58095

Brazil: Alagoas - Fiscal and Public Sector Reform Development Policy Loan
Release of Second Tranche – Full Compliance
(P103770 – Loan no. 7817-BR)

Tranche Release Document

1. This note summarizes the progress made under the Fiscal and Public Sector Reform Development Policy Loan (P103770, Loan No. 7817-BR) to the State of Alagoas, Brazil. On December 17, 2009 the Executive Directors approved the two-tranche Fiscal and Public Sector Reform Development Policy Loan (P103770, Loan No. 7817-BR) in the amount of US$ 195.45 million to support the efforts of the Government of Alagoas (GoA) in implementing cross cutting reforms that will contribute to the State's broad objectives of reducing poverty and increasing growth to levels at least comparable to the average of northeastern states in Brazil. Following the Board decision, the Loan Agreement was signed and became effective on December 23, 2009. The first tranche of US$ 120 million was released upon effectiveness. The second tranche was planned to be disbursed in the fourth quarter of FY10, upon completion of several tranche release conditions related to the Government's reform program.

Background

2. Alagoas is one of the poorest states in Brazil. It has the highest poverty rate in the country, with half the population living below the poverty line. It ranks second-lowest in the Human Development Index (HDI). If it were a sovereign country, Alagoas' HDI would rank 120th among the 185 countries members of the United Nations. In 2006, its per capita Gross Domestic Product (GDP) was US$ 2,200, the third lowest in the country, and only 40 percent of the national average. While Brazil and the Northeast in particular have managed to seize new economic opportunities in recent years, Alagoas has not. Its economic growth over the last decade has lagged both the regional and national averages. Social and economic stagnation are likely to persist unless major reforms are undertaken.

3. The State government is a key factor in the state's social and economic development. It is the main provider of education, health, police, transport and basic infrastructure services. Chronic fiscal crises, poor policy choices, and bureaucratic inefficiency have prevented the State from performing these functions well. As a result of excessive borrowing in the past, the State is highly indebted and must allocate a significant proportion of its revenues to servicing its debts. Much of its remaining revenues are devoted to paying the wages of public employees who tend to be inefficiently allocated among government responsibilities, under-motivated, and in some cases, overpaid relative to public employees in other Brazilian states. Payments to retired state employees are also a significant drain on resources, exacerbated by the State's failure to keep accurate pension records or take advantage of recent national social security reform which mandates the adoption of a set of measures to reduce pensions and improve the administration of civil service social security systems to be applied by the federal, states and municipal governments. The budget proposals of the State secretariats were only loosely related to the State Government's priorities. Expenditure execution is slow and inefficient which is reflected in poor quality of public goods and services.

4. Upon taking office, the new administration undertook a diagnosis that found a close link between the weakened functioning of the Alagoas State public sector and poor economic and social performance. The Government consequently set an agenda prioritizing three reform pillars: the renewal of the public sector, recovery of State public finances and reversal of the deteriorating trend of social and economic indicators. The Governor aspired to leading a government "that established a responsible, efficient and ethical administration, that promoted economic development with environmental sustainability and interrupted the cycle of illiteracy and misery while improving the quality of life of the Alagoan people and rescuing its self-esteem".

5. In this context, in 2008 the GoA sought Bank's assistance in fine tuning its own program of fiscal and public management reforms. The DPL was prepared as to support the consolidation of the State's fiscal adjustment, the creation of additional fiscal space for public investment, and the improvement of public sector efficiency. This program has been structured around the four components of Alagoas's medium term strategy for the enhancement of its fiscal accounts and the improvement of public sector management:

- Consolidating the Fiscal Adjustment and Creating Fiscal Space for Investment
- Improving Human Resource Management
- Reducing State Social Security Deficits
- Strengthening Public Sector Management

6. These four components were intended to restore fiscal sustainability, improve the management of State human resources, reduce social security deficits and improve public sector efficiency. They are fully consistent with the CPS objectives of strengthening macroeconomic fundamentals and public sector management. This operation is one of a number of sub-national DPLs and SWAps designed to reinforce public sector management as an integral part of the Bank's public sector governance strategy in Brazil.

Recent Economic Developments

7. Over the last decade Brazil has built a solid macroeconomic framework which has allowed the country to smoothen the effects of the financial turmoil with relative speed. The federal government has been using its increased fiscal and external solvency and its enhanced credibility to adopt expansionary fiscal and monetary policies without compromising the sustainability of its fiscal framework. Nevertheless, despite the country's ability to smoothen the effects of the crisis, the impact on sub-national governments has not been insignificant.

