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Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 07-Apr-2022 | Report No: PIDA33994

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Brazil	P178729	Rio de Janeiro Adjustment and Sustainable Development Policy Loan (P178729)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
LATIN AMERICA AND CARIBBEAN	24-May-2022	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Municipality of Rio de Janeiro	Secretaria de Transporte, Secretaria Municipal de Fazenda e Planejamento		

Proposed Development Objective(s)

The Program Development Objective of this programmatic series is to support the Municipality of Rio de Janeiro in: (i) strengthening fiscal management to improve medium-term fiscal sustainability; and (ii) accelerating the transition towards a low-carbon, resilient and inclusive urban development .

Financing (in US$, Millions)

SUMMARY

Total Financing	150.00

DETAILS

Total World Bank Group Financing	150.00
World Bank Lending	150.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

The COVID-19 pandemic worsened Rio's public finances, further crippling the municipality's ability to promote investments in favor of its environmental, social and economic goals, including low-carbon, resilient and inclusive urban development. The municipality of Rio de Janeiro (MRJ) fell into fiscal distress prior to the pandemic due to rapidly growing personnel spending, stagnant revenues, and high debt service costs**.** Furthermore, Rio de Janeiro has an important contribution to Brazil's carbon footprint through its transport sector, which is central to its climate mitigation agenda. Yet, the sustainability of the Rio transport system has been challenged by a failing public transport network, preventing investment in green public transport vehicles and contributing to a steady loss of ridership since 2015, especially among women and lower income households. Finally, Rio de Janeiro also faces adaptation challenges linked to its geography, which makes it susceptible to climate-linked disasters such as severe rains and floods. Against this backdrop, the proposed Rio de Janeiro Adjustment and Sustainable Development Policy Loan (ASD-DPL) series will support the Government in strengthening fiscal management to improve medium-term fiscal sustainability and accelerating the transition towards a low-carbon, climate-resilient and inclusive urban development

Despite some fiscal relief in 2021 related to higher tax collections, structural challenges persist and require substantive reforms to tame spending growth. In 2021, the fiscal concerns reemerged once the extraordinary federal assistance ended, and debt repayments were reinstated. Part of these challenges was offset by an estimated increase of 14 percent in the tax revenues caused resulting from the higher economic activity and inflation. However, as Rio de Janeiro is very dependent on its service sector, and in particular the tourism sector, the long-lasting effects of the pandemic are also weakening the revenue side. In particular, the economic rebound on services is being heterogeneous, and subsectors that are more dependent on face-to-face interactions, such as tourism and restaurants, are taking longer to return to pre-pandemic levels. These conditions on the revenue side, along with the fiscal difficulties experienced on the spending side before the pandemic, motivated the municipality to pursue a fiscal adjustment path by adhering to the Federal Government Fiscal Equilibrium Plan (PEF), a federal program that supports Subnational Governments in re-establishing fiscal sustainability.

Overall Brazil's macroeconomic policy framework is deemed adequate for this proposed operation. Brazil successfully mitigated the impact of the pandemic on the poor and achieved high vaccination rates by the end of 2021. These efforts increased fiscal pressures and raised debt, including a further risk of additional demand for social transfers in 2022 as growth slows and the electoral cycle advances. Public debt and rollover pressures are expected to remain high in the next few years, with debt payments within one year projected to stay above 30 percent of GDP. As the economy recovered from the 2020 recession, fiscal adjustment efforts resumed in 2021 and 2022 despite the high costs of the pandemic response (the 2022 approved included an increase in social transfers in 2022). The authorities have reiterated their commitment to observing the federal spending cap (anchor for the fiscal framework). Compliance with the spending cap will be supported by the constitutional pension reform adopted in 2019, a civil service pay freeze, and tight control of discretionary spending, including at the sub-national level. Also, the Central Bank independence law was approved in February 2021., The recently approved financial sector reforms helped to boost competition in the financial markets, financial inclusion and market access. The labor market reform enacted in 2017 and recent reforms approved in 2020 and 2021 have supported market entry and private sector participation in key infrastructure sectors (water and sanitation, telecom, energy). In the medium-term, additional fiscal and structural reforms would be needed to boost potential GDP growth.

