

Project Name	Brazil-Rural Poverty Reduction Project-Minas Gerais
Region	Latin America and the Caribbean
Sector	Agriculture
Project ID	BRPE52256
Borrower	State Government of Minas Gerais
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1. Country and Sector Background. Brazil is a large country with diverse spatial and regional circumstances. This is well-illustrated by the levels of per capita income in the North and Northeast regions, which are less than half of the national average. The Federal Government has used its tax, transfer and expenditure policies in an attempt to reduce regional disparities in the provision of public services. The net impact of Federal Government transfers resulted in a significant redistribution of resources from Brazil's richer regions (the South and Southeast) to its poorer ones (the North, Northeast and Center-West) in the previous decade. Despite these transfers, poverty and inequality continue to be the most important medium to long-term development challenges for Brazil. Policies to reduce poverty and equality include:

- increased income earning opportunities through stability and renewed growth;
- targeted policies to enhance the human and physical capital of the poor
- through education, land reform, and urban, rural and health services - to leverage economic opportunities, and
- a social safety net to protect against shocks in the dynamic international economy.

2. Contrary to popular opinion, poverty in Brazil is not an overwhelmingly urban phenomenon. In fact, despite the considerably larger urban population, rural poverty is so widespread that, in absolute numbers, approximately 43% of the population in poverty are actually rural. From a regional perspective, rural poverty is concentrated in the Northeast, and comprises the single largest concentration of rural poverty in Latin America. The Northeast consists of nine states, and part of a tenth, with a combined land area of 1.6 million km²--16% of Brazil's total land area. The Northeast Region includes the States of Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe, Bahia and the northern part of the State of Minas Gerais. The Northeast is home to 28%, or 45 million, of Brazil's 160 million people, 16.8 million of whom are rural. Of these Northeast rural households, 38% (6.4 million people) live on about US\$1 per day (a number which jumps to 56% or 9.4 million people at around US\$2 per day).

3. Overall, around 17 million people in Northeast Brazil live in poverty. In the rural areas of the Northeast, the incidence of poverty is 48.8%, while in urban areas, the incidence is 30.7%. Given higher urban population figures, these estimates result in roughly similar numbers of poor people in

urban and rural areas of the Northeast: some 8 million individuals in rural poverty and 9 million in urban poverty.

4. Development indicators for Northeast Brazil paint a dismal picture, compared to the rest of Brazil. The region has: (a) a rate of chronic malnutrition of children under five at 27% and, in the rural areas, 31%, compared to 15% nationwide; (b) 37% of households without piped water supply (reaching 77% in the rural areas), compared to 14% nationwide; (c) 37% of rural households without electricity, compared to 25% for the rural nationwide; and (d) 25% of all households (55% of rural households) lacking access to proper sanitation facilities, compared to 9% nationwide. The adult literacy rate in the Northeast is 60%, compared to 86% nationwide. The poor natural resource base, chronic drought and limited access to land, water and financial resources exacerbate poverty. A recent poverty review of Brazil finds annual per-capita incomes in the Northeast - estimated at R\$2,123 (US\$1,135) - are 42% of the overall national annual of R\$4,945 (US\$2,644).

5. Rural poverty in Minas Gerais is concentrated in the northern part of the State and the Vale do Jequitinhonha/ Mucuri. Statewide, some 1.1 million households earn less than one minimum salary each month. Nearly 32 percent of rural households in Minas Gerais lack piped water supply, about 25 percent are without sanitation services, and 20 percent without electricity, compared, respectively, with 4, 2 and 1 percent for urban Minas Gerais, and 7, and 0.9 percent for urban Brazil as a whole.

6. Project Objectives. The proposed project would assist the State Government of Minas Gerais to reduce the state's high levels of rural poverty. To help reduce poverty levels in the State, the project would deliver services to poor rural families, employing a tested community-based approach that builds on the lessons of two successful Bank-financed programs: the Reformulated Northeast Rural Development Program (R-NRDP), and the subsequent Rural Poverty Alleviation Program (RPAP). The proposed project aims to alleviate rural poverty and its consequences by: (a) increasing social and economic opportunities of the rural poor by improving access to basic, social and income-generating infrastructure; (b) increasing the social capital of communities to organize effectively and meet own needs; and (c) fostering local governance and citizenship through creation and strengthening of project municipal councils, at the same time forging links to government, NGOs, civil society, financial institutions and the private sector.