8. The global economic crisis' impact on the Brazilian economy was immediate and strong, but the country has demonstrated significant resilience. Twelve consecutive quarters of GDP growth since 2006 were interrupted by seasonally adjusted declines of 3.5 percent in the fourth quarter of 2008 and 0.9 percent in the first quarter of 2009. GDP figures for Q4 2009 indicate a year on year contraction of 0.2 percent for 2009. The negative 2009 GDP figures owed much to a drop in investment of 9.9 percent per year.

9. Resurgent growth, buoyant aggregate demand and record low unemployment indicate that a swift and strong economic recovery is underway. Seasonally adjusted growth resumed after the second quarter of 2009 and has recorded positive quarter on quarter growth since then. The recovery of domestic demand has been driven by the strong resumption of investment since the second half of 2009 as well as the strengthening of consumption. Industrial production, capacity utilization, the retail index, and the jobless rate also point to a buoyant Q1 2010. Seasonally adjusted industrial output capacity utilization and retail activity kept expanding at a fast pace. Recovery in the industrial sector has been driven mainly by manufacturing. The number of jobs created in Q1 2010 was record high and the seasonally adjusted jobless rate was lower than a year ago. The recovery is expected to continue in 2010 and beyond. Market expectations for GDP growth are around 5.5 percent for 2010 close to the before-crisis growth peak. As a consequence of the fast pace of recovery as well as seasonal and temporary factors, inflation (as measured by the IPCA index) has been increasing since October 2009 reaching 5.1 percent seasonally adjusted in March 2010, above the center of the target (4.5 percent). Market expectations for inflation are around 5.2 percent for 2010 and at the center of the target for 2011. Indeed, the central bank has started in April a series of aggressive interest rates hikes which are expected to quell inflation concerns.

10. The strong economic recovery is widening the current account deficit and fueling international investors' confidence and appetite for Brazil. As a result of depressed global demand, both imports and exports dropped in 2009. The current account deficit narrowed in 2009 on the back mostly of a lower deficit of the services and income balance. Although the domestic and global recovery in Q1 2010 have increased the seasonally adjusted trade balance surplus, they were not sufficient to compensate for the widening of the services and income deficit. As a result, the current account deficit is further widening and expected to reach 3 percent of GDP in 2010. The Real has appreciated to its pre-crisis level-at about R$1.75 per dollar, which is increasing exporters' concerns over declining competitiveness in international markets. The BOVESPA stock market index reached in March 2010 its highest level since June 2008 catching up with its pre-crisis level. Capital inflows have resumed beyond their pre-crisis trend which led the government to impose a 2 percent tax on foreigners' bond and equity acquisitions and a 1.5 percent tax on American Depositary Receipts (ADRs) to slow portfolio investment inflows. The country's international reserves reached US$244 billion by the end of March 2010, well above the pre-crisis peak. Sovereign spreads are below their pre-crisis levels at about 170 bps.

11. A favorable pre-crisis external environment and sound economic policy choices helped foster resiliency, create strong macroeconomic foundations and restore economic growth. First, far-reaching structural reforms and price stabilization in the 1990s were followed by consistent adoption of sound macroeconomic policies in the past decade. Second, floating exchange rates and the accumulation of foreign reserves have allowed Brazil to adjust well to external shocks. Third, adoption of an inflation-targeting regime has contributed to lowering inflation to the center of the target range and enabled the independent central bank to focus on countercyclical monetary policy. Fourth, the Fiscal Responsibility Law (FRL) framework has generated significant primary surpluses, which contributed to decrease net debt and consolidate fiscal adjustment prior to the crisis. Fifth, a pre-crisis boom in commodities and buoyant global demand contributed to dramatically reduce Brazil's fiscal and external vulnerabilities.

12. The strong fundamentals built in the last decade have allowed the use of a wide range of policy tools. The government used its increased fiscal and external solvency and enhanced credibility to adopt expansionary fiscal and monetary policies during the crisis. Monetary, fiscal, and quasi-fiscal countercyclical policies have included lowering the SELIC policy rate to a historical low of 8.75 percent, reducing the reserves requirement on financial institutions, injecting credit into the financial system through public banks, extending credit lines to exporters, and more modest fiscal policy measures.