Relationship to CPF

The proposed DPF is fully aligned with the World Bank Group's Country Partnership Framework (CPF) for the period FY2018–23.[1] The World Bank Group FY18-23 CPF for Brazil (Report no. 113259-BR, discussed by the Executive Directors on July 13, 2017) was prepared against the backdrop of the deep 2014–16 economic recession that led to a fiscal crisis and increased unemployment and poverty levels. The main premise of the CPF was the need to revisit the country's growth model to improve its sustainability and inclusiveness. The CPF is built on three pillars: (i) fiscal consolidation and government effectiveness; (ii) private sector investment and productivity; and (iii) equitable and sustainable development. The first pillar is aligned with Focus Area 1, *Fiscal consolidation and government effectiveness*, and Objectives 1.1 (Strengthening Fiscal Management) and 1.2 (Increase fiscal sustainability and fairness of pension system) of the CPF by: (i) supporting the adherence to the PEF, and an incentive mechanism for subnational borrowers to address their structural fiscal challenges early on, thus reducing the risk of their finances becoming unsustainable; and (ii) supporting reforms to make the pension system more sustainable, including increasing contribution rates for to active civil servants and pensioners with pensions above the INSS ceiling. The second pillar is aligned with Focus Area 2, and Objective 2.3 (Mobilize greater investment in infrastructure to improve services) by: (i) focusing on the digitalization of the mobility sector; and (ii) supporting the mobilization of greater investment in infrastructure to improve services. Pillar 2 is also aligned with Focus Area 3, *Inclusive and sustainable development*, and Objective 3.1 (Support the achievement of Brazil's NDC with a particular focus on land use), and Objective 3.2 (Provide more inclusive and sustainable urban services) by: (i) revamping the BRT system; (ii) supporting the implementation of a Low Emission District in the city center to decrease GHG emissions; and (ii) supporting the achievement of the municipality's and the country's NDCs on reducing CO_2 emissions.

C. Proposed Development Objective(s)

The Program Development Objective of this programmatic series is to support the Municipality of Rio de Janeiro in: (i) strengthening fiscal management to improve medium-term fiscal sustainability; and (ii) accelerating the transition towards a low-carbon, resilient and inclusive urban development .

Key Results

This operation is expected to contribute to strengthen Rio's fiscal management to achieve medium-term fiscal sustainability and support its transition towards a low-carbon, resilient and inclusive development. The fiscal reforms supported in this series are expected to curb recurrent expenditure growth, strengthen tax revenues, and improve the accountability of the government. The resulting increase of the municipalities' s operating balance will allow it to reduce its debt payments, reduce arrears, and provide space to create fiscal incentives to encourage investments in climate adaptation and mitigation. Furthermore, the package of fiscal reforms will also allow the municipality to regain access to borrowing with support from federal government guarantees to promote investments in favor of environmental, social, and economic goals. Reforms in this series are expected to steer Rio in improving public and non-motorized transport to avoid the migration of riders to higher-emitting transport modes, strengthen the municipality's cross-sectoral strategy to reduce GHG emissions, and foster mitigation and adaptation to climate change, therefore fostering urban development. Finally, transport reforms are expected to incentivize women's ridership in the public transport system, contributing to closing gender gaps and a more inclusive transport sector.

[1] The CPF was endorsed by the World Bank's Board of Executive Directors on July 13, 2017 (Report no. 113259-BR).

D. Project Description

This DPF supports the municipality's adhesion to the program the Fiscal Equilibrium Plan (PEF), a federal program that aims to recover fiscal sustainability in the short run. The adhesion of the municipality of Rio de Janeiro in the PEF has clear incentives to comply with the agreed targets, as the municipality is currently CAPAG C under the subnational credit worthiness scoring system (CAPAG), and failure to comply with the PEF targets would prevent them from obtaining the guarantees under the program, and from participating into the COFIEX for new federally guaranteed credit operations. To meet the agreed fiscal targets in the program, this DPL is supporting complementary fiscal reforms, including: (i) the adoption of a law that triggers fiscal adjustment measures in case of fiscal distress; (ii) a legislative reform to simplify the tax on services (ISS) and improve collection from tax evaders; and (iii) a legislative pension reform that increases the contribution rate from 11 to 14 percent for active and inactive civil servants, pensioners, and beneficiaries of special pensions. The second operation aims to build on this first DPL by deepening pension reforms with measures to strengthen pension record management and audits. It also supports reforms to improve fiscal accountability through the adoption of the international public sector accounting standards (IPSAS) and improved internal audit capacity. Finally, it proposes the introduction of a tax incentive to firms that achieve mitigation outcomes, thus using fiscal space opened through pillar one's savings to introduce green fiscal policy measures.

