is broadly consistent with economic principles that suggest that mobile tax bases need to be taxed by the Central Government while immobile bases by sub-national governments.

Broadly speaking, the Federal Government can levy tax on personal income (IRPF) and corporate profits (IRPJ), industrial products (IPI), financial operations (IOF), fuels (CIDE), rural property (ITR) and import duties (II). The Federal Government also levies social contributions on corporate profits (CSLL), payroll (social security contributions) and corporate revenue (PIS/COFINS). Social contributions are meant to finance health, social protection and social security expenditures. Contrary to tax revenues, social contributions are not shared³⁶ among subnational governments.

State governments' largest tax source is the ICMS receipts. Apart from that they also impose tax on motor vehicle property (IPVA) and on donations and inheritances (ITCMD). Of the three state taxes, two of them (25 percent of ICMS and 50 percent of IPVA) are shared with municipalities. The municipalities have the right to tax IPTU, ISS and property transmission (ITBI).

The Constitution also makes room for federal transfers to state and municipalities and state transfers to municipalities to make up for regional disparities. The receipts from federal taxes: IPI, IRPF and IRPJ form the Municipality and State Participation Fund (FPM and FPE respectively). FPM is formed by 23.5 percent of IPI and IRPF/PJ receipts and FPE is formed by 21.5 percent of IPI and IPI and IRPF/PJ receipts.

States and municipalities also receive transfers to compensate them for the abolition of ICMS on exports. The Federal Government must also transfer 29% of the tax receipts from CIDE to states, which in turn must share 25 percent of it with municipalities.

Apart from the aforementioned transfers, states and municipalities receive sectorial transfers aimed at health and education financing. States and municipalities can also receive voluntary transfers from the Federal Government, which are normally intended to cover for capital expenditures.

Figure A4.1 displays the abovementioned intergovernmental fiscal arrangement. Taxes are classified according to their base. Figure A4.2 shows the corresponding aggregate numbers for the intergovernmental fiscal arrangements in 2010, including oil royalties.

Aggregate fiscal discipline is imposed through the FRL, the Debt Renegotiation Agreement between subnationals and the Federal Government and controls on the supply and demand of credit to the public sector. The FRL institutionalized fiscal discipline at all levels of government, incorporating hard budget constraints into a single unifying framework. It explicitly prohibits debt refinancing operations between different levels of government, thereby addressing the moral hazard problem in intergovernmental fiscal relations caused by sequential bailouts. It also sets

³⁶ An exception is the *Salário-Educação*, a contribution imposed over private company's payroll to finance education expenditures.

limits for subnational governments on debt, debt service, payroll expenditures and guarantees.

The Debt Renegotiation agreements tied subnational governments on a stringent declining debt/revenue and on positive primary balance results. Lastly, all governments must publish annual balances, bimonthly budget execution summaries and report on FRL limits every four months. The conformity to the fiscal rules is ensured by the National Treasury and the by the Court of Accounts.