13. In sum, the macroeconomic policy framework for Brazil is considered adequate for the purposes of the ongoing Development Policy Loan. Therefore, **Condition 2 is met**: *that the Guarantor is maintaining a macroeconomic policy framework which does not jeopardize the objectives of the Program.*

14. Despite the country's overall resilience, the crisis has put some strains on the finances of subnational governments, which is likely to slow the resumption of growth in some parts of the country. Subnational governments suffered considerable reductions in fiscal revenues, both as a result of lower tax collections and reduced federal transfers. Given the hard budget constraints and limited credit access entailed by Brazil's Fiscal Responsibility Law (FRL), subnational governments had limited space to implement countercyclical fiscal policies. Instead, they cut discretionary expenditures, mainly investments.

15. As assessed during project preparation, Alagoas has experienced one of the most difficult fiscal situations of any State in Brazil. Excessive personnel expenditures resulted in continuous fiscal deficits and high indebtedness, which has significantly hampered Government's ability to invest and to provide adequate economic infrastructure and public service delivery required for economic growth and social welfare.

16. Relative to this poor state of affairs, the current administration has made significant reform efforts, particularly in the fiscal area. On taking office in 2007, the administration inherited i) a Net Consolidated Debt (NCD) equal to 2.22 times the State's Net Current Revenue (RCL) and ii) substantial public wage increases granted by the previous administration at the end of its term. The government immediately responded by stepping up enforcement on the collection of the State's Value Added Tax (VAT), the so called, *Imposto sobre a Circulação de Mercadorias e Servícios (ICMS)*, reducing discretionary operating costs by 20 percent, negotiating a rollback in the wage increases granted by the previous government, and by making sharp cuts in investment expenditures.

17. As a result of these measures and growth acceleration in 2007 and 2008, the State's fiscal performance improved considerably. The GoA increased its primary and gross operating surpluses, obtained two consecutive positive overall balances (in 2007 and 2008) and reduced the ratio of consolidated debt to net current revenue from 2.22 in January 2007 to 1.85 in August 2009. These measures also permitted increases in capital investments in 2008. In 2007 and 2008, the GoA obtained robust fiscal balances and reduced consistently its indebtedness. Furthermore, for the first time since the enactment of the FRL in 2000, the State is in compliance with the indebtedness ceiling defined in the FRL. In addition the GoA has managed to meet the targets for

primary balances, debt, own tax revenue collection and personnel expenses agreed in the PAF 2007-09 in 2007 and again in 2008.

18. These achievements, however, were threatened by the global economic crisis, which reduced State revenues, mainly constitutional federal revenue-sharing transfers that are the most important GoA's revenue source. Federal tax revenues experienced a strong fall due to the national economic slowdown and the adoption of countercyclical fiscal policies that temporarily reduced rates on the taxes that are shared with sub-national governments. This affected all Brazilian states and municipalities, but especially those more dependent on federal transfers such as the GoA. Facing a strong revenue fall, the State administration recognized that further adjustment measures would be required, especially with regard to the containment of current expenditures.

19. To preserve the fiscal adjustment initiated in 2007, the Government adopted additional decisive actions to reduce current expenses, in particular personnel expenditures, the most important and persistent source of fiscal disequilibria. While federal legislation prohibits the dismissal of civil servants, the State completed a census of personnel in order to identify "ghost" workers and is performing an audit of the State payroll to identify irregularities in the compensation of active employees, pensioners, and dependent survivors. The State also submitted to the State assembly a wide-ranging reform in the pension system for State employees, incorporating administrative, parametric and structural changes to the system. To reduce expenditures on government purchases of goods and services, the GoA has been implementing reforms in its procurement system to generate additional savings.

20. As a result of these measures, despite the reduced State revenues, the Government was able to maintain an appropriate expenditure program and a good fiscal status under the Guarantor's Fiscal Responsibility Law (FRL), as further explained below. Overall, we can conclude that **Condition 3 is also met**: that an appropriate expenditure program and fiscal arrangements is maintained between the Borrower and the Guarantor.

Progress against Tranche Release Criteria

21. Overall progress in implementation of the Government of Alagoas medium term strategy for the enhancement of its fiscal accounts and the improvement of public sector management has been satisfactorily. The reform activities planned under each of the four components progressed well and tranche release conditions have been met as described in greater detail below. Therefore, as a result, **Conditions 1 and 4 are also met**.

Condition 1: satisfactory progress achieved by the Borrower in carrying out the Program.
Condition 4: that the actions described in Part B of Section I of this Schedule for the purposes of the Second Tranche have been taken.

