

**Document of
The World Bank**

FOR OFFICIAL USE ONLY

Report No. 62982-BR

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A PROPOSED LOAN

IN THE AMOUNT OF US\$700 MILLION

TO

THE STATE OF BAHIA

WITH A GUARANTEE OF THE FEDERATIVE REPUBLIC OF BRAZIL

FOR A

BAHIA SOCIO ECONOMIC DEVELOPMENT FOR INCLUSIVE GROWTH DPL

May 25, 2012

Economic Policy Unit
Brazil Country Management Unit
Latin America and the Caribbean Region

This document has a restricted distribution and may be used by recipients only in the performance of their official duties. Its contents may not otherwise be disclosed without World Bank authorization.

BRAZIL - GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS (Exchange Rate Effective May 18, 2012)

Currency Unit	=	Brazil Real
BR R\$1.00	=	US\$0.4958
US\$1.00	=	BR R\$2.0166

ABBREVIATION AND ACRONYMS

ACP	Public Cost Administration System	<i>Apropriação de Custos Públicos</i>
AGE	Internal Audit Department	<i>Auditoria Geral do Estado</i>
BNDES	National Economic and Social Development Bank	<i>Banco Nacional de Desenvolvimento Econômico e Social</i>
CEF		<i>Caixa Econômica Federal</i>
CFAA	Country Financial Accountability Assessment	
CPAR	Country Procurement Assessment Report	<i>Relatório da Avaliação do Sistema de Aquisições do País</i>
CPS	Country Partnership Strategy	
CRA	Social Assistance Reference Center	<i>Centro Referencial de Assistência Social</i>
DERBA	Bahia Road Agency	<i>Departamento de Estradas e Rodagens do Estado da Bahia</i>
DPL	Development Policy Loan	<i>Empréstimo para Políticas de Desenvolvimento</i>
DPGE	Certificates of Deposit Guaranteed by the Deposit Guarantee Fund	<i>Deposito a prazo com grantia especial</i>
FIPLAN	Government Financial Management Information System	
FHP	Family Health Program	
FRL	Fiscal Responsibility Law	<i>Lei de Responsabilidade Fiscal</i>
FPE	Project Structure Fund	<i>Fundo de Estruturação de Projetos</i>
GDP	Gross Domestic Product	
GFS	Government Finance Statistics	
GOB	Government of the State of Bahia	
HR	Human Resources	
IADB	Inter-American Development Bank	<i>Banco Interamericano de Desenvolvimento</i>
IASB	International Accounting Standards Board	<i>Diretoria de Normas de Contabilidade Internacional</i>
IBRD	International Bank for Reconstruction and Development	<i>Banco Internacional para Reconstrução e Desenvolvimento</i>
IBGE	Brazilian Institute of Geography and Statistics	<i>Instituto Brasileiro de Geografia e Estatística</i>
ICMS	Taxes on Goods and Services	<i>Impostos Sobre Circulação de Mercadorias e Prestação de Serviços</i>
IDG-M	Index of Decentralized Management Efficiency of the Municipalities for Bolsa Familia and CadÚnico	
IFC	International Finance Corporation	
IFRS	International Financial Reporting Standards	<i>Normas de Relatórios Financeiros Internacionais</i>
IGP-DI	General Price Index - Domestic Availability	<i>Índice Geral de Preços Disponibilidade Interna</i>
IGP-M	General Market Prices Index	<i>Índice Geral de Preços do Mercado</i>
IMF	International Monetary Fund	<i>Fundo Monetário Internacional</i>

IMR	Infant Mortality Rate	
IOF	Taxes on financial transactions	<i>Imposto sobre Operações Financeiras</i>
IPCA	Extended National Consumer Price Index	<i>Índice Nacional de Preços ao Consumidor Amplo</i>
IPVA	Motor Vehicle Tax	<i>Imposto Sobre a Propriedade de Veículos Automotores</i>
IPSAS	International Public Sector Accounting Standards	
ISO	International Standards Organization	
FGD	Deposits Guarantee Funds	<i>Fundo de Garantia de Depósitos</i>
FPE	State's Participation Fund	<i>Fundo de Participação dos Estados</i>
FUNDEB	Brazilian Campaign for the Right to Education in the creation of the Basic Education Fund	<i>Fundo de Manutenção e Desenvolvimento da Educação Básica e de Valorização dos Profissionais da Educação</i>
LCR	Latin America and the Caribbean	
LDP	Letter of Development Policy	
LRF	Fiscal Responsibility Law	<i>Lei de Responsabilidade Fiscal</i>
MTEF	Medium-Term Expenditure Framework	
NCR	Net Current Revenue	
NRR	Net Real Revenue	
PEFA	Public Expenditure and Financial Accountability	<i>Método de despesa pública e responsabilidade financeira</i>
PFM	Public Financial Management	
PMI	Expression of Interest Process	<i>Processo de Manifestação de Interesse</i>
PNAE	National School Feeding Program	<i>Programa Nacional de Alimentação Escolar</i>
PPA	Multi-year Plan	<i>Plano Plurianual</i>
PPP	Public-private Partnerships	
PROMOSEFA	Secretariat of Finance Modernization Program	<i>Programa de Modernização da Secretaria da Fazenda</i>
PSF	Family Health Program	<i>Programa de Saúde da Família</i>
PSIA	Poverty and Social Impact	
SEDIR	State Secretariat for Development and Regional Integration	
SEFAZ	State Secretariat of Finance	<i>Secretaria do Estado da Fazenda</i>
SEPLAG	Secretariat of Planning of the State of Bahia	<i>Secretaria do Planejamento do Estado da Bahia</i>
SFC	Federal Secretariat of Internal Control	<i>Secretaria Federal de Controle Interno</i>
STN	National Treasury Secretariat	<i>Secretaria do Tesouro Nacional</i>
SUS	Unified Health Services	
TA	Technical Assistance	
TAL	Technical Assistance Loan	
TCU	Court of Accounts of the Nation	<i>Tribunal de Contas da União</i>
TR	Reference rate	<i>Taxa Referencial</i>
TJLP	Brazil Long-term Interest Rate	<i>Taxa de Juros de Longo Prazo</i>
UPR	Standard Reference Unit	<i>Unidade Padrão Referencial</i>
VAT	Value Added tax	

Vice President:	Hasan A. Tuluy
Country Director:	Deborah L. Wetzel
Sector Director:	Rodrigo A. Chaves
Sector Manager:	Auguste Tano Kouame
Sector Leader:	Pablo Fajnzylber
Task Team Leader:	Yaye Seynabou Sakho

BRAZIL
BAHIA SOCIO ECONOMIC DEVELOPMENT FOR INCLUSIVE GROWTH DPL

TABLE OF CONTENTS

LOAN AND PROGRAM SUMMARY	1
I. INTRODUCTION.....	3
II. COUNTRY CONTEXT.....	5
RECENT ECONOMIC DEVELOPMENTS IN BRAZIL	5
CURRENT MACROECONOMIC OUTLOOK	9
RECENT SOCIO-ECONOMIC DEVELOPMENTS IN THE STATE OF BAHIA	12
III. THE GOVERNMENT’S PROGRAM AND PARTICIPATORY PROCESSES	20
THE GOVERNMENT PROGRAM.....	20
IV. BANK SUPPORT TO THE GOVERNMENT’S PROGRAM.....	30
RATIONALE FOR BANK INVOLVEMENT AND LINK TO CPS.....	30
COLLABORATION WITH THE IMF AND OTHER DONORS	31
CHOICE OF INSTRUMENT AND RELATIONSHIP TO OTHER BANK OPERATIONS	31
ANALYTICAL UNDERPINNINGS.....	32
LESSONS LEARNED.....	36
V. THE PROPOSED DEVELOPMENT POLICY LOAN	37
OPERATION DESCRIPTION	37
POLICY AREAS	40
VI. OPERATION IMPLEMENTATION	57
POVERTY AND SOCIAL IMPACT.....	57
ENVIRONMENTAL ASPECTS	60
IMPLEMENTATION, MONITORING AND EVALUATION	62
FIDUCIARY ASPECTS.....	62
DISBURSEMENT AND AUDITING	64
RISKS AND RISKS MITIGATION.....	65
ANNEX 1: LETTER OF DEVELOPMENT POLICY	70
ANNEX 2: BAHIA GOVERNMENT POLICY MATRIX- RESULTS INDICATORS.....	87
ANNEX 3: COUNTRY AT A GLANCE	93
ANNEX 4: FISCAL AND DEBT SUSTAINABILITY ANALYSIS.....	96
ANNEX 5: POVERTY AND SOCIAL IMPACT ANALYSIS (PSIA).....	118
ANNEX 6: MAP.....	132