This municipality expects to shift to a low-carbon and more inclusive urban development through more sustainable mobility and strategies to mitigate and adapt to climate change. The Municipality of Rio de Janeiro acknowledges the need to advance in greening the transport system, the highest emitting sector of greenhouse gases in the city, and its vulnerability to climate change shocks. To address these challenges, the city is introducing reforms to increase the reliance on sustainable mobility modes and reduce GHG emissions, along with a broad strategy to improve building energy efficiency, waste management, green and resilient infrastructure, and disaster risk management solutions to strengthen its climate resilience. To address these challenges, the city is introducing reforms to increase the reliance on sustainable mobility modes and reduce GHG emissions, along with a broad strategy to improve building energy efficiency, waste management, low-carbon and resilient infrastructure, and disaster risk management solutions to strengthen its climate resilience. Actions in this pillar support: (i) critical legislation to improve the operational efficiency, multimodal integration, and safety for women in the Bus Rapid Transit (BRT) system to attract passengers to public transport; (ii) measures to promote low-carbon transport through regulations that expand the cycling network and make the urban environment more conducive to walking and cycling; (iii) the approval of legislation that promotes climate mitigation and adaptation practices in urban mobility, energy, green infrastructure, and waste management (Low Emission District); and (iv) the adoption of a municipal sustainable development and climate action plan, including measures to advance e-mobility, and climate risk prevention and preparedness measures such as contingency plans for coastal management and extreme heat events. To deepen the impact of these actions, the second DPL will further strengthen the sustainability of public transport services by enacting regulations that separate bus operations from the fleet provision. It will also support the legal and regulatory framework required for implementing the "Municipal Cycleway Plan" and "Low Emission District" to further expand low-carbon mobility and connect low-income areas. Finally, the second DPL will continue supporting reduction of GHG emissions by greening the municipal government's transport and energy consumption matrix.

E. Implementation

Institutional and Implementation Arrangements

The secretariat of finance and planning (*Secretaria Municipal de fazenda e planejamento-SFP*) is responsible for collecting and monitoring information related to program implementation and progress toward the achievement of the results. SFP is responsible for coordinating all necessary actions among the agencies involved in the reform program supported by this DPF. SFP will be directly responsible for the first pillar of the operation in coordination with other municipal agencies. The secretary of transport and the Secretary of Environment oversee policies and coordinates different institutions under the second pillar of the program. The World Bank team has worked closely with the above agencies as well as the Federal Treasury to define results indicators that are clearly spelled out and measurable, giving preference to those that are already collected by the government on a regular basis so as to avoid duplication.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

Reforms implemented by the municipality and supported by this DPF have the potential for positive equity and social impacts. Policy changes included in the first pillar – under the umbrella of the Fiscal Equilibrium Plan – are expected to allow the municipality to regain its fiscal long-term fiscal sustainability, while: (i) creating fiscal space to finance investment projects, including g social, environmental, and economic priorities; (ii) and regaining access to borrowing with support from federal government guarantees to promote investments in favor of its environmental, social and economic goals. As a result, they are expected to have positive indirect poverty and social impacts. Meanwhile, policy changes included in the second pillar may have indirect positive poverty and social impacts as they could contribute to improvements in the BRT service on which low-income households depend on, to increased access for women to safer transport modals and of dwellers of poor neighborhoods to safer transport modals and to the reduction of the city’s exposure and vulnerability to disaster risks exacerbated by climate change.

Environmental, Forests, and Other Natural Resource Aspects

The prior actions included in the DPF are likely to result in positive effects on the environment with significant emission reduction measures. Pillar one reforms that are not likely to cause direct negative impacts on the environment. On the contrary, the approval of the new fiscal regime PA#1 encompasses prior actions which are likely to have significant positive effects on the environment, all linked to the goal of promoting green growth and reducing CO2 emissions in the second operation. Policy changes supported under the second pillar are expected to support the reduction of emissions by strengthening the BRT public transport system, improving multi-modal integration, implementing Low Emission District in the city center, adopting the Sustainable Development and Climate Action Plan.

G. Risks and Mitigation

The overall risk of this operation is rated as substantial. Political and governance risks in the run-up to the 2022 electoral cycle are high, that can be mitigated by the strong incentives provided by the inclusion of Rio de Janeiro in Fiscal Equilibrium plan (PEF), that has clear and feasible sanctions to the subnational government that does not comply to the agreed fiscal plan. Macroeconomic risks are also substantial, arising mainly from the fiscal and the growth outlook, and mitigating factors include commitment by the authorities to complying with the federal expenditure ceiling, the implementation of the reforms submitted to the Congress, and other macroeconomic buffers that reduces public debt rollover risks. Economic and fiscal risks at the municipal level are substantial, and can be mitigated with the municipal’s fiscal plan and the incentives created by the PEF, that will allow the municipality to ramp-up social, climate and infrastructure investments. Similarly, pro-growth reforms supported in this operation will facilitate Rio’s post Covid-19 economic recovery and complement through a higher revenue base the tax effort of the city and support the fiscal sustainability. The fiduciary risk is rated as Substantial, and to mitigate the risk, some additional fiduciary arrangements will be put in place for the operation, including: (I) establishing a dedicated local currency bank account (an account used exclusively for DPO proceeds); (ii) requirement of an external audit of the dedicated account; and (iii) action plan related to the trigger, which includes the timely adoption of the International Public Sector Accounting Standards (IPSAS) and the strengthening of the audit capacities of the municipality. Stakeholder risks are assessed as substantial and relates to sensitivities about the reform agenda. The authorities are aware of these risks and to mitigate these risks are utilizing continuous face-to-face and online consultation processes with stakeholders, mainly with transport operators and fleet providers, civil society organizations, the private sector, and with the legislative and judiciary branches.

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APPROVAL

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