Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 23-Feb-2022 | Report No: PIDA33647

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Brazil	P177632	BR State of Goias Sustainable Recovery DPF (P177632)	
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
LATIN AMERICA AND CARIBBEAN	14-Apr-2022	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Estado de Goiás	Secretaria de Estado de Agricultura, Pecuária e Abastecimento (SEAPA), Secretaria da Economia, Secretaria Estadual de Meio Ambiente e Desenvolvimento Sustentável de Goiás (SEMAD)		

Proposed Development Objective(s)

The Program Development Objective of this DPF is to support the State of Goiás in: (i) improving fiscal sustainability; and (ii) adopting climate-smart, resilient, and inclusive policies for its agricultural sector.

Financing (in US$, Millions)

SUMMARY

Total Financing	500.00

DETAILS

Total World Bank Group Financing	500.00
World Bank Lending	500.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

Goiás is facing a weakened fiscal position and significant environmental sustainability challenges that are limiting its

ability to pursue a sustainable post COVID-19 recovery. The State fell into fiscal distress prior to the pandemic given rapidly growing personnel spending and high debt service costs, and its finances were further impacted by the COVID-19 crisis. Goiás is also facing significant climate change and environmental sustainability challenges, with growing Green-house Gases emissions between 2009 and 2020, mainly, in the Agriculture Sector. This Sustainable Recovery Development Policy Financing (DPF) will support the State in dealing with these challenges by strengthening its fiscal and environmental management frameworks for a more sustainable and climate friendly recovery. An important feature of this DPF is that it supports Goiás in becoming the first State to be admitted into the federal government's "Fiscal Recovery Regime" (FRR) that became effective in December 2021, thus advancing the implementation of a strategic federal government program for the fiscal recovery of sub-national entities.

Despite some fiscal relief in 2021 related to higher tax collections, structural fiscal challenges persist and require substantive reforms to tame Goiás spending growth. In 2021, fiscal challenges reemerged once the extraordinary federal assistance of 2020 was not extended in 2021, and debt repayments were reinstated despite an estimated increase of 20 percent in tax revenues caused by the rebound of economic activity and higher inflation. As Goiás is very dependent on its agriculture sector, the booming commodities market in 2021 also played a decisive rule to improve the State's revenues. However, these factors are conjunctural and their revenues growth impacts are not expected to last. These conditions, along with the fiscal difficulties experienced on the spending side prior to the pandemic, motivated the State to pursue a fiscal adjustment path by adhering to the Federal Government Fiscal Recovery Regime Program (FRR), a federal program that supports States 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 end 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 is 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

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

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 operation is fully aligned with CPF objectives 1.1 (Strengthening Fiscal Management) and 1.2 (Increasing Fiscal Sustainability) under CPF Pillar 1, which supports an incentive mechanism for subnational borrowers to address their structural fiscal challenges early on, thus reducing the risk of their finances becoming unsustainable. The operation is also aligned to CPF objectives 3.1 (Supporting the Achievement of Brazil's NDC with a Particular Focus on Land Use) and 3.3 (Promoting Socioeconomic Development of Small Rural Producers and Protecting Vulnerable Groups) under CPF Pillar 3, by focusing particularly on land-use planning, deforestation, environmental compliance, and payment for environmental services in a State that is critical to Brazil's climate mitigation commitments. This pillar is also consistent with the WBG Climate Change Action Plan 2021-2025[2] and 2050 targets to step up climate action so as to support countries in delivering and exceeding their Paris commitments.

C. Proposed Development Objective(s)

The Program Development Objective of this DPF is to support the State of Goiás in: (i) improving fiscal sustainability; and (ii) adopting climate-smart, resilient, and inclusive policies for its agricultural sector.

Key Results

This operations is expected to contribute to improve Goiás' fiscal sustainability and to adopt climate-smart, resilient, and inclusive policies for its agricultural sector. With the implementation of fiscal reforms that restrict recurrent spending growth, the State expects to improve its primary balance and clear its arrears over the coming years, allowing it to fully meet its financing needs. Coupled with the compliance with the Fiscal Responsibility Law limit for personnel spending, the State will recover its credit rating, allowing it to access new credit lines and become eligible to receive federal government's guarantees. The State also expects to shift its agriculture production towards climate-smart practices, including the adoption of the State Plan to address climate mitigation and adaptation. The DPF would also support measures that reduce GHG emissions and increase carbon storage in the soil, by aiming at a 10 percent per year increase in the use of non-chemical fertilizers and phytosanitary products. It would strengthen the climate focus of the State's environmental licensing framework by reducing compensation fees for GHG emission-neutral enterprises. Finally, the DPF would support land tenure regularization for smallholders under land tenure regulations that are environmentally conscious and cognizant of women's land title rights.

D. Project Description

The Program Development Objective of this proposed standalone DPF is support the State of Goiás to (i) improve fiscal sustainability; and (ii) adopt climate-smart, resilient, and inclusive policies for its agricultural sector. The proposed DPF is comprised of a standalone operation articulated around two pillars:

i. The first pillar of the DPF supports reforms that strengthen the State's medium-term fiscal sustainability, primarily by containing recurrent spending, through the adoption of: (i) an expenditure rule that limits growth of the primary expenditures to inflation as a fiscal anchor for the States' public finances; (ii) reforms to make the pension

[2] https://openknowledge.worldbank.org/handle/10986/35799

system more sustainable, including increasing the minimum retirement age and contribution rates; and (iii) a medium-term fiscal adjustment plan.

ii. The second pillar supports reforms that supports the State's in the adoption of climate-smart, resilient, and inclusive policies for its agricultural sector through: (i) the adoption of the state plan of climate change mitigation and adaption; (ii) a national program for bio-inputs to enhance climate-smart- agricultural practices; (iii) the increase of the climate focus of the state's environmental licensing systems; and (iv) the regularization of legal land tenure for vulnerable small-scale farmers, with focus on inclusiveness, environmental sustainability and gender balance.

