

**PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE**

Report No.: AB4519

Operation Name	BR: ALAGOAS FISCAL AND PUBLIC MANAGEMENT REFORM
Region	LATIN AMERICA AND CARIBBEAN
Sector	Sub-national government administration (50%);Water supply (30%);Compulsory pension and unemployment insurance (20%)
Project ID	P103770
Borrower(s)	STATE GOVERNMENT OF ALAGOAS
Implementing Agency	STATE SECRETARIATS OF FINANCE, PLANNING AND MANAGEMENT
Date PID Prepared	February 4, 2009
Estimated Date of Appraisal Authorization	May 28, 2009
Estimated Date of Board Approval	July 21, 2009

1. Key development issues and rationale for Bank involvement

Located in the Northeast region, the poorest in Brazil, Alagoas is a small state with 27.8 thousand km² (0.3 percent of Brazil's territory), a population of 3 million inhabitants (1.5% of Brazilian population) and a GDP amounting R\$15.8 billion in 2006 (approximately US\$7 bi or 0.7 percent of Brazil's GDP).

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 under the Human Development Index. In 2006, its per capita GDP was the third lowest in the country, and only 40% 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 rate 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.

The performance of the state public sector is a principal explanatory factor for the precarious economic and social conditions of Alagoas. Chronic fiscal disequilibria, poor policy choices and managerial inefficiency are behind the inability of the Government of Alagoas (GOA) to turnaround the historically difficult economic and social situation of the state.

Continuous fiscal deficits resulted in high indebtedness that in turn has significantly hampered the ability of the GOA to enhance the economic growth conditions of Alagoas and to improve the social welfare of its population. The unsustainable fiscal position has been the clearest and the most worrisome sign of GOA's institutional dysfunction. Nonetheless, inefficiencies in public expenditure management have not only aggravated the impact of resource scarcity on the quality of public service delivery but also have further worsened the difficult fiscal conditions of GOA.

The proposed operation is a US\$195.5 million Development Policy Loan (DPL) designed to assist the Government of Alagoas (GOA) in taking the first steps in a long-term process of financial and management reform. Operating in a difficult economic and political environment, the project will support significant, sustainable reforms in key areas of public administration. It will also permit the state to leverage recent improvements in fiscal performance and define a program of capital investments. Such improvements will be instrumental in enabling the state to meet the larger objectives of reducing levels of poverty and achieving levels of economic growth at least comparable to other states in the region.

The proposed operation and associated Bank support meet the criteria for engagement with sub-national governments agreed under the Country Partnership Strategy (CPS) for 2008-2011. As specified in the CPS, the level of Bank lending must be consistent with the credit ceilings specified in each state's PAF and must be approved by the STN. The proposed operation has been developed on the basis of key principles of engagement: 1) a shared understanding of the fiscal and managerial challenges facing the state, ii) state ownership of the program, with policy measures emerging from the authorities own initiatives and designed in collaboration with Bank staff; and iii) political commitment at the highest levels.

The Rationale for Bank involvement is based in part on the fact that Alagoas is the poorest state in Brazil. A failure to address the state's problems condemns 1.5 million people to ongoing poverty. A breakdown of the state administration could also have adverse fiscal effects on a national scale. The emergency measures that would be required to address a complete collapse in the state's finances could prompt demands for similar treatment by other states, undermining the delicate political balance that enables the Federal Government to enforce the Law of Fiscal Responsibility and other regulatory constraints that are critical to macroeconomic stability.

The Bank is uniquely positioned to provide this assistance. In addition to our technical expertise in the various areas of the project, the Bank has specific experience in assisting the process of state reform in Brazil, through our previous operations in Ceara, the Federal District, Minas Gerais, and Rio Grande do Sul. We also offer an assurance of political neutrality. The Bank has no partisan agenda and is therefore able to offer advice that might be viewed as politically intrusive if it emanated from the Federal Government. This role is recognized and endorsed by the Federal Government. Indeed, it is at the specific request of the STN and the State Government that we are developing this operation.

2. Proposed objective(s)

The overall goal of the proposed operation is to support the GOA's efforts in taking the first steps in the implementation of cross cutting reforms that will be instrumental in enabling the state to meet the larger objectives of reducing levels of poverty and achieving levels of economic growth at least comparable to other northeastern states.

To pursue this overall goal, the proposed program defines four specific objectives:

- Consolidation of the State's fiscal adjustment and enlargement of the fiscal space for government investments;
- Enhancement of State human resource management to rationalize personnel expenses and improve service delivery;
- Reduction of the imbalances in the social security system of civil servants, and;

Improvement of public sector management system for planning, budgeting and expenditure management

3. Preliminary description

The operation has four major components associated with each one of the specific objectives set above. The program has been structured into a policy matrix, with specific actions for each of the four components whose implementation is associated with disbursements in 2 tranches. The four components are described in more detail below.

Loan Components:

- The *fiscal adjustment component* will define specific measures for revenue enhancement and improvements in treasury operations and set specific targets for improvement in the each of the

major parameters of fiscal performance to bring Alagoas within the FRL limits and guarantee fiscal sustainability in the long run.

- The *human resource management component* will focus on improving the management of personnel records to eliminate fraud and overpayments. It will also prepare the groundwork for longer term reforms in the level and allocation of staffing and in levels of compensation.
- The *social security component* will focus on improving the administration of the state employee pension system and reducing pension benefits to the extent permitted by federal legislation.
- The *budget management component* will focus on improving coordination between the budget formulation units of sectoral departments (*secretarias*) and the state secretariat of planning.

4. Environment Aspects

Not Applicable. The proposed project does not involve any activities that are likely to have any environmental impacts.

I. Tentative financing

Source:	(\$m.)
Borrower	0
IBRD	195.5
Total	195.5

II. Contact point

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