Component 1: Consolidating Fiscal Adjustment

22. This component comprises government actions directed at: guaranteeing the financial sustainability of Alagoas; reinforcing the decreasing path of State indebtedness; complying with the federal fiscal discipline framework; and expanding fiscal space for investments.

23. As mentioned above, in 2007 and 2008, the GoA obtained robust fiscal balances and reduced consistently its indebtedness. Furthermore, for the first time since the enactment of the FRL in 2000, the State is in compliance with the indebtedness ceiling defined in the FRL. In addition the GoA has managed to meet the targets for primary balances, debt, own tax revenue collection and personnel expenses agreed in the PAF 2007-09 in 2007 and again in 2008. The team's analysis during project preparation suggested that the underlying adjustment relied upon the reduction of investment expenditures which are also highly dependent on federal capital transfers. Reducing investments would invariably slow growth and should not be relied upon unless there is no other recourse available. Furthermore, Alagoas and other states are confronting a reduction in federal transfers owing to the current economic recession. Therefore, Alagoas will need to increase its net operating balances to finance with its own sources the expansion of investments and reduce its dependence on federal capital transfers.

24. Consistent with this assessment, this operation supported the increase of government fiscal balances, the reduction of indebtedness, improvements in tax collection and the control of current expenses. Besides the specific actions aimed at improving revenue collection and modernizing procurement procedures, the project also aimed to support the Government's maintenance of an appropriate macroeconomic and expenditure program and fiscal arrangements in line with the Federal Government of Brazil's Fiscal Responsibility Law. Therefore, the tranche release condition related to this component is the following:

> *Tranche Release Condition 1: The Borrower, through its general attorney's office (Procuradoria Geral do Estado de Alagoas) has presented a legal opinion in form and substance satisfactory to the Bank certifying that the Borrower has maintained good fiscal status under the Guarantor's Fiscal Responsibility Law.*

25. This tranche release condition is met. The State's general attorney's office has presented the required legal opinion confirming that the Borrower has maintained good fiscal status under the Guarantor's Fiscal Responsibility Law. The Government confirmed that, with the exception of the indicator on personnel expenditures to net current revenue ratio, the State has met all of the Fiscal Responsibility Law (FRL) requirements. It is important to highlight though that in spite of not having met the personnel expenditures indicator, the State is still in compliance with the FRL since the law provides for an exceptional treatment in occasions when the Gross Internal Product has experience a decrease. In light of the economic slowdown seen in 2009, the Federal Government recognized the exceptional occasion and the State has the possibility of adjusting its personnel expenditures to meet the target in 2010.

26. This component also has milestones for the second tranche, indicating the expected follow up on the prior actions for the first tranche. While these do not represent formal conditions for the release of the second tranche, they indicate that the Government's reform program has been

evolving as expected. Overall, the policies under this component have progressed well and the milestones were fulfilled.

Component 2: Improving Human Resource Management

27. This component comprises government actions directed at: exerting effective control over the payroll; developing efficient human resource policies; and enhancing civil service performance. The operation supports the enhancement of GoA's human resource management strategy which consists in two sequential sets of actions. The first set, completed prior to loan signing, consists in the improvement of the information systems regulating staffing, individual remuneration and overall payroll. In this regard, a Census of the civil service staff was carried out and remedial measures adopted. The second set of actions comprised of an audit of the payroll and follow up measures to the audit findings. The conclusion of the audit and adoption of remedial measures were included in the project as tranche release conditions:

> *Tranche Release Condition 2: The Borrower, through SEGESP has: (a) publicly accepted, as fully satisfactory, the final report issued by the Audit Consultant, including the identification of any alleged irregularities in the provision of social security benefits; and (b) based on the findings of the final report issued by the Audit Consultant, the Borrower, through all the necessary legal, administrative and accounting measures required therefore: (i) has, on a case-by-case basis, conducted the administrative investigation and promoted the initiation of judicial processes required to substantiate the Borrower's decision to revoke, if necessary, the provision of social security benefits which do not conform with the provisions of the Social Security Law and subsidiary legislation; and (ii) has taken the necessary actions to regularize the provision of payment of relevant benefits in cases where irregularities have been adequately substantiated, all in a form and substance satisfactory to the Bank, as evidenced through a communication (Oficio) from SEGESP to the Bank found satisfactory to the Bank.*

