Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 02-Aug-2023 | Report No: PIDA36637

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Brazil	P179182	Rio de Janeiro Fiscal Management and Sustainable Development Policy Loan (P179182)	P178729
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
LATIN AMERICA AND CARIBBEAN	26-Oct-2023	Transport	Development Policy Financing
Borrower(s)	Implementing Agency		
Municipality of Rio de Janeiro	Secretaria Municipal de Fazenda e Planejamento, Secretaria Municipal de Transportes		

Proposed Development Objective(s)

The Program Development Objective of this programmatic series is to support the Municipality of Rio de Janeiro in: (i) strengthening fiscal management to improve medium-term fiscal sustainability; and (ii) accelerating the transition towards a low-carbon, resilient and inclusive urban development .

Financing (in US$, Millions)

SUMMARY

Total Financing	135.24

DETAILS

Total World Bank Group Financing	135.24
World Bank Lending	135.24

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

The COVID-19 pandemic worsened Rio's public finances, further reducing the municipality's capacity to invest in advancing its environmental, social, and economic objectives, including low-carbon, resilient and inclusive urban development. MRJ fiscal balances were weakened even before the pandemic, caused by the rapid growth of personnel expenses and declining revenues. Investments went down from a peak of BRL 5.2 billion (US$ 959 million) in 2015 to only BRL 746 million (US$ 138 million) in 2019. In 2020, Rio experienced the second highest number of deaths among Brazilian states' capitals (38,247), only surpassed by São Paulo city (44,921).[1] The crisis reduced the services sector activity and increased the municipal's unemployment rate to the peak of 16.4 percent in the third quarter of 2020. Although emergency federal fiscal support helped Rio to safeguard investments in 2020, its declining revenues resulted in an increase of its personnel expenditures and an accumulation of arrears in 2020. Supported by reforms under this DPF series, Rio's fiscal balances improved significantly in 2021 and 2022 and arrears were repaid in full. Rio improved its credit rating under the Federal Treasury methodology in 2022. Most of fiscal measures implemented in 2021 have medium-term fiscal effects and will continue to benefit the municipal's fiscal consolidation between 2023 and 2026.

In addition, Rio de Janeiro plays a significant role in Brazil's carbon footprint as the country's second most populous city, particularly through its transport sector, which is central to its climate mitigation agenda. However, the public transportation system was until recently facing a serious financial sustainability crisis, preventing investments in low-carbon vehicles, and contributing to a steady loss in ridership, especially among lower income households. Policies promoted under DPF1, have begun to transform the sector and encourage individuals to shift from cars and motorcycles to public transportation and active mobility options. Despite being at the forefront of Brazil's climate agenda for the past forty years, the city faces substantial adaptation challenges due to the looming threats of rising sea levels, landslides, heat waves, and floods. Against this backdrop, the proposed Rio de Janeiro Adjustment and Sustainable Development Policy Loan (ASD-DPL) series will support the Government's efforts to advance a sub-set of reforms to strengthen fiscal management to achieve medium-term fiscal sustainability and support the transition towards low-carbon, resilient and inclusive urban development.

Overall, Brazil's macroeconomic policy framework is deemed adequate for this proposed operation. The World Bank considers the Guarantor's macroeconomic policy framework adequate for this DPF. Brazil's macroeconomic framework is characterized by a high government's cash balance positions, low public debt exposure to exchange rate fluctuations, strong external accounts, strong financial sector regulations that supports a solid financial system, a consolidated inflation target system based on an independent Central Bank and a flexible exchange rate regime that is able to anchor inflation expectations, and a new fiscal framework that is expected to contribute to stabilize debt over the medium-term. The scenario of approval of key structural reforms is positive. Two tax reforms under discussion (one focusing on indirect taxes replaced by a simple VAT and the other on income taxation) will probably advance through 2023 and 2024, making taxation more progressive, diminishing the heavy tax burden on the poorest population, while improving business environment and productivity prospects through tax simplification. 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, and energy). This scenario of reforms and the reduction of the political uncertainty after the general elections in 2022 have reflected in the country risk performance, that has reduced 230 basis points in June 2023 (the lowest level since January 2020). Central Bank has offered swap contracts to the market

[1] Data as of May 31, 2023.

to reduce the floating exchange rate volatility and to provide liquidity to the financial market when the Real is under pressure, preventing the Central Bank from losing reserves and keeping them at high levels (17.5 percent of GDP). Brazil recently concluded a Free Trade Agreement (FTA) with the EU and with the European Free Trade Association (EFTA) countries as part of the Mercosur regional trade block (both pending ratifications by countries' legislative houses), which could increase competition and productivity.