LIST OF TABLES

TABLE 1. BRAZIL - KEY MACROECONOMIC INDICATORS AND PROJECTIONS, 2005-2015	6
TABLE 2. TRANSFER REVENUE COMPOSITION 2004-2010	16
TABLE 3. EVOLUTION OF FISCAL RESPONSIBILITY LAW DURING 2004-10	17
TABLE 4. ANALYTICAL UNDERPINNINGS	34
TABLE 5. SUMMARY OF PROPOSED OPERATION'S OBJECTIVES, POLICY AREAS AND PRIOR ACTIONS	38
TABLE 6. SUMMARY OF PROPOSED OPERATION'S OBJECTIVES, POLICY AREAS AND CONDITIONS SECOND TRANCHE DISBURSEMENT	39

LIST OF FIGURES

FIGURE 1. GROWTH, POVERTY AND GINI IN BAHIA	12
FIGURE 2. BAHIA'S GDP GROWTH RATE	14
FIGURE 3. EVOLUTION OF REVENUES, EXPENDITURES AND FISCAL BALANCES IN THE STATE OF BAHIA	16
FIGURE 4. TOTAL NUMBER OF DISASTERS PER YEAR	25

LIST OF BOXES

BOX 1. BRAZILIAN FISCAL FEDERALISM AND THE CONTROL OF SUB-NATIONAL FISCAL PERFORMANCE	11
BOX 2: LINKAGES WITH EXISTING OPERATIONS	35
BOX 3. APPLICATION OF THE GOOD PRACTICE PRINCIPLES ON CONDITIONALITY TO THE PROPOSED BAHIA DPL	37

The State of Bahia Socio Economic Development for Inclusive Growth Development Policy Loan was prepared by an IBRD team consisting of Yaye Seynabou Sakho, Roland Clarke, Pablo Fajnzyblber, Rafael Barroso, Michael Drabble, Anna Fruttero, Maria Madalena dos Santos, Luis Felipe Lopez-Calva, Edward Bresnyan, Erik Alda, Miriam Muller, Carlos Costa, Gregoire Gauthier, Sivan Tamir, Taimur Samad, Arturo Herrera, Evelyn Levy, Joseph Kizito, Fernando Lavadenz, Edith Kikoni, Ezau Pontes, Alberto Costa, Jorge Jatoba, Paulo Santos, Rogerio Santarrosa, Florencia Liporaci, Cindy Audiguier, Antonio Velandia, Miguel Navarro Martin, Marcela Santacoloma, Andresa Lagerborg, Patricia Miranda, Silvana Feitosa Hill, Patricia Chacon Holt, Miguel Santiago de Oliveira, and Ana Lucia Armijos.

LOAN AND PROGRAM SUMMARY
BRAZIL
BAHIA SOCIO ECONOMIC DEVELOPMENT FOR INCLUSIVE GROWTH
DEVELOPMENT POLICY LOAN

Borrower	State of Bahia
Implementing Agency	STATE SECRETARIAT OF FINANCE <i>Secretaria da Fazenda do Estado de Bahia</i>
Financing Data	US\$700 million. Commitment linked, IBRD Flexible Loan with variable spread, with level repayments and 30 years Final Maturity.
Operation Type	Two tranches of US\$350 million each.
Main Policy Areas	The proposed operation will support policy actions in the following areas: <ul style="list-style-type: none"> • Improving Social and Productive Inclusion (Equity) • Developing Social, Physical, and Institutional Infrastructure for Sustainable Development (Efficiency) • Strengthening Planning and Management of the Public Sector (Governance)
Key Results Indicators	<p>Improving Social and Productive Inclusion (Equity)</p> <p>Education:</p> <ul style="list-style-type: none"> • Number of partnership agreements signed by the State with the municipalities increases from 217 in 2011 to 329 by 2013. <p>Health:</p> <ul style="list-style-type: none"> • Increase in the proportion of pregnant women enrolled by primary health care teams from a baseline of 46.67% in 2010 to a target of 50% by 2014. <p>Productive Inclusion:</p> <ul style="list-style-type: none"> • Increase in the targeted number of rural producers benefiting from technical assistance under the State Program for Productive Inclusion from a baseline of zero to a target of 150,000 producers by 2014. <p>Social Inclusion:</p> <ul style="list-style-type: none"> • Increase in the household registrations to the Social Assistance Reference Center CRAS and in the <i>Cadastro Único</i> in the 50 most vulnerable municipalities (with the lowest IGD-M) of 20 percent from 2011 to 2014. <p>Crime and Violence:</p> <ul style="list-style-type: none"> • Increased number of priority municipalities that receive prevention programs/interventions through initiatives of the Sub-committee of crime and violence prevention through Social Development CSPS from a baseline of 4 municipalities in 2011 to a target of 20 municipalities by 2014. <p>Gender:</p> <ul style="list-style-type: none"> • The Integrated Management Group for Gender (<i>Grupo de Gestão Integrada</i>) is fully operational as evidenced by an increased number of sectoral partnerships signed and implemented between the Secretariat for Women and other secretariats to mainstream gender issues in State programs from a baseline of 1 Agreement with <i>Secretaria de Agricultura</i> to a target for December 2014 of at least 5 sectoral partnerships signed. <p>Developing social, physical, and institutional infrastructure for sustainable development (Efficiency)</p> <p>Disaster Risk Management:</p> <ul style="list-style-type: none"> • The State of Bahia's Disaster Risk Management Policy is operational as evidenced by: (i) 5 regional nodes established and trained by December 2014; (ii) Risk- mapping for 2 pilot areas done; and (iii) 10 self-established voluntary brigades trained by December 2014. <p>Transport:</p> <ul style="list-style-type: none"> • Bahia Advisory Committee issues 3 resolutions by 2014. <p>Strengthening Planning and Management of the Public Sector (Governance)</p> <p>Planning and Budgeting:</p> <ul style="list-style-type: none"> • Reduction of number of intra year modifications to the budget by at least 75 percent from a baseline for 2010 of 7000 modifications. <p>Financial and Human Resource Management:</p> <ul style="list-style-type: none"> • Budget preparation and reporting takes place consistent with IPSASs • All the personnel from the secretariats of health and of public security (<i>segurança</i>) are fully documented within the new HR system. <p>Tax Administration:</p> <ul style="list-style-type: none"> • Tax arrears collection as a percentage of tax revenue increases from a baseline in 2010 of 1.02% to a target for December 2014 of 1.8%.

	<p>PPPs:</p> <ul style="list-style-type: none"> • Two or more private sector participation in early project stage PMI processes are undertaken.
Program Development Objective(s) and Contribution to CPS	<p>The objective of the proposed operation is to support the State of Bahia’s program to reduce social inequality, develop more efficient institutional infrastructure and logistics, and strengthen public sector management. The proposed operation is fully consistent with and closely linked to the objectives of the new CPS 2012-2015 which emphasize reducing extreme poverty, vulnerability and exclusion, promoting growth through sustainable resource use, and improving competitiveness as key pillars for achieving sustainable development and inclusive growth.</p>
Risks and Risk Mitigation	<p>The operation is subject to three main risks:</p> <p>Domestic economic and fiscal risks are related to various sources of variability in revenues and expenditures. These stem from heavy reliance on ICMS tax revenues which are vulnerable to macroeconomic fluctuations in Brazil and partners countries (Europe, US, China). In addition, Bahia is vulnerable to a reduction of the FPE transfers—an important source of revenue-- stemming from federal reform. Bahia is also vulnerable to natural disasters such as the ongoing drought and floods which affect planted crops and as such revenues. Challenges on the expenditure side include (i) curbing current expenses– such as compensation of employees (wage bill and pensions) and goods and services consumption – and (ii) controlling the costs of large investment projects and large social programs, including those associated with natural disaster response. Risks associated with revenues and expenditures variability are mitigated by (i) the Fiscal Responsibility Framework which monitors the State’s borrowing and sets up fiscal targets accordingly, (ii) the State’s commitment to fiscal discipline, (iii) the increase in the State’s tax collection over the last four years, due to both, strong growth and to key efficiency reforms and the commitment of the State Government to implement more fiscal reforms, (iv) the reforms supported by this operation to improve the efficiency of public investment planning, costing, the public financial management system and revenues performance; and (v) reform supported by this DPL to increase the institutional capacity to effectively respond but also manage and prevent natural disasters.</p> <p>External risks: Brazil could be affected by a possible crisis in the Euro zone through its growth, its external sector, its fiscal and debt accounts and its financial sector. However, the country would enter the crisis with a strong external position, a reasonable fiscal position and a strong financial sector position. Brazil rebounded quickly from the 2008 crisis to achieve the highest GDP growth rate (7.5%) in the last 20 years in 2010. Brazil is poised to respond to a possible crisis, actively using a wide array of policy tools. Earlier interventions in recent months with the easing of monetary policy and the reduction of capital controls indicate that it is ready to promptly deal with any external threats to domestic growth.</p> <p>Political and institutional risk: The main institutional risk at the State level is its modest capacity to implement and deliver planned investment and social programs which could delay the disbursement of the second tranche of the loan. In this regard, revamping public sector management for greater integration of budgeting, management and planning; reviewing and redesigning business processes; and modernizing human resources management which are supported in this operation are crucial steps. The State will also need to improve coordination of policies in the Government as well as with other government levels (Federal and Municipal) to align government priorities with expenditures. Finally, the State needs to improve the institutional framework to leverage partnerships with the private sector through PPPs and through subcontracting which are becoming increasingly important for efficient service delivery. These risks are mitigated by the implementation of reforms supported in this DPL and their irreversible nature. The Bank will also support the reform agenda by providing, first, advice and support through policy dialogue during the DPL preparation and supervision, and second through complementary technical assistance in the policy areas supported by the DPL. In this context, the Bank has discussed with the Government the possibility of providing additional financing to existing investment loans with the State of Bahia, which will be restructured as needed for this purpose.</p>
Operation ID	P126351

**IBRD PROGRAM DOCUMENT FOR A
PROPOSED
SOCIO-ECONOMIC DEVELOPMENT FOR INCLUSIVE GROWTH DPL
TO THE STATE OF BAHIA**

I. INTRODUCTION

1. **This document presents a proposed two-tranche Development Policy Loan (DPL) of US\$700 million to the State of Bahia in Brazil.** The objective of the proposed operation is to support the Government of the State of Bahia's (GOB) program to reduce social inequality, develop more efficient institutional infrastructure and logistics, and strengthen public sector management.