28. This tranche release condition is met. As planned, the audit of the payroll (including active personnel, pensioners and survivors) was concluded. The audit report was delivered to the Government and SEGESP (State Management Secretariat) presented a declaration confirming that the service was adequately carried out by the auditors. This declaration was published in SEGESP's website. The audit finding indicated 32,542 potential irregularities in the payroll that represented a potential saving of R$ 8,835,380 (approximately US$ 5 million) and, based on the audit findings, the State has been adopting the necessary measures to initiate the administrative investigations as well as regularize payments of relevant benefits. As part of the evidence of compliance of this tranche release condition, the Government has presented reports describing the procedures put in place in order to investigate and process these cases, the types of cases investigated and a list identifying case-by-case the type of irregularity found. Moreover, the Government has presented a list of the administrative processes already initiated and declarations from collegiate bodies and the Public Ministry confirming that they have received administrative processes from SEGESP in order to further investigate and process, since it is part of their competences to do so. Priority was given to those cases that represented a higher potential economy to the State and SEGESP introduced an electronic system to generate the paperless administrative processes to expedite the work.

Component 3: Reducing the State Social Security Deficits

29. This component comprises government actions directed at improving the managerial control of the State social security system, reducing the cash and actuarial deficits of the State social security system; and reducing the contribution of the State Treasury to the social security system through the gradual transition from a Pay As You Go (PAYG) system to a fully funded system.

30. During project preparation Alagoas' social security system was identified was one of the main sources of disequilibrium of State public finances. Projections performed for the preparation of this operation indicated that the RPPS's financial disequilibrium would be aggravated over time resulting in a significant increase in the financial burden unless steps are taken. This is in large measure due to an expected increase in pensioners and survivors relative to active public servants. Therefore, social security reform comprises an essential pillar of the effort to reduce the State fiscal disequilibrium.

31. The project supported the adoption of administrative, structural and parametric reforms by the State. Prior actions for first tranche disbursement included the approval by the State Assembly of the Law No 7114/2009 establishing the Single Administrator (*Gestor Único*) for the Government of Alagoas's (RPPS) pension system and the restructuring of the State Social Security System directed to a gradual transition to a fully funded system. For the second tranche, the State had to undertake tranche release conditions, as described below:

> <u>Tranche Release Condition 3</u>: *The Borrower, through SEGESP, has, through the necessary legal, judicial, administrative, technical and accounting measures required therefore:*
> *(a) obtained and maintained a regular CRP as evidenced through a corresponding certificate found satisfactory to the Bank;*
> *(b) (i) updated the Borrower's payroll, data bases and accounting systems, through the cross-checking of relevant Guarantor's and Borrower's social security registries and data systems; (ii) ceased, during FY 2010, the payment of any social security benefits that have been confirmed by SEGESP (on a case-by case-basis), to be irregular or illegal in accordance with the provisions of the Guarantor's Social Security Legislation (including, inter alia, salaries paid to active civil servants, pensions and other benefits paid to retired civil servants and pensions paid to surviving heirs or designated beneficiaries of deceased civil servants), all in a form and substance satisfactory to the Bank; and (iii) fully integrated within the Borrower's legal and regulatory frameworks the provisions of the Guarantor's Social Security Legislation, in particular its articles 40.7.1.; 40.3.; 40.21.; all this as evidenced through a communication (Oficio) from SEGESP to the Bank found satisfactory to the Bank; and*
> *(c) adopted administrative, legal and regulatory instruments required to fully implement the provisions of the Social Security Law, including, inter alia: (i) the issuance of the statutes of the Single Administrator, the staffing of the governing bodies and appointment of officials and key technical staff of the Single Administrator, the approval of its financing plan; (ii) the segregation of the three funding schemes referred to in Section I. A. 3 (a) of this Schedule; (iii) the capitalization of the funding mechanism referred to in Section I. A. 3 (a) (i) of this Schedule, through the approval therefore by SEGESP, of an amount of at least R$122,500,000 (one hundred twenty two million and five hundred thousand Reais) for FY*

2010, all in a form and substance satisfactory to the Bank; all this as evidenced through a communication (Oficio) from SEGESP to the Bank found satisfactory to the Bank.