Relationship to CPF

The proposed DPF is fully aligned with the Country Partnership Framework (CPF) for the period FY2018–23[2]. 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 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 proposed activities are fully aligned with the Brazil CPF. The first pillar is aligned with Focus Area 1, *Fiscal consolidation and government effectiveness*, and Objectives 1.1 (Strengthening Fiscal Management at all levels of government) and 1.2 (Increase fiscal sustainability and fairness of pension system) of the CPF by strengthening its public management systems though (i) improving fiscal accountability and internal audit capacity, and (ii) strengthening the pension record management and audits. The first pillar is also aligned with Focus Area 3, *Inclusive and sustainable development*, and Objective 3.1 (Support the achievement of Brazil's NDC) by (iii) supporting measures to promote a green economy. The second pillar is aligned with Focus Area 2, and Objective 2.3 (Mobilize greater investment in infrastructure to improve services) by: (i) focusing on optimizing the transport sector; and (ii) supporting the mobilization of greater investment in infrastructure to improve services. Pillar 2 is also aligned with Focus Area 3, *Inclusive and sustainable development*, and Objective 3.1 (Support the achievement of Brazil's NDC), and Objective 3.2 (Provide more inclusive and sustainable urban services) by: (i) revamping the BRT system; (ii) making the public and active transport more accessible to the most vulnerable; (iii) supporting the implementation of a Low Emission District in the city center to decrease GHG emissions; and (iv) supporting the achievement of the municipality's and the country's NDCs on reducing CO_2 emissions.

C. Proposed Development Objective(s)

The Program Development Objective of this programmatic series is to support the Municipality of Rio de Janeiro in: (i) strengthening fiscal management to improve medium-term fiscal sustainability; and (ii) accelerating the transition towards a low-carbon, resilient and inclusive urban development .

Key Results

This operation is expected to contribute to strengthening Rio's fiscal management to achieve medium-term fiscal sustainability and support its transition towards a low-carbon, resilient, and inclusive development. The fiscal reforms supported in this series are expected to curb recurrent expenditure growth, strengthen tax revenues, and improve the accountability and efficiency of the government. The resulting increase of the municipalities' operating balance will allow it to reduce its debt payments, reduce arrears, and provide space to a supported reform that is expected to create fiscal incentives to encourage investments in climate adaptation and mitigation. Reforms in this series are expected to improve the efficiency, safety, and modal integration of Rio's public and non-motorized transport to help avoid the migration of riders to higher-emitting transport modes, strengthen the municipality's cross-sectoral strategy to reduce GHG emissions

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

and promote a green economy, and foster mitigation and adaptation to climate change, thus promoting sustainable urban development. Finally, they are expected to eliminate a possible transport barrier for low-income female survivors of domestic violence to access the support of the Specialized Network for Combating Violence Against Women.

D. Project Description

This DPF seeks to strengthen Rio's fiscal management. The quality of public accounting in the Rio de Janeiro municipality has been a subject to concern and scrutiny. The municipality has faced challenges in ensuring accurate and reliable financial reporting, which has implications for transparency, accountability, and fiscal sustainability. To address these challenges, this DPF supports (i) measures that enhance auditing procedures, which are crucial to assure that financial resources are used efficiently and effectively. In addition, this operation supports the introduction of a (ii) legislation that provides a tax incentive to firms that achieve mitigation outcomes, thus using fiscal space opened through the fiscal consolidation to introduce green fiscal policy measures. The municipal pension system has been decentralized, with multiple secretariats being responsible for assessing the retirement requirements and benefits of their own staff, leading to fragmented processes and inefficiencies. To address these issues, the municipality embarked on (iii) a reform aiming to centralize the management of the public pension system into one single agency.