Figure A4.1 – Tax Assignment and Intergovernmental Fiscal Transfers in Brazil

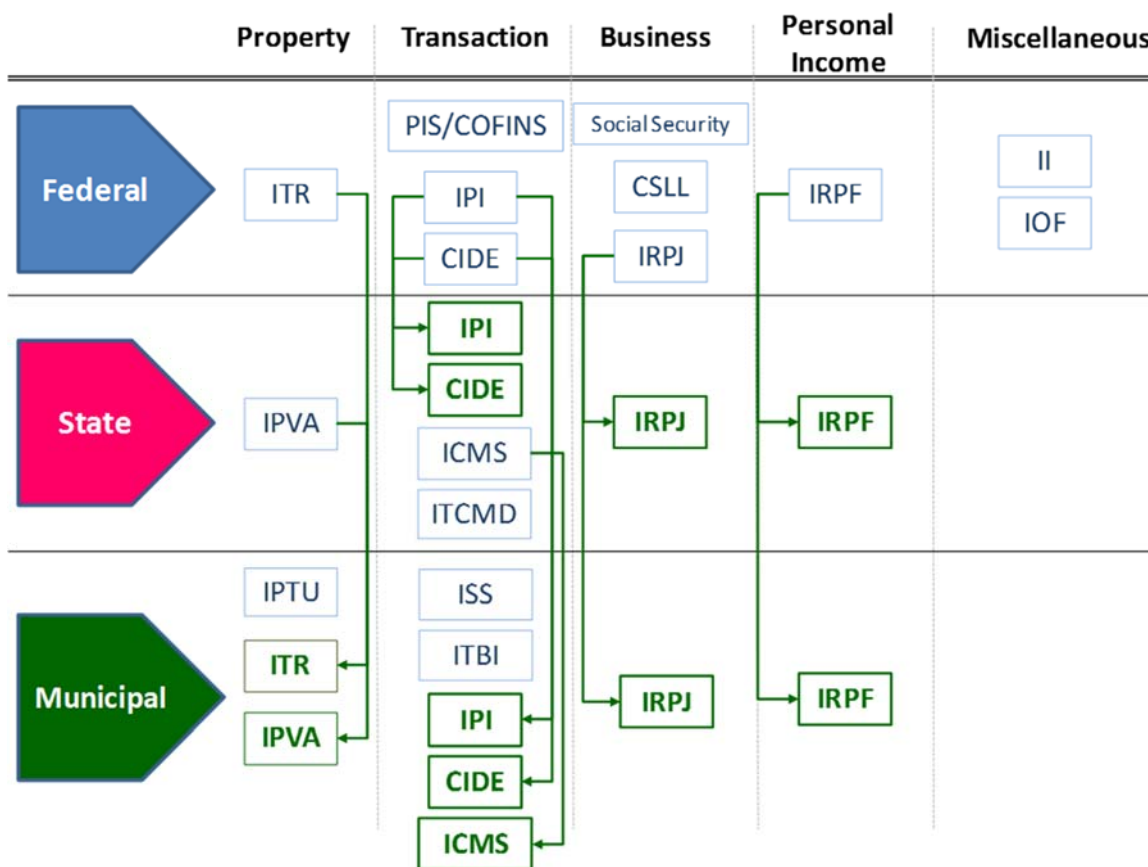


Figure A4.2 – Revenue collected and after transfers by government level: 2010

	Tax Collection		Revenue after Transfers	
	% of GDP	% of Total	% of GDP	% of Total
Federal	23.8	67.8%	20.0	57.0%
State	9.2	26.2%	8.7	24.7%
Municipal	2.1	6.0%	6.4	18.3%
TOTAL	35.2	100.0%	35.2	100.0%

ANNEX 5: ASSUMPTIONS FOR THE FISCAL AND DEBT SUSTAINABILITY ANALYSIS

Variables	Baseline Scenario	Worst Case Scenario
Revenues		
GDP	GDP follows projections in table 1 and stabilize at 2.5% from 2018 onwards.	GDP reports a larger contraction in 2016 (-2%) and null growth in 2017/2017. Between 2017 and 2020, GDP grows 11.5% annually. Afterwards, we assume 2.5% GDP growth until the end of the DSA projection (2030).
Inflation	Inflation follows projections in table 1 and stabilize at 4.5% from 2018 onwards.	Inflation reached 99.2% in 2015, 6.5% in 2016 and stabilizes at 5.5% between 2017 and 2020. We then assume inflation at 4.5% from 2021 until the end of the DSA projection (2030)
ISS	ISS is expected to grow with inflation and GDP. We apply an additional 2.5% growth for the first two years of the projection due to efficiency gains.	ISS is expected to grow with inflation and GDP.
IPTU	IPTU is expected to grow with inflation and GDP. We apply a 20% growth in the first two years of the projection due to a larger tax base and a 10% growth due to efficiency gains.	IPTU is expected to grow with inflation and GDP. We apply a 20% growth in the first two years of the projection due to a larger tax base.
IRRF	IRRF is expected to grow with payroll.	
Social and Economic Contribution	Social Contribution is fixed as a shared of payroll (20%), while economic contribution grow with inflation	
FPM	We use the Municipality forecasts for the first three years and then assume FPM will grow with inflation and GDP for the remaining of the projection.	
ICMS transfers	We use the Municipality forecasts for the first three years and then assume ICMS transfers will grow with GDP and inflation for the rest of the projection.	We use the Municipality forecasts at a discount for the first three years (90%) and then assume ICMS transfers will grow with GDP and inflation for the rest of the projection.
FUNDEB	FUNDEB grows with FPM and ICMS transfers	
Other Current Transfers	Other Current Transfers are expected to grow with inflation and GDP	
Capital Transfers	Set at R\$25 million for the entire projection period	
Other Current Revenues	Other Current Revenues are expected to grow with inflation.	
NCR	NCR grows at the same rate as Total Revenues (net of new loans and asset sales) for the GFS projection period (2015-2020). We then assume it will grow with GDP and inflation until 2030.	
New Loans	Follows the disbursements schedule provided by the Municipality	Follows the disbursements schedule provided by the Municipality and assumes that Manaus will obtain additional R\$80 million annually with new credit operations from 2017 onwards.
Asset Sales	Fixed at R\$0.5 million for the entire period of the projection	
Expenditures		
Payroll	Payroll is expected to grow 3.8 percent in real terms, in line with the historical growth rate.	
Interest Payments and Debt Amortization	Payments are obtained from the debt sustainability analysis with loan amounts and cost of loans provided by the Municipality.	
Other Current Expenditures	Other Current Expenditures are expected to grow with GDP and inflation.	
Investments in non-financial assets	Projected to grow by 1.1 percentage points of NCR every year.	Projected to be equal to the Gross Operating Balance plus Transactions in Financial Assets and Liabilities.
Investment in financial assets	Fixed at R\$3 million annually for the entire period of the projection.	

