Program Information Document
(PID)

Concept Stage | Date Prepared/Updated: 09-Dec-2019| Report No: PIDC28067

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Brazil	P172455	First Amazonas Fiscal and Environmental Sustainability Programmatic DPF (P172455)	
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
LATIN AMERICA AND CARIBBEAN	May 28, 2020	Environment, Natural Resources & the Blue Economy	Development Policy Financing
Borrower(s)	Implementing Agency		
State of Amazonas	State Secretariat of Finance (Segretaria do Estado da Fazenda)		

Proposed Development Objective(s)

To support the State of Amazonas to strengthen its fiscal sustainability and enhance its institutional capacity for forest conservation and green growth.

Financing (in US$, Millions)

SUMMARY

Total Financing	250.00

DETAILS

Total World Bank Group Financing	250.00
World Bank Lending	250.00

Decision
The review did authorize the preparation to continue

B. Introduction and Context

Country Context

1. **Brazil is undertaking ambitious structural reforms aimed at buttressing fiscal adjustment and increasing productivity growth**. Brazil's economy declined by about 7 percent during a deep recession between 2014 and 2016, recovering only slightly in the years since, with growth of about 1 percent a year. The public sector deficit peaked at over 10 percent of GDP in 2015 and public debt increased quickly reaching 79percent of GDP. Since December 2016 fiscal consolidation at federal level is anchored by a constitutional rule limiting the increase in primary expenditures. The federal administration that took office in 2019 has taken measures to comply with the expenditure-based fiscal adjustment, starting with a pension reform that is expected to save R$800 billion over the next decade. The recession and slow recovery have also affected subnational governments that have seen their revenue base decline while they struggle to adjust fiscally given high expenditure rigidities, largely governed by federal laws and the constitution. As a result, a growing number of state governments have faced liquidity and solvency crises since 2015, which undermines critical service delivery.

2. **The State of Amazonas' development model has historically been focused on overcoming the disadvantages inherent in its geography rather than building on its natural assets**. The State experienced a first economic boom in the late 19th century based on the extraction of natural rubber. Beginning in the 1970s, the Brazilian government established a policy to develop a manufacturing sector in the Amazon region through investments in infrastructure and preferential tax treatment, creating the Manaus Free-Trade Zone (*Zona Franca de Manaus* - ZFM). At the time, deforestation was seen as a necessary part of this push for economic development. While the rate of deforestation has since been reduced, the State's economic development model is still centered around the production and assembly of manufactured goods for the national market, relying largely on imported components and a preferential tax environment compared to the rest of Brazil. The production of goods and services that make sustainable use of the State's natural resources and biodiversity remain underdeveloped.

3. **Supporting the sustainable economic development of the State of Amazonas needs to ensure the protection of the Amazon rainforest, given its huge potential and its critical role for the rest of Brazil, let alone its global externalities.** Brazil is home to about 60 percent of the Amazon basin, which contains the world's largest tropical rainforest, the world's largest freshwater resources and highest density of biodiversity. About 20 percent of the Brazilian Amazon has been deforested in recent decades. While deforestation rates declined by about 80 percent between 2003 and 2011, recent years have seen an increase of deforestation with widespread forest fires in 2019 capturing worldwide attention. In Amazonas, growing agricultural expansion and speculation in the State's southern region, associated with the State's lack of infrastructure, capital, and personnel resources have led to a jump from a yearly average of 582 km^2 of deforestation per year during the decade 2006-2015 to 1,149 km^2 during the period 2016-2019, the largest such increase among Brazilian states. Amazonas's deforestation rate for 2019, at 1,421 km^2, is an increase of 36 percent over 2018 and the largest single-year figure for the State since 2004. Because of its importance as a carbon sink, protecting the Amazon forest is critical to mitigate climate change and to maintain the evaporation of moisture from the Amazon basin that supports rainfalls vital for agriculture, hydropower and urban populations in central and southeastern Brazil.

Relationship to CPF

4. **The proposed DPF is fully aligned with the World Bank Group's Country Partnership Framework (CPF) for the period FY2018-2023**. The operation is fully aligned with CPF objectives 1.1 - Strengthening Fiscal management and 1.2 -

Increase Fiscal Sustainability under CPF Pillar 1 as well as with objectives 3.1 - Supporting the Achievement of Brazil's NDC with particular focus on land use, and 3.3 - Promote socio economic development of small rural producers and protect vulnerable groups, under Pillar 3. The first pillar of the series of subnational DPFs creates an incentive mechanism for subnational borrowers to address their structural fiscal challenges early on, reducing the risk of their finances becoming unsustainable. The second pillar of the operation supports the third CPF pillar ("Support the achievement of Brazil's NDC with a particular focus on land use"), by focusing particularly on land use planning, deforestation, environmental compliance, and payment for environmental services in a State critical to Brazil's climate mitigation commitment. This pillar is also consistent with the WBG Climate Change Action Plan 2016-2020,[1] to support countries to deliver and exceed their Paris commitments.