2. **The State of Bahia, which represents the sixth largest economy in Brazil and the fourth state in terms of population, is the largest economy in Northeast Brazil.** Bahia accounts for about 4.2 percent of the national gross domestic product (GDP) and its population of 14 million inhabitants represents 7.5 percent of total national population. Bahia, like other Northeastern states, has long lagged behind the rest of Brazil in terms of socio economic development; the State's GDP per capita of R\$9,364 (in 2009) is about 56 percent of the national average.

3. **Bahia has seen a dramatic fall in poverty in recent years.** The percentage of the population living below the poverty line¹ has decreased from 60 percent in 2003 to about 39 percent in 2009. National social policies coupled with high economic growth in the State of Bahia, averaging over five percent annually since 2003, have lifted a great part of the poor into the middle class.

4. **Yet today Bahia is the State with one of the largest absolute number of extreme poor in Brazil.** About 14 percent of the population is extremely poor. About 60 percent of the population receives conditional cash transfers from the Government.

5. **Bahia needs to address many challenges to attain sustainable poverty reducing economic growth.** Success in the 1960s to 1980s in attracting petrochemicals and automotive industries fueled growth in Bahia at a higher pace than the national average. However, that growth was not inclusive as the poverty headcount of Bahia remained at almost double the national average and the Gini coefficient of Bahia stayed well above the total for Brazil. This trend was only reversed in the last decade as poverty began finally to be reduced significantly in Bahia through the combination of national social policies and strong growth. Nevertheless, the State faces a key challenge; to improve human capital through improvements in access to quality health and education services, so as to foster job creation with higher wages as well as attract businesses to the State.

¹ The poverty line is defined as the double of the extreme poverty line, which is defined as the costs of basic food basket that supply the minimum individual caloric intake. The poverty line varies between regions, states, urban, rural and metropolitan areas. Poverty lines account for these differences. Poverty rates obtained from IBGE/IPEA.

6. **Regional disparities have strong socio economic implications.** Growth has remained geographically concentrated. As such, though Bahia's GDP has grown more rapidly than Brazil in the 2000s, most of Bahia's poorest municipalities, especially in the semi-arid landlocked zone have not grown as fast.

7. **Bahia's new strategic vision aims to foster higher and more inclusive growth that can be expanded to lagging regions and poorer populations.** As such, the strategic plan of the State of Bahia supports productive and social inclusion via family agriculture, social and solidarity economy, democratization of access to public services and housing and improving social services (health, education) as key elements for sustainable development. The State recognizes that these sectoral policies require an overall modernization of the state, and is actively implementing a medium term public sector management reform program to support the sectoral reforms.

8. **As the first DPL with Bahia, the proposed operation represents an innovation in Bank engagement with low income and low capacity subnationals in middle income countries for three reasons.** First, the proposed operation puts a great emphasis in supporting a strong social reform program in education and health but also in social and productive inclusion, reduction of gender inequality and crime and violence prevention, which are essential for inclusive growth. Second, the proposed operation supports a broad set of multisectoral issues as well as coordination mechanisms, which are key for the alignment of policies across sectors. For this, the operation has a strong focus on results and the use of monitoring and evaluation to feed directly into evidence based policy-making and implementation. Third, the proposed DPL will support the alignment of policies across different Government levels. In particular, it supports several results agreements between the State and its municipalities to improve public service delivery in health, education, social protection, and disaster risk management.

9. **The policies supported by the proposed DPL are aligned with the Strategic Vision of Bahia as represented in its multiyear plan (Plano Pluriannual -PPA) and are an integral part of GOB's medium-term reform program.** The Government's program under its multi-year Plan is organized around three strategic axes: (i) social inclusion and affirmation of rights; (ii) sustainable development and infrastructure for development; and (iii) democratic management of the state. As such the proposed operation will focus on three policy areas which are key pillars for achieving sustainable development and inclusive growth: (i) improving social and productive inclusion (equity); (ii) developing social, physical, and institutional infrastructure for sustainable development (efficiency); and (iii) strengthening planning and management of the public sector (governance). The selection of the policy areas reflects the priorities of the Government of Bahia and their importance to long-term sustainable growth and development as described in the Strategic Vision prepared by the Secretariat of Planning of the State (SEPLAG).² The proposed operation is a two-tranche development policy loan. The first tranche (US\$350 million) will be disbursed once the loan goes into effect, while the second tranche (US\$350 million) is contingent upon the Government's completion of additional policy actions.

² Bahia: *Visão Estratégica*, Secretaria do Planejamento - Superintendência de Planejamento Estratégico, 2011.

10. **The proposed development policy loan is fully consistent with and closely linked to the objectives of the Brazil Country Partnership Strategy³ (CPS) 2012-2015.** The CPS is grounded in the IBRD and IFC regional strategies, which focus on creating opportunities for growth and employment, targeting the poor and vulnerable, strengthening governance and promoting global collective action, as well as stimulating private sector innovation and competitiveness.

II. COUNTRY CONTEXT

RECENT ECONOMIC DEVELOPMENTS IN BRAZIL

11. **Brazil's relative resilience to the global financial crisis reflected good macroeconomic management and a solid financial system.** Following the global crisis in September 2008, Brazil suffered a sudden reduction in external and domestic credit, and significant currency depreciation. Rapidly falling external demand and a sharp decline in investment led to a 4.2 percent contraction in Gross Domestic Product (GDP) in the fourth quarter of 2008 followed by a 2 percent decline in the first quarter of 2009. The recession, however, lasted only those two quarters. Prompt response by the authorities avoided a credit crunch, and mitigated the impact of the global financial crisis on the Brazilian economy, which recovered rapidly. Fiscal policy was appropriately countercyclical in 2009 and remained expansionary in 2010, driven by strong rigidities in current expenditures, the political cycle, and difficulties in quickly reversing the countercyclical measures enacted in the previous year. After contracting by 0.3 percent in 2009, the economy grew at a 7.5 percent annual rate in 2010.

12. **At least until mid 2011, large portfolio inflows exerted a strong upward pressure on the real and were accompanied by growing private sector external indebtedness.** The currency, which had already appreciated by 11.9 percent in 2010, traded at a high of R\$1.59 per US dollar at the end of August 2011, a 44 percent appreciation since the start of 2009. The Central Bank rapidly accumulated international reserves, reaching US\$365.2 billion in March 2012 (up from US\$239.1 billion in December 2009). This was accompanied, however, by an increase of about 50 percent in Brazil's total external debt, from US\$198 billion in December 2009 to US\$299.6 billion in end-March 2012, of which 88 percent had a maturity of more than 360 days. Broadly defined gross external debt, however, including intercompany loans and nonresident holdings of domestic fixed income instruments, has also increased significantly, from US\$373.4 billion to US\$541.5 billion between December 2009 and March 2012. Private sector gross external indebtedness, in particular, rose 70 percent over this period, reaching US\$354.9 billion. The biggest increase occurred among banks, whose gross external debt reached US\$139.5 billion in March 2012, a 119 percent increase with respect to December 2009.

13. **At the same time, Brazil's public external debt-to-GDP ratio has shown a marked decline in recent years, largely reflecting the country's prudent fiscal policy stance.** Gross public sector external debt as a share of GDP plummeted from 9.3 percent in 2005 to 2.7 percent

³ World Bank Group's Country Partnership Strategy (CPS) 2012-2015 (Report No.6373-BR), discussed by the Executive Directors on November 1, 2011.

in 2011, and is projected to stabilize around that level for the next few years. Other external sector vulnerability indicators have behaved similarly. For example, total external debt service in terms of exports fell by 40 percent between 2007 and March 2012. Even more remarkably, total external debt as a share of international reserves plunged from 557.1 percent in 2002 to a projected 82 percent in 2012. In addition, nonresident holding of general Government debt remains relatively low, estimated at end 2011 as 3.8 percent, in comparison to the emerging market average of 20.4 percent.

