



# Program Information Document (PID)

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Concept Stage | Date Prepared/Updated: 23-Jan-2020 | Report No: PIDC27902



**BASIC INFORMATION**

**A. Basic Project Data**

Country Brazil	Project ID P172401	Project Name BR Santa Catarina Fiscal Adjustment and Sustainable Agriculture DPL (P172401)	Parent Project ID (if any)
Region LATIN AMERICA AND CARIBBEAN	Estimated Board Date Mar 26, 2021	Practice Area (Lead) Macroeconomics, Trade and Investment	Financing Instrument Development Policy Financing
Borrower(s) Governo do Estado de Santa Catarina	Implementing Agency Secretaria de Estado da Agricultura, da Pesca e do Desenvolvimento Rural, Secretaria de Estado da Fazenda		

**Proposed Development Objective(s)**

Program Development Objective of this DPL is to support the State of Santa Catarina to (i) regain fiscal sustainability and (ii) promote sustainable agriculture.

**Financing (in US\$, Millions)**

**SUMMARY**

<b>Total Financing</b>	210.00
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**DETAILS**

<b>Total World Bank Group Financing</b>	210.00
World Bank Lending	210.00

**Decision**

The review did authorize the preparation to continue



## B. Introduction and Context

### State Context

1. **Increasing pension spending and concentration of debt service payments are at the center of future fiscal challenges in Santa Catarina state.** Economic recession in 2015 and 2016 pushed revenue collection down and overall revenues declined by 3 percent in the period, led by the Tax on Goods and Services (ICMS, for its acronym in Portuguese) (60 percent of current revenues), and further compounded by 11 percent fall in federal transfers (19 percent of revenues). Since 2016, acceleration of the state economic growth contributed to improve tax collection but could not cope with steady pension growth due to large number of retirements and previously granted salaries increases. In addition, the state's debt maturity structure is heavily weighted on the short term and net debt services are expected to raise 14.4 percent in the next years. Fiscal deterioration led the state disqualified the state to access new borrowing with Federal Guarantees, forcing an excessive fiscal adjustment as debts cannot be rolled over.

2. **With a diversified economy, the agricultural sector stands out as the most important source of employment and income for most municipalities of Santa Catarina.** Agricultural production accounts for 6 percent of GDP and represents 18.6 percent of the manufacturing value added, totaling 35 percent of Santa Catarina's GDP. In addition, the sector has its production made on family farming (162,580 male and 18,757 female farmers<sup>1</sup>) and concentrates 16 percent of the state population living in rural areas and 7 percent of the local employments. Agriculture sector also accounts for 66 percent of the state exports and its export success results from improved production systems and solid animal health protection and inspection protocols. The proposed pillar will support the State to build the necessary institutional blocks for expanding production, reaching out external markets and ensuring environmental protection to promote a sustainable economic growth.

3. **The objective of the proposed Fiscal and Sustainable Agriculture Development Policy Loan (DPL) is to support the State of Santa Catarina regain fiscal sustainability and promote sustainable agriculture.** This proposed operation of US\$ 320 million provides short-term budget support for the state to continue to implement its fiscal consolidation program based on front-loaded structural measures. Under the first pillar, the proposed operation supports a program of short-term fiscal adjustment and structural reforms to safeguard the State's fiscal capacity despite growing pressure from the pension system transition and debt service. In the second pillar, this DPL responds to the State's long-term vision to streamline economic opportunities through a sustainable agriculture growth by exploring export market niches while safeguarding its environmental assets. To this end, the proposed operation intends to support a set of actions creating the building blocks to create a competitive export-oriented agriculture: adopting the state *Agroconsciente* Program, the masterplan for sustainable agriculture development; create the state plant health defense law; and improve the governance and enforcement instruments of environmental policy, to facilitate phytosanitary and environmental agricultural certification going forward. It is expected that the current DPL will allow the state to restore fiscal and repayment capacities to access external financing and federal guarantees that would allow for future investment projects in the agriculture sector.

### Relationship to CPF

4. **The proposed DPL is fully aligned with the World Bank Group's Country Partnership Framework (CPF) for FY2018-2023.** 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.<sup>2</sup> In line with the CPF, the proposed

<sup>1</sup> According to the Agricultural Census 2017 from the Brazilian Institute of Geography and Statistics (IBGE)

<sup>2</sup> The CPF was endorsed by the Board in July 2017 (Report No. 113259-BR).



operation intends to support fiscal adjustment and sustainable development, including climate co-benefits, in subnational entities, in collaboration with the Federal Treasury. The proposed operation is fully aligned with the first and third pillars of the CPF. The fiscal pillar of the DPL specifically supports objectives 1 (“Strengthen fiscal management at all levels of government”) and 2 (“Increase fiscal sustainability and fairness of pension system, and effectiveness of social protection system”) under the first CPF pillar. It does so by supporting measures to increase tax revenues, control spending growth and implement a pension reform in Santa Catarina in close cooperation with the Federal Government. The operation creates an incentive mechanism for States to address their fiscal deficits, reducing risk of unsustainable State debt paths and restoring the (fiscal) capacity of subnational entities to receive federal guarantees for additional borrowing, which will ultimately reduce the contingent liability to the Federal Government. The second pillar of the operation is closely aligned with the first (“Support the achievement of Brazil’s NDC with a particular focus on land use”) and third (“Promote socio economic development of small rural producers and vulnerable groups”) objectives under the third CPF pillar. This operation will support Brazil to reach its COP21 Nationally Determined Contribution (NDC) targets, by focusing particularly on land use planning, deforestation, environmental compliance, as small family farms remain important in rural Santa Catarina. This pillar also is consistent with the WBG Climate Change Action Plan 2016-2020,<sup>3</sup> which aims to work with countries to help them deliver on and exceed their Paris ambitions, including through financing, technical assistance, and knowledge sharing.