C. Proposed Development Objective(s)

To support the State of Amazonas to strengthen its fiscal sustainability and enhance its institutional capacity for forest conservation and green growth.

Key Results

Indicator Name	Baseline	Target
#1: State personnel spending as share of the net current revenue	51.1% (2019)	46.5% (2021)
#2: Revenues from electricity as a share of total ICMS revenues	3.7% (2018)	10.0% (2022)
# 3: Deficit of *Fundo Financeiro*	Value % (2018)	Value% (2022)
#4: Public health spending as share of current revenues	22% (2019)	19.5% (2021)
# 5: Km^2 of area illegally deforested	1,421 (2019)	1,130 (2022)
# 6: Number of CARs validated	471 (2019)	8,054 (2022)
# 7: Number of forest concessions	none (2019)	TBD
# 8: Number of families enrolled in BFP	XXXX (2019)	TBD)

D. Concept Description

5.   The financing of US$250 million provided by this operation will address the State's immediate funding needs, in particular the cost of transitioning to a funded pension system for the State's civil service in the short term. The proposed approach is a programmatic series of two operations, with the first one focusing on early reforms at the beginning of the current administration with a second operation deepening reforms during 2020-2021.

6.   **The proposed DPF series will support policies and programs anchored in two key pillars of the government's development strategy**: (i) fiscal adjustment and structural reforms to safeguard the State's fiscal sustainability and enhance the efficiency of public expenditures (ii) institutional reforms to strengthen the State's ability to protect forests and other natural resources while promoting a model of economic development that uses the State's natural endowments in a sustainable manner. For this purpose, Pillar A of the proposed programmatic series supports the government of the

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[1] World Bank; IFC; MIGA. 2016. World Bank Group Climate Change Action Plan 2016-2020:
https://openknowledge.worldbank.org/handle/10986/24451

State of Amazonas to implement a package of fiscal policies that creates fiscal space in the short term while addressing structural challenges of spending efficiency. This will allow the State Government to finance the transition to the funded pension scheme, while maintaining investments in public services. The operation's pillar on forest conservation and green growth is aligned with the Government's program for the control of illegal deforestation and forest fires (*Plano de Ação para Prevenção e Controle do Desmatamento e Queimadas do Estado do Amazonas – PPCDQ*), aimed at stopping and reverting the growth rate of deforestation in the State. It supports measures to increase social inclusion in forest areas and to increase state revenues generated from the sustainable use of forest resources through environmental regularization and forest concessions

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

Poverty and Social Impacts

7.   **Overall, the proposed prior actions supported by this DPO are expected to marginally decrease poverty and inequality in the state**. The first pillar targets the state's precarious fiscal situation. The second pillar targets environmental sustainability, with an eye towards supporting forest-dependent households. Prior action #4 in particular, which supports Bolsa Floresta, is expected to have direct impacts on poverty in the state.

Environmental, Forests, and Other Natural Resource Aspects

8.   **The policies supported by this DPF are not likely to cause significant negative effects on the environment forests or other natural resources and is likely to have significant positive effects.** The policies supported under Pillar A of this operation focus on strengthening fiscal sustainability. The prior actions (A.1 and A3) linked to payroll and pension aspects are unlikely to generate any negative environmental effects. The strengthening of taxation on electricity with an incentive to production and use of solar energy should also generate potentially more efficient use of electricity and reduce fossil fuel use, avoiding expansion of generation systems, and increasing sustainable sources of energy. Increased use of electronic payment systems is unlikely to have negative environmental effects and may have positive effects through improving efficiency in transfer of funds, reduce waste from unnecessary purchases of goods and potentially less use of paper.

9.   **The policies supported under Pillar B are focused on sustainably managing and conserving the natural resource base of Amazonas State and designed to have significant positive effects.** The legislation and regulations of PA B.1 to strengthen the control of illegal deforestation and forest fires should have a significant positive effect considering the extensive impacts they have had in the last two years. Reduced forest fires should also have positive health impacts from decreased air pollution throughout Amazonas and southern Brazil. Strengthening of the Rural Environmental Cadaster under PA B.2 will also provide positive environmental effects thanks to the clear delineation of landholdings that should allow more effective interventions of illegal deforestation as well as ensuring that legally mandated forest cover is being maintained on rural properties. Boundaries of protected areas will also be clearer for enhanced protection and for establishing sustainable forest management concessions. Forest concession (B.3) are expected to generate positive effects through increasing the value of forests and protection by generating sustainable income and employment, reducing pressures to deforest for carbon-intensive agriculture and livestock ranching. Potential negative effects could occur if the concessions are not adequately designed, licensed, and supervised by the state forest and environmental agencies. The legislative framework in this regard however is strong and aligned with best international practices on sustainable forest management. The PES program supported under the BFP also generates positive environmental effects as it supports impoverished families and community groups to protect and sustainably manage the forests with enhanced protection requirements under the new upscaled program.

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APPROVAL

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