7. Project Description. The Project would provide matching grants to rural community associations to finance small-scale subprojects (up to US\$50,000 each) identified by these groups as priority investments that would improve community well-being. Project funds would be disbursed directly to community associations to finance the implementation of approximately 1,900 community subprojects. The matching grants would be disbursed under three subprograms - FUMAC, FUMAC-P and PAC.

- Municipal Community Schemes (FUMAC). FUMAC will be the primary delivery mechanism under the proposed project, constituting 72%, or US\$30.2m of total subproject funds. In FUMAC, decision-making on subproject approval is delegated by the State to project Municipal Councils, composed of community members and representatives of civil society and municipal authorities. At least 80 percent of municipal council members are potential beneficiaries of the project. The project municipal councils prioritize the demands presented by rural communities through local consensus-building and approve subprojects, within an indicative annual budget, for financing by the STU which then disburses funds for subproject implementation directly to approved community associations.

- Pilot Municipal Community Funds (FUMAC-P). The FUMAC-P is a more decentralized variant of FUMAC. It is expected that 3% of total subproject costs, or US\$1.3m would be invested under in the proposed project. Under FUMAC-P, Project municipal councils prioritize and approve subprojects submitted by rural communities and then finance them within the context of an annual budget envelope defined by the STU according to a distribution formula, based on clear and measurable criteria, such as rural population, poverty levels and previous year's performance. Based on this budget, the Municipal Councils prepare and submit an Annual Operating Plan (POA - Plano Operativo Anual) to the STU for approval. Upon approval, funds are transferred to the municipal council, which is then responsible for transferring funds to and assisting community associations to implement approved subprojects. The project would emphasize the integration of FUMAC-P council activities with broader municipal planning and budgeting processes.

- State Community Schemes (PAC). It is expected that up to 25%, or US\$10.5m of total subproject costs would be invested through PAC in the proposed project. Under PAC, rural communities submit their subproject investment proposals directly to the State Technical Unit (STU). The STU screens, and approves subprojects and releases funds directly to the beneficiary communities.

8. The proposed project would also finance institutional development through technical assistance and training to increase the capacity of implementing entities, including Municipal Councils, Community Associations and the State Technical Unit. Also included would be funds to support technical assistance to the state government for modernization and reform of the State. Finally, the project would finance incremental costs of project administration and coordination including supervision, monitoring and impact evaluation.

9. Project Financing. The total project cost is US\$46.8 million, of which the Bank would finance US\$35.0 million (75%). The State Government of Minas Gerais will provide counterpart funding of US\$7.6 million (16%), while community associations will provide up to US\$4.2 million (9%), in cash or in kind.

10. Project Implementation. The State Secretariat of Planning of the State of Minas Gerais would undertake project oversight, delegating project coordination to SUDENOR (State Superintendency for Development of North Minas), which would receive and approve the Annual Operating Plans for the project Municipal Councils (and would receive and approve community subproject proposals in the case of PAC). SUDENOR will be responsible for day-to-day project coordination with respect to monitoring, supervision of municipal councils, evaluation and required reporting under the project.

11. Community Associations comprise locally-based groups with a common interest who are organized into legally-constituted civil associations. Community associations will be responsible for identifying, preparing, implementing, supervising, operating and maintaining their own subprojects, assisted by technical specialist contracted directly by community groups, as well as technical assistance and training made available by municipal councils and the State Technical Unit. For subproject related assistance in design and implementation, community associations have access to a percentage of subproject costs.

12. Municipal Councils composed of representatives of beneficiaries and civil society (constituting 80% of the membership), as well as local government (20% of membership) - are the key organization for targeting of

benefits, for allocating resources under the project, and provide a critical link to local government thereby promoting long term institutional sustainability of the program. They have a fundamental role in mobilizing communities and promoting community participation in municipal decision making. Councils receive, prioritize and approve subproject proposals from community associations, during regularly scheduled and widely publicized meetings that the public is encouraged to attend. The Councils then prepare annual investment plans which they provide to State Technical Unit. The Municipal Councils also play a supervisory role for the community associations during both preparation and implementation of subprojects.