14. **To address risks of overheating, in 2010 the Central Bank adopted a contractionary monetary policy stance, complemented with a tighter fiscal policy in 2011.** Consumer price inflation (IPCA), as measured by the Brazilian Institute of Geography and Statistics (IBGE), closed 2010 at 5.91 percent. To control inflation, the Central Bank increased the policy rate by 375 basis points, starting in April 2010, to 12.5 percent in June 2011. Furthermore, in February, 2011, the Government announced cuts in budgeted expenditures of R\$50 billion, which, coupled with strong revenue performance enabled it to generate a projected primary surplus of 3.1 percent of GDP in 2011, compared to 2.4 percent in 2010 (see Table 1 for Key Macroeconomic Indicators).

Table 1: Brazil - Key Macroeconomic Indicators and Projections, 2005-2015

Indicator	2005	2006	2007	2008	2009	2010	2011	Projection			
								2012	2013	2014	2015
National Accounts											
	(annual real percent change)										
Real GDP Growth	3.2	4.0	6.1	5.2	-0.3	7.5	2.7	3.2	4.3	5.0	4.2
	(in percent of GDP)										
Gross domestic investment	15.9	16.4	17.4	19.1	18.1	19.5	19.3	20.5	21.3	21.5	21.5
External Sector											
	(in US\$ billions, unless noted)										
Current account	14.0	13.6	1.6	-28.2	-24.3	-47.3	-52.5	-69.4	-75.8	-90.3	-99.6
Trade balance	44.7	46.5	40.0	24.8	25.3	20.1	29.8	19.1	14.6	5.1	4.5
Exports (fob)	118.3	137.8	160.6	197.9	153.0	201.9	256.0	263.4	277.1	295.7	326.5
Imports (fob)	73.6	91.4	120.6	173.1	127.7	181.8	226.2	244.3	262.5	290.6	322.0
Nonfactor services, net	-8.3	-9.6	-13.2	-16.7	-19.2	-30.8	-38.0	-44.3	-51.1	-55.6	-59.5
Income and current transfers, net	-22.4	-23.2	-25.3	-36.3	-30.3	-36.6	-44.3	-44.2	-39.4	-39.8	-44.5
Direct investment, net	12.5	-9.4	27.5	24.6	36.0	36.9	67.7	56.7	56.4	67.3	71.7
Portfolio investment, net	4.9	9.1	48.4	1.1	50.3	63.0	35.3	25.9	26.4	28.8	31.2
Gross international reserves	53.8	85.8	180.3	193.8	238.5	288.6	352.0	384.0	400.0	407.9	441.1
Current account (% of GDP)	1.6	1.3	0.1	-1.7	-1.5	-2.2	-2.1	-2.9	-2.8	-3.1	-3.3
General Government											
	(in percent of GDP)										
Total Revenues and Grants	35.8	35.9	35.7	36.3	35.0	36.6	36.2	37.5	37.8	38.2	38.3
Total Expenditure	39.3	39.5	38.3	37.7	38.1	39.4	38.6	39.9	40.4	40.5	40.7
Current Expenditure	37.2	37.4	36.4	35.3	35.6	35.1	35.8	36.7	37.2	37.1	37.3
<i>of which: Interest payments</i>	7.3	6.8	6.1	5.4	5.2	5.2	5.5	5.6	5.7	5.3	5.4
Capital Expenditure	2.1	2.1	2.0	2.4	2.4	4.3	2.8	3.2	3.3	3.3	3.3
Primary Balance	3.8	3.2	3.4	4.0	2.1	2.4	3.1	3.1	3.1	3.0	3.0
Overall Balance	-3.5	-3.5	-2.7	-1.4	-3.1	-2.8	-2.4	-2.4	-2.6	-2.3	-2.4
Gross Public Sector Debt	69.2	66.7	65.2	63.5	66.9	66.8	62.9	60.2	57.6	54.6	52.3
Domestic Debt	59.9	60.0	60.6	58.4	63.2	63.7	60.1	57.4	54.7	51.8	49.6
External Debt	9.3	6.7	4.6	5.1	3.7	3.1	2.7	2.8	2.8	2.8	2.7
Prices											
	(annual percent change)										
GDP Deflator	7.2	6.2	5.9	8.3	7.2	8.2	7.0	5.5	5.0	5.0	5.0
Consumer Price Index (eop)	5.7	3.1	4.5	5.9	4.3	5.9	6.5	5.3	5.5	4.8	4.7
Producer Prices (eop)	-1.0	4.3	9.3	9.8	-4.1	13.8	4.1	4.4	4.9	4.8	4.7
Memorandum items:											
Nominal GDP (in R\$ billions)	2,147	2,369	2,661	3,032	3,239	3,770	4,143	4,396	4,814	5,307	5,807

Source: IMF, BCB, IBGE, EIU, WB Calculation

15. **Although inflation accelerated during most of 2011, starting in August 2011, the Central Bank eased its policy stance in response to the worsening global and domestic economic outlook.** During most of 2011, labor market conditions tightened, with record levels of job creation and historically low unemployment (4.7 percent in December). Inflation reached 6.5 percent in 2011, in line with the upper limit of the inflation target. However, since August 31, 2011, in response to a perceived deterioration in the outlook for global growth and the expectation that it will have a disinflationary impact in Brazil, the Central Bank has reduced its policy rate by 350 basis points to 9 percent. Moreover, in November, 2011, the Central Bank significantly reduced capital requirements for consumer loans, by 50 percent in the case of loans with terms above 60 months. Similarly, in January 2012 the Central bank allowed large banks to use up to 36 percent of their reserve requirements on time deposits to provide liquidity to small and midsize banks, and in May 2012, the Government announced new rules reducing the minimum guaranteed return on tax-free savings deposits, to facilitate further policy rate cuts. On the fiscal policy front, however, the Government intends to maintain its current neutral policy stance. In particular, it has committed to primary surplus targets of 3.1 percent of GDP in both 2012 and 2013. This commitment, backed by the announcement in February 2012 of cuts in 2012 budgeted expenditures of R\$55 billion, has to date resulted in a primary surplus of R\$45.9 billion in the first quarter of 2012, representing about one third of the target for the year, and indicating higher probability that the Government will meet its target.

16. **Economic activity decelerated significantly during 2011 reflecting both domestic and external factors.** On the one hand, the deceleration was driven by the tighter monetary and fiscal policy stances adopted by the Government during the first half of the year. On the other hand, the fiscal crisis in the Euro zone has led to a worsening of the global economic outlook coupled with a reduction in business and consumer confidence. In this context, GDP growth decelerated to 2.7 percent in 2011. After stagnating during the third quarter of 2011, GDP posted a modest recovery and increased 0.3 percent in the last quarter of the year, below the observed average for the previous four quarters (0.5 percent). On the supply side, growth was led by agriculture and services, which increased by 3.9 and 2.7 percent, respectively. In contrast, the industrial sector, hit by global economic developments, posted an annual growth of 1.6 percent. On the demand side, growth was driven by private consumption (4.1 percent), and gross fixed capital formation (4.7 percent), while Government consumption increased by 1.9 percent.

17. **More recent data suggest that the industrial sector continues to dampen the pace of economic activity, despite robust consumption growth.** Strictly defined retail sales expanded 4.1 percent in the first quarter of 2012 relative to the last quarter of 2011. Broadly defined retail sales (including vehicles and construction material) increased 7.7 percent year to date in March, 2012. However, recovery in the industrial sector remains slow: in the first quarter of 2012, industrial activity was 0.5 percent below the level of the last quarter of 2011 (deseasonalized series). In this context, the Central Bank's economic activity index (IBC-Br), a proxy for monthly GDP, exhibited a 0.35 percent contraction in March, after having declined by 0.26 percent in January and 0.38 percent in February. In the first quarter of 2012, IBC-Br reported a 0.15 percent expansion. However, the 3-month moving average continued deteriorating, contracting by 0.33 percent and halting the positive trend observed since November.

18. **To counter the recent growth slowdown, particularly regarding domestic industrial output, the Government has taken action to curb exchange rate appreciation and has also moved towards more direct industrial policy interventions.** Specifically, the Government has enhanced restrictions on capital inflows through the extension of financial transaction taxes on international flows (IOFs), to cover all loans maturing within the next five years, and more recently the Central Bank stepped up its interventions in the spot foreign exchange market. The result of these actions, in combination with the easing of monetary policy, has been a rapid devaluation of the real against the dollar by over 12 percent in the last three months, with the exchange rate standing at R\$2.02/US\$ in mid-May 2012. Furthermore, a new package of industrial policy measures aimed at bolstering the manufacturing sector was launched in April. The measures include the reduction of payroll taxes for industries hardest hit by unfavorable global and domestic conditions and additional funding to the state development bank BNDES, amounting to R\$45 billion. To compensate for some of the possible revenue shortfalls, including losses from industrial payroll taxes that are currently estimated at R\$7 billion, the Government has announced an increase in the rates of two corporate social security taxes, PIS/Cofins.