### C. Proposed Development Objective(s)

5. **The Proposed Development Objective of this DPL is to support the State of Santa Catarina to (i) regain fiscal sustainability and (ii) promote sustainable agriculture.** For this purpose, the US\$ 320 million of this operation will address the state’s immediate funding needs, improving the States’ debt profile and support the development and sustainability of the agriculture sector to diversify the economy, build export potential and generate income in rural areas.

#### Key Results

6. **The main results expected from the operation include create the additional fiscal space to accommodate increasing debt services and pension expenditures and enhance institutional capacity to promote a more competitive and sustainable agriculture.** Reforms aim to reduce tax incentives, limit primary expenditure growth in 2020 to inflation and increase civil servants’ contributions to the pension system. The operation’s pillar on sustainable and competitive agriculture is aligned with the Government’s program *Agroconsciente* that aims to boost the State’s agribusiness through policies supporting producers to safeguard their production, environmentally regularize their properties, access new markets and bring innovation opportunities.

### D. Concept Description

7. **Based on the results of the in-depth fiscal diagnostic, the State Government has adopted a front-loaded fiscal adjustment package that will contribute to increase the gross operating balance and recover the state’s capacity of payment (CAPAG) until 2022.** In July of 2019, the State adopted in the Budget Guidelines Law of 2020 two key fiscal measures to reduce tax incentives by 2022 and extend until 2020 the current primary expenditure ceiling set by the Federal Complementary Law No. 156, of 2016. The reform also adopts at the state’s level the Federal pension reform that was approved by the Congress in October of 2019 and will contribute to sustainably reduce the financial pension deficit by the increase of pension contributions. Finally, new procedures for the state’s procurement are expected to improve efficiency

<sup>3</sup> “World Bank; IFC; MIGA. 2016. World Bank Group Climate Change Action Plan 2016-2020. (<https://openknowledge.worldbank.org/handle/10986/24451>)



and provide fiscal savings on the expenditure side. Consequently, gross operating balance is expected to increase 3.8 percent of the current revenues between 2018 and 2022 as a result of an annual average real growth of 3.6 percent of the current revenues and 1.3 percent of the current expenditures.

8. **This operation supports selected state government policies aimed at increasing its institutional capacity to promote sustainable and a more competitive agriculture.** The operation supports the creation of: the *Agroconsciente* Program, which sets the framework to incentivize farmers to adopt climate-smart agriculture practices and reduce and adequately use agrochemicals; the plant health defense law to improve the inspection and protection of State's agricultural production; and the institutional instruments to improve the governance and implementation of environmental policy.

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

### Poverty and Social Impacts

9. **Overall, the proposed prior actions supported by this DPO are not expected to affect increase poverty or inequality in the state.** The prior actions focusing on tax incentives and procurement are unlikely to have distributional impacts or direct effects on low-income households, both those living in poverty or those vulnerable to falling in poverty. The expenditure ceiling can limit wage bill growth and affects public servants (current and retired) and the increase of the pension contributions by pensioners and survivors can will reduce net pensions received by pensioners and survivors. However, as 85 percent of the state's civil servants are in the top thirty percent of the state's income distribution, limiting salary increases and reducing pensions can have positive distributional effects in the public spending. The *Agroconsciente* Program has the potential to have positive distributional effects if they lead to successful strategies for knowledge sharing for smaller farm families, especially those with lower human capital. The implementation of phytosanitary protection, the validation of the Rural Environmental Registry (CAR) information and the enabling of private rural properties to follow the National Forest Code are expected to lead to income increases for participating agricultural producers.

10. **There are significant gender inequities in agriculture and land ownership in the state.** Rural women have high labor force participation rates (77 percent) with most working in agriculture (88 percent), yet only 10 percent of farms in Santa Catarina are managed by women.<sup>4</sup> Careful implementation of the PAs in the second pillar can lead to greater inclusion of women in decision making roles and empowerment.

### Environmental, Forests, and Other Natural Resource Aspects

11. **The policies supported by the DPL are not likely to cause any negative effect on the environment, forests, or other natural resources.** Overall, positive effects are expected. The policies supporting efforts to regain fiscal sustainability have not significant adverse environmental effects. Reducing tax incentives does not have direct effects on the environment. The expenditure ceiling is also not expected to have any impact on the environment. However, it is necessary to deepen discussions to understand the restriction's extent to avoid effects on actions such as supervision and monitoring. Procurement processes changes and pension contributions increase are not expected to have any impact on the environment. The policies under the second pillar are designed to improve environmental management and likely to have significant positive effects. The *Agroconsciente* Program is expected to have an important positive environmental impact reducing the use of agrochemicals, intensifying the use of climate-smart agriculture (CSA) technologies and reducing the impacts of agricultural activity improving environmental services regionally and climate change mitigation

<sup>4</sup> Síntese Anual da Agricultura de Santa Catarina 2017-2018.



co-benefits. The policy associated with phytosanitary protection is also expected to have significant environmental positive effects on the environment. CAR and the enabling of private rural properties to follow the National Forest Code are essential tools for improving the environmental quality of the state as a whole.

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**APPROVAL**

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**Approved By**

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