13. The State Technical Unit - SUDENOR - would serve as the implementing unit for the proposed project. Under the proposed project, SUDENOR would gradually delegate its supervision activities to Municipal Councils and concentrate its activities on supervision of the Municipal Councils, as well as general coordination and promotion of the project. These duties include continuous execution of the information campaign, project reporting, impact evaluation, updating the Management Information System (MIS), as well as the design and provision of tailored training modules for Municipal Councils and community associations on key project issues.

14. Project Sustainability. Financial analyses and field investigations confirm the sustainability of the investment subprojects funded by the project. A sample of over 8,000 community subprojects funded in 1995 (under the R-NRDP) and in 1997/98 (under RPAP) was reviewed and it was found that 89% of these subprojects are fully operational to date. Analysis of productive subprojects revealed that cost recovery through user fees paid by community associations is adequate to cover both operation and maintenance and replacement of the original investment long before the end of its useful economic life. Beneficiary participation at all stages of the subproject cycle, as well as significant levels of community contribution (up to 25%) help to ensure subprojects are maintained. Further, the democratic process intrinsic to FUMAC and FUMAC-P ensure better selection and prioritization of subprojects by beneficiaries, enhancing long term sustainability. The Project requires the establishment of community funded operation and maintenance plans - only subprojects that have realistic maintenance plans would be approved and financed. Subproject maintenance would be monitored by Municipal Councils and SUDENOR during the Project. Performance incentives for proper operation and maintenance are included in project design.

15. Lessons from Bank Experience. As the principal lending institution engaged in a sustained, long-term relationship with the Brazilian Government to address rural poverty issues in the Northeast, the Bank is particularly well-placed to support expansion of the existing program of community-based rural development in the region. The Bank contributes its experience under the successful community-based Rural Poverty Alleviation Project (RPAPs) in eight states of Northeast Brazil - a program that has served as a template in the design of the proposed project. The RPAP provides a wealth of lessons regarding how to successfully design and implement community-based rural development, which are cited below.

16. Decentralization of fiscal and investment decision-making and implementation from federal to state and local governments, to community associations, ensures efficient program administration and superior outcomes. Experience shows that decentralized community approaches reduce bureaucracy, eliminate administrative bottlenecks and reinforce accountability for project performance by placing decision-makers near beneficiaries. Under the new project the existing, decentralized institutional structure will be further devolved, with increased delegation of duties to municipal councils and

greater utilization of STU regional offices to promote more responsive and local level monitoring, data collection, coordination, and supervision. Participation by beneficiaries in the selection, financing, execution, and operation and maintenance of subprojects has ensured that investments meet genuine community needs, led to cost savings, and has increased community 'ownership' leading to improved sustainability of investments. This methodology will be continued under the proposed project.

17. Poverty targeting mechanisms that are simple, verifiable and based on objective criteria, can foster transparency, minimize political interference in project resource allocation and ensure that project resources reach the poorest communities. Experience with project municipal councils demonstrates that communities are the best-positioned and informed to target effectively. Under the new project, broad targeting will be undertaken (i) at the municipal level, with indicative budgets assigned to each municipal council, differentiated according to poverty indices; and (ii) at the community level, by the Municipal councils.

18. Supervision has been found to be an indispensable determinant of success and sustainability. It needs to be reinforced at all levels and involve local entities closest to the communities, particularly Municipal Councils and NGOs. Under the new project supervision responsibilities will be increasingly devolved to Municipal Councils, who will be supported with training and technical assistance from external partners. Measures will also be taken to modernize all Councils, gradually providing computers and information technology to all of them.

19. A user-friendly monitoring and evaluation system facilitates the subproject evaluation process, provides feedback and necessary information to improve targeting and efficiency, and is an essential management and planning tool. Under the new project, the MIS will be established in order to permit real-time monitoring of the entire project cycle, and to allow more accurate assessment of project impact. A rigorous impact evaluation component will also be introduced to measure the gains achieved from the subproject investments.

20. Dissemination of "best practices", such as experiences with NGOs in Rio Grande do Norte, EMATERCE in Ceará, FUMAC Councils in Bahia and Sergipe and FUMAC-P Councils in Pernambuco can hasten learning and reward innovation. Under the new project exchanges between states, municipalities and communities will be expanded further using training seminars, and workshops. Standardization of subproject documents, technical designs and unit costs simplifies the subproject preparation and evaluation process, improves the quality of subprojects, facilitates the procurement of goods and works, prevents over-design and enables participation by poorer communities. The existing database of standard designs and documentation will be reviewed, technically updated where necessary, and further expanded under the new project.