19. **The financial system remains stable, coping well with heightened turbulence in global markets.** The stock of credit to the private sector reached R\$2.070 trillion in March 2012, equivalent to 49.3 percent of Brazil's GDP, a substantial jump of 4 percentage points in a year. Early stage delinquency indicators (loans that are between 15 and 90 days overdue) have been rising gradually, mainly in the consumer segment (6.8 percent in March 2012 up from 6.0 percent in December 2011). Even though this development portends higher non-performing loan (NPL) ratios in the upcoming months, banks appear well prepared to withstand such negative developments. The system-wide solvency ratio currently stands at around 16 percent, as supervisors have been phasing in tightened capital requirements in anticipation of Basel III while banks have obtained robust profits which they have been able to capitalize. Housing loans have grown very strongly: 42 percent in the year to March 2012, accounting for 18.7 percent of the 18 percent expansion in total credit to the private sector over that period. However, there is a low risk of an "asset bubble" developing in Brazil's real estate markets. Indeed, those loans still represent only 10 percent of total private sector credit and their delinquency rates have fallen significantly thanks to the improvement of the mortgage foreclosure system (e.g. loans overdue for more than 90 days have fallen by more than 75 percent since 2006).⁴ The system also has important non-fiscal buffers in the event of a liquidity crunch: not only are international reserves at record high levels, but also the deposit insurance fund (FGC) has R\$19 billion in liquid assets and reserve requirements stood at R\$440 billion.

20. **The current account remained roughly stable during 2011 while FDI exhibited solid growth even as the global economic outlook has deteriorated.** The current account deficit totaled \$52.6 billion in 2011 (2.1 percent of GDP, compared to 2.2 percent in 2010). Net direct investment, however, reached \$76 billion in 2011 compared to \$36.9 billion in 2010. Going forward, the current account deficit is expected to increase in 2012, driven by lower growth in export prices and a reduction in the trade surplus. At \$14.9 billion through March 2012, FDI flows are expected to remain strong over the medium term despite uncertainties centered on the unfavorable external scenario and the possibility that some of the high FDI flows in 2011 were

⁴ In addition, housing credit demand is being driven mainly by first time home owners, rather than by purchases with speculative purposes.

reversible interest-sensitive flows circumventing the IOF tax on fixed income capital flows. Owing to the high liquidity in international markets and the prospect of higher growth in the economy over the next few years compared to most developed economies, FDI flows should remain sufficient to finance the majority of the current account deficit.

21. **The prospect for growth in foreign portfolio investments is less positive.** Driven mainly by high real domestic interest rates at a time of exceptionally low interest rates internationally, these inflows put strong upward pressure on the real and prompted the authorities to increase taxes on financial transactions (IOF) of foreign fixed income investments from 2 to 6 percent in October 2010. This measure, together with recent increases in global risk aversion associated with the fiscal crisis in Europe, has already caused a slowdown in portfolio flows. Going forward, these inflows could be negatively affected by the increased international turmoil. Moreover, while real interest differentials are likely to remain large, the recent Central Bank decisions to reduce the policy rate will diminish the incentive for carry-trade operations. On the positive side, portfolio inflows should benefit from the suspension of IOF taxation on foreign variable income investments announced in December 2011. Notwithstanding the recent increase in portfolio investments amounting to US\$7.5 billion in the first quarter of 2012, preliminary evidence suggests that the composition effect (more FDI, less portfolio investments) has been more pronounced than volume changes as a result of the restrictions on capital inflows.

22. **Going forward, persistently higher domestic interest rates should lead to a further build-up of reserves, but are also expected to prompt the private sector to continue increasing its external indebtedness.** In this context, the Central Bank has stepped up its monitoring of prudential and macro-prudential risks associated with potential currency mismatches by financial and non-financial companies, by increasing reporting requirements on foreign borrowing by non-financial corporations. It has also taken measures to mitigate those risks by tightening regulations on banks' net open positions and, at least until very recently, by also tightening capital requirements to curtail credit growth.

CURRENT MACROECONOMIC OUTLOOK

23. **The medium-term macroeconomic outlook points to an annual GDP growth rate of between 4 and 4.5 percent.** In the short term, the forecast is for lower growth compared to previous periods, as the Brazilian economy suffers the consequences of the deterioration in the global economic outlook. Besides the lower growth forecast, negative developments in the rest of the world may have an impact on Brazil's external and fiscal accounts in the short term. In the medium term, growth is likely to be driven by strong domestic aggregate demand. Investment growth, in particular, will be spurred by the development of new offshore oil fields and preparation for upcoming mega sporting events.

24. **In the short term, the external sector is one of the main sources of Brazil's vulnerability to a global slowdown through possible impacts on trade volumes, commodity prices and exchange rate movements.** A worsening of the global economy caused by a full-blown euro zone debt crisis and/or a US recession, may translate into lower external demand for

Brazil's exports⁵, while a Chinese hard landing would hit Brazil's terms of trade, and demand for exports, given the significant demand from China⁶. The current account deficit is expected to increase slightly in 2012, driven by a decline in the trade surplus, owing mainly to lower growth in export prices. As the current-account deficit widens, the Real could weaken slightly in nominal terms against the US dollar, as was observed during the third quarter of 2011. Nonetheless, Brazil's vulnerability to external events will remain low due to its high reserves and favorable debt composition (see Table 1).

25. Secondly, the banking sector is vulnerable to continued global slowdown given the exposure of some small and medium sized banks to liquidity risk. Small and medium sized banks, currently holding 8 percent and 12 percent respectively of the Banking system's assets, still largely rely on relatively volatile sources of funding. However, system-wide assessment of banks indicates that Brazil's banking system currently has solid liquidity levels and capital cushions. Moreover, although banks might be indirectly affected by potential external funding problems of the non-financial corporate sector, the system's direct exposure in foreign currency is limited: 7.2 percent of liabilities and 4 percent of assets.

26. Further worsening of the global economic environment also poses risk to the fulfillment of fiscal targets. The achievement of primary surplus targets may be affected by the deceleration of economic activity, as federal revenues could decline and social protection expenditures are likely to increase. Moreover, despite the Government's current commitment to using mainly monetary policy levers to counter the ongoing economic deceleration, recent policy measures suggests that it remains open to adopting complementary fiscal and quasi fiscal stimuli if economic activity were to decelerate more sharply. In particular, in early December the Government announced a set of fiscal stimuli, consisting mainly in reduced tax rates for white line appliances and other selected goods and financial transactions for a total potential fiscal impact of about R\$7.6 billion.

27. In the medium term, Brazil faces structural challenges that limit its long-term growth potential. A short list of challenges includes developing a private market for long-term financing and improving the business environment (in particular, reducing the costs associated with complying with tax obligations and obtaining business permits and licenses). Other important issues are the need to increase public and private investment, so as to address growing infrastructure bottlenecks and achieve faster productivity growth, and that of improving the effectiveness and cost-effectiveness of public expenditures.

28. Despite the above external risks and domestic challenges, the Government's overall macroeconomic framework is deemed adequate and sustainable in the medium term. Brazil's fiscal framework (see Box 1 for more details on Brazilian Fiscal Federalism) provided the Government with the flexibility to successfully respond to the 2008/09 global financial crisis with an array of fiscal, monetary, and external measures to stimulate domestic demand. Gross public sector debt is expected to decline in the future, from 63.5 percent of GDP in 2011 to 58.3

⁵ Currently, exports to the Eurozone represent about 20 percent of total exports, while exports to the US account for 9.5 percent of total exports respectively.

⁶ China is the primary destination of Brazil's exports. The share of China in Brazil's exports stood at 16.8 percent in October 2011.

percent of GDP in 2013, despite difficulties in maintaining fiscal balance in the face of large investment needs and pressures from current expenditure growth. Moreover, flexible exchange rates, relatively large foreign reserves and a well capitalized banking system should help Brazil address the consequences of a potential external crisis, including a possible abrupt shift in market perceptions and an associated turn-around in capital flows.

Box 1. Brazilian Fiscal Federalism and the Control of Sub-National Fiscal Performance

The fiscal stance of Brazilian states has always been an important element in macroeconomic management in Brazil. Until the late 1990s, the expansionary fiscal policies by the states and the lack of effective controls over their indebtedness resulted in frequent sub-national debt crises. On three different occasions (1989, 1993 and 1997) the federal Government had to take on and reschedule the debts of the states. The largest operation occurred in 1997, under Law 9496, when the federal Government restructured R\$200 billion (12 percent of national GDP) of the debts owed by the states.