The Municipality of Rio expects to shift to a low-carbon, safe, and inclusive urban mobility and put in place institutional arrangements for multi-sectoral low-carbon development in central Rio. Since the approval of the first operation, the MRJ has maintained momentum on a broad program of policy reforms, incentives, and investments to promote inclusive and sustainable urban mobility, but further reforms are needed. The Municipality acknowledges the need to advance in greening the transport system, the highest emitting sector of greenhouse gases (GHG) in the city, and its vulnerability to climate change shocks. To address these challenges, the city is introducing reforms to increase the reliance on sustainable mobility modes and reduce GHG emissions. This DPF supports the Municipality in improving public and non-motorized transport and enhancing the effective integration of sustainable transport modes to avoid the migration of riders to cars and motorcycles. It also strengthens the Municipality's cross-sectoral strategy to reduce GHG emissions and foster mitigation and adaptation to climate change. To do so, the package of reforms includes (i) measures to improve the operational efficiency of the BRT system to attract passengers to public transport, (ii) critical regulations that improve public transport services available to low-income populations and the overall integration of the city's public transport system, (iii) the approval of legislation that facilitates the access by female survivors of domestic violence to referral services via free public transport, (iv) measures to promote low-carbon non-motorized transport through regulations that expand the cycling network and improve safety for all road users, and (v) actions that establish a governance and monitoring and evaluation framework to promote low-carbon and climate-resilient mobility, energy, and waste management in a Low Emission District.

E. Implementation

Institutional and Implementation Arrangements

The Secretariat of Finance and Planning (*Secretaria Municipal de fazenda e Planejamento-SMFP*) is responsible for collecting and monitoring information related to program implementation and progress toward the achievement of the results. SMFP is responsible for coordinating all necessary actions among the agencies involved in the reform program supported by this DPF. SMFP will be directly responsible for the first pillar of the operation in coordination with other municipal agencies. The Secretariat of Transport and the Secretary of Environment 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

Overall, most prior actions included in this operation have the potential of positive equity and social impacts. Policy changes included in the first pillar – a continuation of the reforms launched as part of the state's Fiscal Equilibrium Plan – are expected to allow the municipality to improve the efficiency of their spending. Policy changes related to the adoption of public sector accounting standards and an improvement in the pension record management and audit system may open more fiscal space for public investments on the government's priorities which, based on an analysis of the budget allocation, are likely to support the provision of basic public services, benefiting social groups in the bottom of society and boosting equality of opportunity. Meanwhile, policy changes included in the second pillar have both direct and indirect poverty and social impacts. Improvements in the public transportation system, on which the low-income population disproportionately relies, will positively impact the wellbeing of Rio residents by lowering the transportation costs (both pecuniary and non-pecuniary) of connecting to the city's economic opportunities. Direct positive social impacts are also expected from the support to women suffering from domestic violence. Finally, other policies are expected to have indirect positive effects through the reduction of congestion and pollution.

Environmental, Forests, and Other Natural Resource Aspects

The prior actions supported by this DPF are likely to have positive effects on the environment through the significant emission reduction measures. Pillar one contains strengthening fiscal management reforms that are not likely to cause direct negative impacts on the environment, forests, or other natural resources. On the contrary, the pillar encompasses prior actions which are likely to have significant positive effects on the environment, all linked to the goal of promoting green growth and reducing GHG emissions. The DPF is designed to promote a low-carbon economy (under Pillar I) and the transition towards a low-carbon, climate-resilient and inclusive urban development (Pillar II), by strengthening and promoting public and active transportation and implementing a Low Emission District in the city center.

G. Risks and Mitigation

The overall risk of this operation is rated as moderate. The principal risks to the objectives of this operation include stakeholder risks. Stakeholder risks are assessed as Substantial. A wide range of stakeholders could be affected by the supported reforms, including government's own agencies, public sector unions, private sector, and households. The prioritization of low-carbon transport technologies over fossil fuels and the implementation of a low emission zone in the city center could be questioned by interest groups. The authorities are aware of these risks and to mitigate these risks are utilizing continuous face-to-face and online consultation processes with stakeholders, mainly with transport operators and fleet providers, civil society organizations, the private sector, and with the legislative and judiciary branches. In addition, the MJR is committed to maintaining a participatory implementation approach of prior actions with a consistent communication plan.

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APPROVAL

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