21. Environmental protection criteria for the proposed project, based on approaches applied under the previous project, will ensure subprojects adequately deal with environmental issues. Experience demonstrates, that because of their small scale, most subprojects do not have a significant effect on the environment. Nevertheless, the detailed environmental checklist developed under RPAP will be maintained and updated for the proposed project. Where environmental issues are a concern, standard subproject designs have been developed and will continue to be used by communities and Municipal Councils during subproject implementation. Further, an environmental specialist will be maintained at the STU to provide additional technical assistance on environmental matters as well as provide training to increase

environmental awareness of Municipal Councils and community groups.

22. Technical assistance enhances the ability of community associations and Municipal Councils to identify, prepare and implement subprojects, thereby augmenting their capacity to compete for investment funds. Technical assistance needs to be targeted to weaker municipalities to improve their planning, management and financial capacity to participate in the project. Locating and/or developing sources of technical assistance in rural areas requires significant attention and needs to be monitored at the local level. Under the new project increased attention will be placed on training at the community level - funds will be made available for the appointment of 'technical advisors' to be recruited by each municipal council. These advisors will be responsible for managing and coordinating local technical and training needs. Increasing efforts will also be placed on more meaningful involvement of civil society (e.g., NGOs and other civil and church groups) - particularly with respect to increasing the flow of information, mobilizing the poorest groups and supporting training activities at the community level.

23. A clearly-defined, well-disseminated and enforceable system of checks and balances is essential to ensure proper use of funds and sound targeting of resources. Rules and procedures for a system of checks and balances, including guidelines for performance incentives and penalties, will be reviewed and updated for adoption under the new project.

24. The PAC approach should be minimized, particularly since the FUMAC component performed significantly better (under the R-NRDP and particularly the RPAP), and shows clear advantages with respect to targeting, sustainability and social capital formation in poor rural communities. Under the new project, FUMAC and FUMAC-P subprograms will account for 75% of total subproject expenditures.

25. Productive subprojects should be subjected to rigorous selection, preparation, technical assistance and supervision criteria. Under the new project, a 'one-shot' seed grant will be provided to eligible productive investments (i) that provide services for a large number of community members; (ii) whose collective use is regulated by strict operational guidelines (regulamento de uso); and (iii) for which operation and maintenance is assured by charging adequate user fees to both association members and non-members. Revised procedures for productive subprojects will be developed and outlined in the new Project Operational Manual. Mechanisms will also be established, with the assistance of the Bank of the Northeast, to graduate communities with successful productive experience to alternative sources of financing, including credit.

26. Graduation of communities which have met basic needs, to alternative forms of financing (including credit) ensures more equitable distribution and improved targeting of project resources. Under the new project, communities which have improved their relative socio-economic conditions due to prior investments would gradually receive fewer funds during the course of project implementation as they gain access to other sources of financing and reach a point where a 'safety net' is no longer necessary. In field observations of RPAP, municipal councils were found to already - albeit informally - practice this type of 'graduation' by excluding subproject requests from those communities who had already received a number of subprojects. Under the new project, a graduation strategy will be formalized based on objective criteria (e.g., level of accumulation of socioeconomic assets, level of community organization and level of social well-being) encouraging these communities to search for alternative sources of investment. Graduation decisions will be the responsibility of Councils in the case of FUMAC or FUMAC-P, and by SUDENOR in the case of PAC municipalities. The Manual of Operation will

include the frameworks, norms and procedures that will be followed for graduation. A user-friendly version of this operational manual will be widely shared with all the Municipal Councils immediately following project effectiveness.

27. Poverty and Program Objective Category. The proposed project is part of the Bank's Program of Targeted Interventions. The Northeast Region has the greatest incidence of poverty in Brazil. The project also employs a targeting mechanism at the beneficiary, community and municipal level which takes into account poverty-related criteria and other key parameters to ensure that project resources reach those communities which contain a higher concentration of rural poor than the rest of the State.

28. Environmental Aspects. The proposed project has been classified as B. Given their relatively small size and nature, most community subprojects would not have a significant impact on the environment. The project would, however, ensure proper environmental screening and enforcement measures to prevent any negative environmental effects that certain types of productive or infrastructure investments could produce. The Project Operational Manual would specify environmental criteria, screening procedures and enforcement mechanisms to be followed.

29. Contact Point

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