In the 1997 refinancing operation, the debts were refinanced for 30 years. This refinanced debt, so called *intra-limite* debt, carries a real interest rate of 6 percent with the nominal value of the debt rising by inflation. The debt service was capped at 13 percent of states' net current revenues. Any debt service above the 13 percent cap is recapitalized and added to the *intra-limite* debt stock. At the end of the contracts (in 2028), if there are residual debt balances, the state must pay off the remainder within 10 years.

The 1997 bailout was conditioned upon the state's compliance with medium-term fiscal adjustment and structural reform programs. In exchange for the rescue package, the debt renegotiation contracts mandate the implementation of three-year rolling Programs of Fiscal Adjustment (PAFs) to be agreed upon by the National Treasury Secretariat and the 25 states that had their debt rescued by the National Treasury Secretariat during the period of the contract. The PAFs set annual targets on indebtedness, primary balances, personnel spending, tax revenue and public investment, in order to guarantee a gradual decline in indebtedness. In addition, the PAFs include structural reforms such as privatization or other public sector modernization initiatives.

The controls on sub-national fiscal performance were further strengthened by the approval of the Fiscal Responsibility Law (*Lei de Responsabilidade Fiscal*—FRL) in 2000. The FRL institutionalized fiscal discipline at all levels of Government, incorporating hard budget constraints into a single unifying framework. It explicitly prohibits debt refinancing operations between different levels of Government, thereby addressing the moral hazard problem in interGovernmental fiscal relations caused by sequential bailouts. Complementary Senate resolutions also prohibit borrowing if: (i) the net consolidated debt exceeds twice net current revenue (RLC—*Receita Líquida Corrente*); (ii) new credit operations exceed 16 percent of RLC; and (iii) debt service exceeds 11.5 percent of RLC. Borrowing is also prohibited if it violates the debt reduction schedules set by the debt renegotiation contracts under the Law 9496. Finally, issuance of sub-national Governments bonds is generally prohibited through 2016; however, states whose net debt is less than net current revenue can issue bonds after 2011, although even here the Federal Government retains the option to review the decision to issue bonds.

This system of controls has resulted in repeated State and municipal surpluses—an adjustment that has continued through four federal administrations. In addition, this system has also favored the adoption of appropriate expenditure programs by sub-national Governments. Besides the controls on indebtedness, FRL requirements improved transparency and strengthened budgetary practices.

Transparency: budget outturns and compliance with the FRL—including a statement of corrective measures if the relevant provisions are breached—are reported on a regular basis. Municipalities and states are also required to report the fiscal outturns of the previous year to the Ministry of Finance. The legislative branch of each level of Government, aided by their respective Court of Accounts, monitors observance with the fiscal targets and ceilings.

Budget Institutions: the FRL introduces more stringent requirements on fiscal targets in the preparation of the Budget Guidelines Law (*Lei de Diretrizes Orcamentárias*—LDO), strengthening its role in budget preparation and fiscal management in general. The LRF also calls for a detailed assessment of the Government's contingent liabilities and strengthens the link between the Annual Budget Law (*Lei de Orçamento Anual*—LOA) and the LDO. A complementary Fiscal Crime Law is applied to all levels of the public administration, with the possibility of detention for those public officials not complying with the FRL.

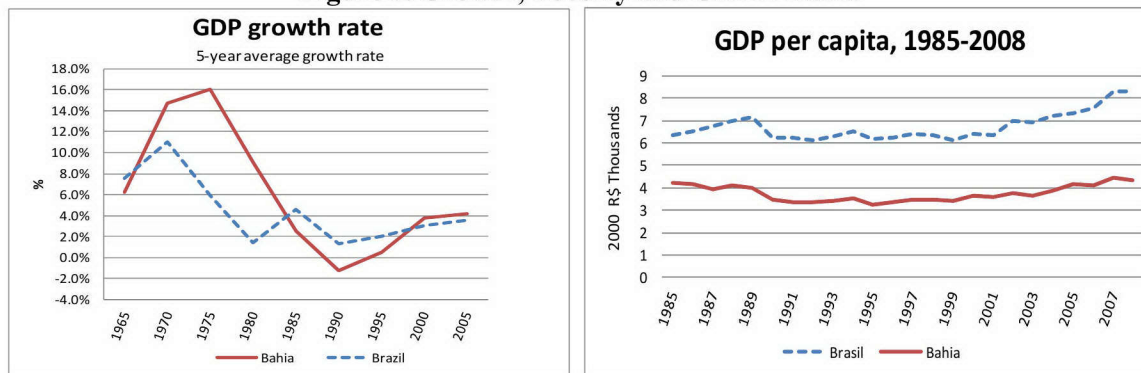
RECENT SOCIO-ECONOMIC DEVELOPMENTS IN THE STATE OF BAHIA

29. **The State of Bahia is largely rural; however most of its GDP is generated around the metropolitan area of Salvador.** Bahia has one of the lowest urbanization ratios in the country at 68 percent. Salvador, the State’s capital and largest city, is home to 2.7 million inhabitants in the Municipality and 3.4 million in the larger Metropolitan Region. Moreover, 53 percent of the State GDP is concentrated in the Salvador Metropolitan Region. Most of Bahia’s 417 municipalities are poor, especially in the semi-arid zone. Although the State is divided in 26 regions (*Territórios de Identidade*)⁷, they can be grouped in three larger regions : *Litoral* (eastern most part along the Atlantic), *Semi-Árido* (center) and *Cerrado* (western most part). The *Semi-Árido* region, spanning 68.7 percent of the territory, is the poorest and least developed region of the State.

30. **Bahia is the State with the largest absolute number of extreme poor in Brazil.** Out of a population of approximately 14 million inhabitants, 1.96 million are extremely poor, and 8.2 million are registered in the *Cadastro Único* (CadÚnico) to receive social assistance through Government conditional cash transfers. As such, Bahia is one of the main targets of the Federal Government’s recently launched program for the eradication of extreme poverty - *Brasil Sem Miséria*- through income transfer programs, access to public services, and productive inclusion.

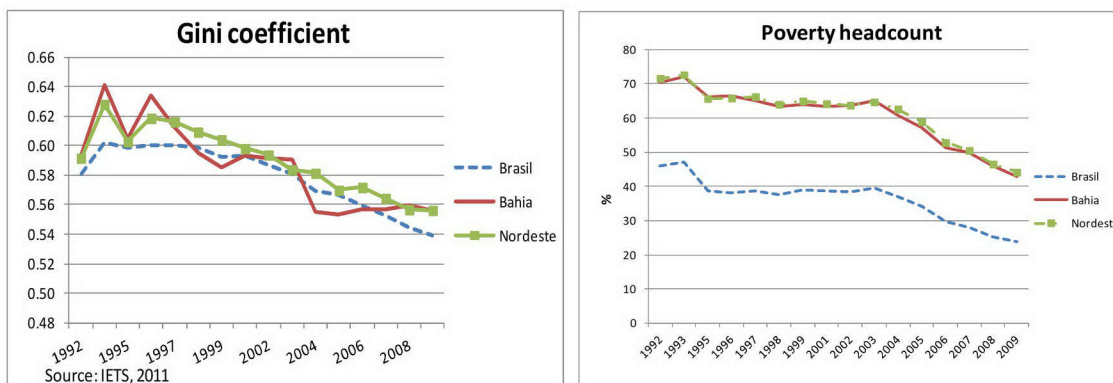
31. **Nonetheless poverty has sharply declined over the past decade.** Social policies and high growth lifted a great part of the poor into the middle class in the 2000s. Indeed, the percentage of the population living below the poverty line has decreased from 60 percent of the population in 2003 to about 39 percent of the population in 2009. This is also reflected in the sharp growth of the middle class: the so-called “Class C” (monthly income from R\$1,125 to R\$4,854) grew from 20 percent of the population in 2003 to 35.7 percent in 2009. The reduction in poverty has also been strongly assisted by an average growth rate of over five percent annually since 2003, led by the agricultural sector. The 2000s mark an inflexion point for Bahia. Success in developing vibrant agricultural poles spurred economic activity above national average. This is a break from a long past of non-inclusive growth patterns in the 1960s and 1980s, and relative stagnation in the following decade (See Figure 1).

Figure 1. Growth, Poverty and Gini in Bahia



Source: <http://www.ipeadata.gov.br>

⁷ The *Territórios de Identidade* share common interests and realities allowing the Government to implement regional coherent policies instead of municipal-based isolated ones.



Source: IETS, 2011

Note: The poverty line is defined as the double of the extreme poverty line, which is defined as the costs of basic food basket that supply the minimum individual caloric intake. The poverty line varies between regions, states, urban, rural and metropolitan areas.