E. Implementation

Institutional and Implementation Arrangements

The State Secretariat of Economy (*Secretaria da Economia - SE*) is responsible for collecting and monitoring information related to program implementation and progress toward the achievement of the results. SE is responsible for coordinating all necessary actions among the agencies involved in the reform program supported by this DPF. SE will be directly responsible for the first pillar of the operation in coordination with other State agencies. The State Secretariat for the Environment (SEMAD) and the State Secretariat of Agriculture, Livestock and Supply (SEAPA) 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

The policy measures supported under the first pillar are not expected to have direct poverty or social impacts, and positive indirect effects on equity. These reforms aim to open more fiscal space for public spending social and economic priorities, as well as improving the State's creditworthiness in the medium-term, increasing its access to resources for investment. The fiscal recovery of the State may contribute to ensure – in the medium and long-term – more fiscal space to provide basic public services on which most disadvantaged and vulnerable social groups rely, thus promoting equity. But fiscal consolidation reforms will have a moderate impact on the incomes of civil servants and pensioners, through the taxation of pension benefit amounts that surpass the minimum wage. In addition, efforts to contain recurrent spending may constrain the growth of civil service pay and benefits over time. These impacts are mitigated by the economic status of State civil servants who, in 2019, comprised 11 percent of the labor force in the Goiás, but only 1.8 percent of the working poor and among workers in the bottom decile.

A rationalization of the public spending to meet the fiscal program requirements is also expected to incentivize the enhancement of the volume and quality of public services by using current resources more efficiently. Brazil's public spending is out of line with international comparison, inefficient in many areas, and, in addition to this, overall fails to reduce the very high level of inequality of wealth and income.[3] Like many other states in Brazil recently, Goiás is facing a fiscal sustainability crisis due to a long-standing structural trend of increasing current expenditures. Given their large size in the state budget, the reform of the public pension system and the rationalization of the public sector wage will be critical to contain spending pressures and restore long-term fiscal sustainability. Eliminating inefficiencies will create additional space to face future spending pressures and generate resources that can be reallocated to programs which have shown positive social and poverty impacts. Notably, in priority areas such as health and education, spending inefficiencies imply that the same or even better results could be achieved with fewer resources.

The policy changes supported under the second pillar are expected to have positive direct poverty and social impacts among certain subgroups of the rural population. The adoption of a legal framework on climate change mitigation and adaptation in agriculture is expected to have positive effects on rural and agricultural incomes. It is also expected to have an indirect positive impact on the state's economy by contributing to increase the sustainability of the main economic sector and mitigate the impact of climate change. The use of bio-inputs in the agriculture sector is expected to have positive effects on rural incomes. It could also promote the competitiveness and resilience of the agriculture sector, indirectly having a positive contribution socially and economically for rural households. It may also open new job opportunities in rural areas, as the use of bio-inputs is more labor intensive. More efficient environmental licensing systems is also expected to support a better business environment in Goiás, thus contributing to growth and job creation in the State. Finally, the rural land regularization program for small-scale farmers is expected to yield direct and pro-poor distributive impacts.

Environmental, Forests, and Other Natural Resource Aspects

The prior actions included in the DPF are likely to result in positive effects on climate change mitigation/adaptation and the environment, including natural habitats, biodiversity and quality of natural resources. The prior actions under the first pillar have low potential for negative effects on the environment but a certain degree of risk cannot be totally discarded, because of the already weakened capacity of the State to manage natural resources, enforce the environmental regulatory framework, investment in protected areas and fire brigades which already suffer from staff reductions and investment limitations. It is strongly recommended that the fiscal adjustment does not affect investments in enforcement, conservation units, and firefighting.

Under the second pillar, significant positive environmental impacts are expected. The adoption of a state plan on climate change adaptation and mitigation in the agricultural sector will stimulate a sustainable agriculture. The bio-inputs law, whose major benefit is the reduction of emissions associated with the use of inorganic inputs in agricultural production, is expected to have a positive climate and environmental impact. The increase of the climate focus of the state's environmental licensing systems is not expected to have negative environmental impacts. However, it is necessary to pay attention to the technical capacity and the monitoring of the activities that gain the incentive of the discount on the environmental compensation fees for the classification of neutral GHG emissions. The effort of the State of Goiás in land tenure regularization is expected to represent environmental gains in regularized properties as the producer will be

[3] For a discussion about the inefficiencies of the public spending in Brazil, see the Brazil Public Expenditure Review Report "A Fair Adjustment", available in https://www.worldbank.org/pt/country/brazil/publication/brazil-expenditure-review-report.

obliged to comply with the environmental legislation, protecting natural resources and permanent preservation areas, and improving ecosystem services.

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 Goiás in the Fiscal Recovery Regime, that has clear and feasible sanctions to the State 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 State level are substantial, and can be mitigated with the state's commitment to the fiscal consolidation plan, that will allow the State to maintain an appropriate level of public investments. Risks related to institutional capacity in some policy areas are substantial and will be closely monitored to assure that the policy implementation is adequate. Environment and social risks are assessed as substantial. For this reason, the DPF focuses on raising the credibility of the state's climate change approach and environmental institutions. Strengthening their links to federal and community efforts introduces incentive systems and broadens the coalition to mitigate environmental impacts across the State. Stakeholder risks are assessed as substantial and relates to sensitivities about the reform agenda. In order to mitigate these risks, authorities have been and continue to be engaged in close consultations with several stakeholder groups, with the goal of exchanging on the rationale of the reforms and increasing their overall acceptance.

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APPROVAL

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