32. This tranche release condition is met. Over the past year the Government has been taking all the necessary measures to regularize the situation of its Social Security System for Public Employees (*Regime Próprio da Previdência Social – RPPS*) and receive the regularity certificate (CRP) from the Federal Government's Ministry of Social Security on a normal basis (without any judicial interference). The State of Alagoas recently complied with all the requirements is in a position to obtain a regular CRP, as confirmed by the Ministry of Social Security. Moreover, the State has undertaken important efforts to improve its payroll, databases and accounting systems through the crosschecking with the Federal Government's database on deceased people. As a result of this work, more than 150 additional deceased civil servants that had been receiving benefits were recently excluded from the payroll, representing a monthly saving of R$ 169,467 (approximately US$ 97,000). The GoA, with the assistance of the Ministry of Social Security has also been trying to crosscheck GoA's systems with the Ministry's register of beneficiaries of other national social security systems (federal and sub-national ones); however, this has not been possible yet due to technical problems. The Ministry is currently working on a platform to make this crosschecking feasible for all subnational governments, but there is no estimate date on when this will be possible. In line with the work to regularize the audit findings, the Government has also adopted the necessary parametric measures to be in line with the provisions of the Federal Legislation on social security. A report has been prepared by the Government and presented to the Bank evidencing the measures adopted. Finally, SEGESP has presented the necessary evidence confirming that all the administrative, legal and regulatory measures needed to fully implement a single administrator of the State pension system, effectively introduce the segmentation of the RPPS participants and the temporary coexistence of PAYG and fully funded systems have been taken.

Component 4: Strengthening Public Sector Management

33. This component comprises government actions directed at providing planning, budgeting and management tools, methods and arrangements for better implementation of government programs; and improving government service delivery through the gradual adoption of intensive management in a selected set of government priority programs.

34. The government's priority reform agenda includes addressing the weaknesses identified in the planning, budgeting, expenditure execution cycles. Failures at all these levels result in poor policy choices marked by inefficient resource allocation and lack of prioritization, dispersion of government resources in a large number of programs, low budget and financial execution of the great majority of programs and fiscal vulnerabilities related to the generation of contingent liabilities as well as corruption, rent seeking and state capture.

35. In order to address these issues, the Government prepared an action plan that consists of a set of policy measures addressing key issues in its planning and budgeting cycle identified by a diagnostic work. Moreover, given resource scarcity, the GoA is taking steps to allocate resources to priority undertakings and avoid fragmentation. Hence in 2009, a portfolio of priority projects was selected to receive differentiated treatment during budget preparation and execution and be intensively monitored to improve budget and project execution. The introduction of these

managerial tools constitutes the GoA's first steps in delivering results in an efficient and effective manner. The tranche release conditions were aimed at supporting the continued government efforts to strengthen its public sector management practices:

> *<u>Tranche Release Condition 4</u>: (a) The Borrower, through SEPLAN, has taken a series of administrative and financial actions aimed at improving its planning, budgetary and financial management systems detailed in the Action Plan through, inter alia, the successful achievement of at least five of the nine target actions defined in Annex 2 to Decree No. 4197, all in a form and substance satisfactory to the Bank as evidenced through a communication (Oficio) from SEPLAN to the Bank found satisfactory to the Bank. (b) The Borrower, through SEPLAN and SEGESP, has taken all the necessary measures to effectively implement its two Priority Programs referred to in Section I.A.4. (c) of this Schedule, through the carrying out of procurement of goods and services, staffing and incurring in other contractual obligations, all constituting, in the aggregate for both programs, the execution of at least R$5,000,000 (five million Reais) at the commitment stage (criterio empenho) in the State Budget for FY 2010, in a form and manner satisfactory to the Bank, as evidenced through a communication (Oficio) from SEPLAN to the Bank found satisfactory to the Bank.*

36. <u>This tranche release condition is met</u>. Over the past six months the GoA has been undertaking important efforts to complete the actions included in the Action Plan. Overall the actions have progressed well, and the Government has met the minimum criteria specified above: five of the nine target actions have been adequately met. Efforts towards completion of the remaining actions will continue over the next months. The Government has also provided evidence that the two priority programs to strengthen public sector practices are progressing well, that the planned activities are being executed, and that at least R$ 5 million of the resources allocated to these programs have been committed.

Conclusion and Recommendation

37. Based on the information provided above, it is possible to assess that:

- the progress achieved by the Borrower in carrying out the Program is satisfactory (Condition 1);
- the Guarantor is maintaining a macroeconomic policy framework which does not jeopardize the objectives of the Program (Condition 2);
- an appropriate expenditure program and fiscal arrangements is maintained between the Borrower and the Guarantor (Condition 3); and
- release conditions for the second tranche have been carried out (Condition 4).

38. It is therefore recommended that the second tranche be released.