32. **Economic activity has been geographically concentrated.** Industrial activities are geographically concentrated in the Salvador metropolitan area, with capital intensive petrochemical and automotive industries,⁸ the South East (Ilheus), the West (Luis Eduardo Magalhães) and the North (Juazeiro and Paulo Afonso). The agricultural sector is represented by three main poles: the poles of cellulose and cocoa in the extreme south, grains (mostly soybeans) in the west (Luis Eduardo Magalhães), and fruits in the north of the State (Juazeiro). Cocoa, which is concentrated around the city of Ilhéus, has been declining while the soybean production in the western part of the State has been dynamic. Other agricultural activities are concentrated in regional clusters. The northern portion by the São Francisco area has irrigated fruit culture production and the largest caprine herd in the country. The southern portion has the largest bovine livestock production. The Conquista plain concentrates on coffee production, and along the coast, the cultivation of cacao, forestry and industrial cellulose production. Mining can be found scattered in the State's central area.

33. **This geographical concentration has implications for logistics and transport as well as regional growth.** Indeed, transport logistics constraints to getting more products to the port or to market has affected the growth in some sectors such as soybeans and limited growth in landlocked regions such as the *Semi-Árido*. As such, even though Bahia's GDP has grown more rapidly than Brazil, most of Bahia's poorest municipalities, especially in the semi-arid zone have not experienced growth.

34. **The low level and slow growth of the State's average wage points to challenges in health and education.** The economy has been able to generate an increasing balance of formal jobs. From 2008 to 2010, the number of formal jobs created has tripled. However, the average salary has increased very slowly compared to other states, indicating that the jobs being created are mostly low wage jobs. For instance, the average salary of the State is 30 percent lower than that of Rio de Janeiro. As such, one of the main challenges of the State is to improve human capital in health and education to foster job creation with higher wages as well as attract businesses to the State.

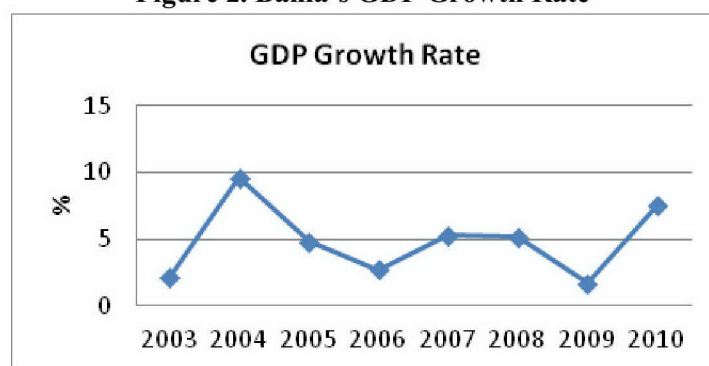
⁸ The petrochemical cluster is concentrated in São Francisco do Conde and Camaçari where are located the Petrobrás refinery plant a petrochemical cluster and a Ford Motor plant (both in Camaçari).

35. **The coverage of health care services has increased.** However, Bahia's performance was not as good as the rest of Brazil's. Federal programs such as the Family Health Program (*Programa de Saúde da Família – PSF*), and state-level health sector reform, have expanded primary healthcare to Bahia's rural and poor population. However, Bahia still faces significant health challenges such as a high infant mortality rate (IMR) -- which is the seventh highest of the 26 states in the country -- and a high maternal mortality ratio (MMR). Reducing MMR is also core to reduce infant mortality, especially early neonatal mortality, which is mostly related to conditions that arose during pregnancy.

36. **Improving the quality of education services remains a challenge.** While the enrollment rate in elementary school has increased, it remains low for high school. The rate of illiteracy for people over 15 years is 16 percent and the average schooling of adults of 25 years and older is only 6 years. The quality of teaching is low. Only 20 percent of students from fifth grade have a satisfactory performance in Portuguese and 17 percent in mathematics. In the case of high school, only 26 percent of the students have a satisfactory performance in Portuguese, and 6 percent in mathematics.

37. **Economic activity in the State of Bahia has rapidly recovered from the 2008/09 global financial crisis.** GDP grew 7.5 percent in 2010, the second highest growth of the 2000s (See Figure 2). All sectors recovered from the global financial crisis: Agriculture grew 8.5 percent- driven by a record grain harvest; industry expanded 8.4 percent driven by strong growth in construction, and the services sector grew 6.9 percent, mainly due to the dynamism of retail trade. In addition, a substantial increase in public and private investment in infrastructure and production capacity boosted aggregate demand. Investment should continue growing, considering the upcoming Soccer World Cup and the expansion of industry. Consumption growth in Bahia, despite the financial crisis, was resilient, driven by a number of counter-cyclical Government measures and conditional cash transfer programs. Also important is the expansion of consumer credit over the past year, the growth of formal employment and wages, and increased demand for industrial and agricultural commodities produced by the state.

Figure 2. Bahia's GDP Growth Rate



Source: SEI – Secretaria de Planejamento da Bahia (GDP for 2009 and 2010 are estimated)

38. **The recovery of industrial and agricultural production has benefitted from global demand.** Manufacturing industry rebounded strongly leading the State of Bahia to a 7.1 percent growth in 2010. The major impacts were observed in: (i) petroleum refining and alcohol production (22.6 percent); (ii) food and beverage (8 percent), from the increase in beer

production and soybean oil; and (iii) metallurgy (9.3 percent). The performance of manufacturing industry in Bahia also benefitted from strong global demand from the oil and mineral extraction sector as well as the pulp industry. There has been an expansion of agribusiness in recent years based on repeated records in the production of grains, especially soybeans, corn and cotton. High prices for grain and growing international demand for commodities has also stimulated these crops.

39. **In 2010, Bahia's trade balance registered a surplus of US\$2.26 billion, although this is declining partly as a result of the currency appreciation.** Exports reached US\$8.9 billion, a 26.8 percent increase over the previous year. Imports, in turn, grew 41.8 percent to reach US\$6.6 billion. The strong appreciation of the Real in recent years has increased relative prices of locally produced goods by 16.7 percent, slightly eroding the surplus. Bahia is also benefitting from increased sales to emerging countries and the resumption of US purchases after the crisis.

40. **The strong rebound of the economy is also reflected in the labor market.** In 2010, the formal labor market continued to expand creating 91,402 jobs, up from 71,170 jobs in the previous year. Job creation was translated in an improvement in the general conditions of productive insertion of families without income and families who earned less than minimum wage. One of the main challenges for Bahia remains the persistence of low levels of formal labor in rural areas. In agriculture, only 4.1 percent of workers were formally registered in 2009.

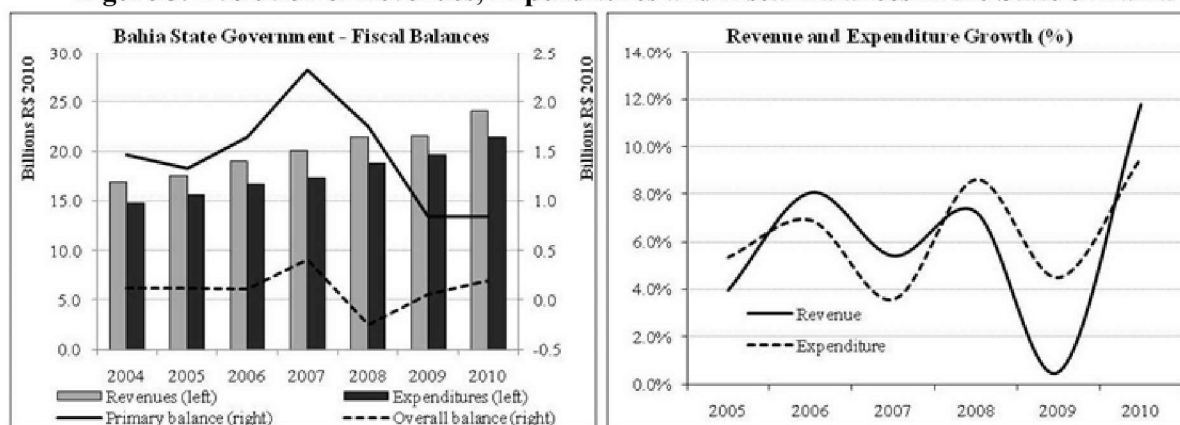
Recent Evolution of Fiscal and Debt Indicators for the State of Bahia⁹

41. **Fiscal balances benefited from strong economic growth as well as increased efficiency in revenue collection from 2004 to 2008.** Following the debt renegotiation with the Federal Government and the adoption of the Fiscal Responsibility Law in 2000, the Government's strategy was to rapidly pay down the existing stock of debt. This involved building up the Gross Operating Balance¹⁰ with revenues growing faster than current expenditures in a context of: (i) GDP growth rate in Bahia higher than the national average which markedly increased the tax base of the State (see Figure 3); (ii) the successful implementation of a modernization of tax administration through the PROMOSEFAZ program from 2001 to 2004 which increased the State capacity to collect revenues; and (iii) the favorable effects of the inflation and exchange rate indices (due to the incidence of ICMS over imports) on tax collection.

⁹ See annex 4 for detailed analysis.

¹⁰ Revenues minus current expenses.

Figure 3. Evolution of Revenues, Expenditures and Fiscal Balances in the State of Bahia



Source: SEFAZ, WB Calculations

42. **The interGovernmental fiscal arrangements of the State of Bahia with the municipalities and with the Federal Government are deemed adequate.** Transfers expenditures to municipalities are rule-based and represent a fixed amount of 25 percent of ICMS revenues and 50 percent of IPVA revenues. Transfers to municipalities remained stable at around 20 percent of Bahia's Net Current Revenues (Table 2). Bahia is a net contributor to FUNDEB: the State of Bahia provided up to R\$2.7 and received the amount of R\$1.9 bn in 2010.

43. **Current transfers from the Federal Government are high and have remained stable in terms of Net Current Revenues since 2005.** FPE, the main component of the federal transfers, remained stable at around 28 percent of NCR from 2004 to 2010 (Table 2). However, Bahia's dependency on the Federal Government or the share of FPE transfers as a function of ICMS tax collection has been more volatile. While FPE transfers represented 34 percent of ICMS tax revenues in 2004, this ratio went up to 41 percent in 2010. Indeed, the State of Bahia was the biggest beneficiary of FPE in Brazil in 2010 (9.4 percent). The movement in the ratio also reflected increased FPE transfers (in terms of net current Revenues) in 2008 and 2009. In the medium-term, the distribution rule of FPE might change. For Bahia a lower share might put pressure on its public revenues. Transfers from (Federal Health System Fund-*Sistema Único de Saude* -SUS) have increased due to mandated legal increases. Other current revenues have been increasing by 17 percent over the period from 2004 to 2010.

Table 2: Transfer Revenue Composition 2004-2010

	Percentage of Net Current Revenues (NCR)						
	2004	2005	2006	2007	2008	2009	2010
Transfers revenues	34.0%	42.7%	43.5%	42.2%	42.8%	44.5%	43.1%
Current transfers	32.1%	42.4%	42.8%	41.4%	42.0%	41.6%	39.7%
FPE	24.8%	27.3%	28.9%	27.6%	29.6%	29.0%	26.4%
Other	7.4%	15.2%	14.0%	13.8%	12.3%	12.7%	13.3%
Capital transfers	1.9%	0.3%	0.7%	0.8%	0.8%	2.8%	3.4%

Source: SEFAZ, WB calculations

44. **The 2010 budget was 12 percent larger than the 2009 one due to stronger revenue performance.** The increase in expenditures was mostly in investment and goods and services (in the other current expenditure category in Table 3 below). In 2010, expenditures in goods and services grew at a real rate of 23 percent, largely driven by increased investment. Increased consumption of third-party contracted services also resulted in higher expenditures in the other

current expenditures category. Social contributions also grew due to a mandated increase of the State's employer's share between 2004 and 2005.

45. **Investment expenditure has been rising in recent years.** Following a decline in investment as a proportion of revenue between 2004 and 2007, the trend was reversed as investment rose from 6.6 percent of revenue in 2007 to 11.8 percent in 2010.

46. **Bahia's Net Consolidated Debt has been falling since 2004.** Due to growing fiscal revenues and consistent fiscal adjustments, the net consolidated debt-to-revenue ratio fell steeply from over 140 percent of NCR in 2004 to 52 percent by 2010, well within the LRF (*Lei de Responsabilidade Fiscal*) limit of 200 percent. Debt service¹¹ has been decreasing sharply since 2008 driven by lower interest payments and amortization. Indeed, interest payments have sharply decreased since 2007 while amortization started decreasing in 2009.

47. **The macroeconomic framework of Bahia is deemed adequate.** Bahia's macroeconomic and fiscal situation is sound and in compliance with the prudential limits set out in the LRF since 2004. Bahia is below the legal limits for all indicators monitored by the federal treasury under the LRF. They are related to personnel expenditure, indebtedness and revenue collection.

Table 3. Evolution of Fiscal Responsibility Law during 2004-10

Value in Current Million R\$

Indicators	LEGAL LIMITE % NCR	2004		2005		2006		2007		2008		2009		2010	
		VALUE	% NCR	VALUE	% NCR	VALUE	% NCR	VALUE	% NCR	VALUE	% NCR	VALUE	% NCR	VALUE	% NCR
Personnel expenditures															
Executive	49%	3,747	41%	4,161	40%	4,809	42%	5,378	43%	6,136	43%	6,859	47%	7,501	43%
Overall	60%	4,366	48%	5,028	49%	5,906	52%	6,601	52%	7,539	53%	8,391	57%	9,128	53%
Net consolidated debt	200%	12,878	142%	12,048	117%	11,616	102%	10,371	82%	10,238	72%	9,235	63%	9,057	52%
Garantees Total	22%	263	3%	180	2%	129	1%	107	1%	105	1%	99	1%	95	1%
Credit Operations Revenues	16%	314	3%	254	2%	386	3%	160	1%	133	1%	988	7%	654	4%
Net Current Revenues (NCR)		9,075		10,329		11,360		12,585		14,238		14,671		17,373	

Source: Sefaz, WB calculations

Risks and Challenges

48. **The main challenge for Bahia is the creation of fiscal space for the expansion of public services and productive investments within the framework of the fiscal responsibility law.** The main risk related to revenues is Bahia's heavy reliance on ICMS tax in a few sectors which are vulnerable to macroeconomic fluctuations in Brazil and partners countries. As such, Bahia's revenues are vulnerable to a worsening of the Eurozone crisis or the slowdown of US growth as well as a potential hard landing from China. In addition, Bahia is vulnerable to a reduction in the FPE transfers, an important source of revenue, stemming from federal reform. Bahia is currently facing its worst drought in the last 47 years and, in some cases, accompanied by flooding; the drought has affected, to some extent, agricultural production and, as such, revenues in the affected areas.

49. **The main risks on the expenditures side are linked to growth of personnel as well as goods and services expenditures.** Challenges on the expenditure side include: (i) curbing

¹¹ In 2009, increased fiscal consolidation which allowed it to improve the terms of payment of the debt with the federal Government (Lei 9496/97) from 13 percent of Net Real Revenue (NRR) to the terms of the amortization schedule (Tabela Price), reducing its commitment to around 8 percent of NRR.

current expenses – such as compensation of employees (wage bill and pensions) and goods and services consumption – and (ii) controlling the costs of large investment projects and large social programs. Indeed, salary increases are the main drivers of Government expenses along with goods and services expenditures and are non-discretionary. This suggests the relevance to control current expenditures and salary adjustments to maintain fiscal balance. See Annex 3, which displays the projections of fiscal revenues and expenditures as well as the resulting fiscal balances for the period under consideration.

50. In an environment of fiscal competition among Brazilian States, the Government of Bahia faces important challenges to increase ICMS tax revenue collections. ICMS, a VAT tax on the commerce of goods and services, accounts for approximately 24 percent of the State's total revenues and 87 percent of tax revenues. ICMS has benefited from rapid growth in retail and wholesale sales. Concerns remain in two main aspects: (i) the 'old economy' tax base coverage focused on petroleum and energy and relative little coverage of the fast-growing services sector. Corporate tax revenue collections are highly concentrated: 400 companies are responsible for 80 percent of corporate tax collections (Petrobras alone accounts for 28 percent); (ii) related to this, the Electronic Transactions-*Comércio Eletrônico*, for which goods are taxed exclusively where the retail warehouse is located (usually a southeastern state). The Federal Government has initiated a discussion with all states on possible institutional changes to address the issues.

51. The State of Bahia has large investment needs and an ambitious program to address them. Firstly, there is the need for expansion of basic public services, including water and electricity (e.g. through the *Luz Para Todos* and *Agua Para Todos* programs) among others which require capital investments. Secondly, the State has a substantial deficit in basic infrastructure that promotes economic activity, including road, air, and waterborne transport. Thirdly, the 2014 World Cup will require further investments in urban mobility (building *and integrating* modes of public transport) as well as security, to be financed by PPPs. Currently envisioned investment projects include: the Ferrovia Oeste-Leste (construction on-going), *the expansion of existing ports (Porto Seguro and Barreiras)* and construction/ upgrading of airports (especially regional airports, aiming at improving access from remote areas), transportation of soy and grains through freight, and the construction of new ports (*Porto Sul de Ilhéus, Porto de Aratu, and Porto de Salvador*).

52. Bahia's medium-term and projected fiscal accounts show sustainable trends and the State's macroeconomic framework is deemed adequate for the purpose of this DPL. Tax revenues are expected to grow at a regular pace during in 2011-16. *On the expenditures side, total expenditures* are projected to keep growing in line with revenues growth. Interest payments are expected to decrease starting in 2011 as Bahia is paying down its debt very fast. As a result, the Gross Operating Balance will remain stable at around 15 percent of Net Current Revenues. Investment is *expected to decrease* in 2011 due to an increase in debt service. However, investment is expected to recover in 2014 to reach 9.4 percent of Bahia's Net Current Revenues.

Fiscal and Debt Sustainability Analysis

Underlying Assumptions

53. **Under the baseline scenario, the fiscal balances of the State of Bahia will evolve as follows:** revenues and expenditure will broadly grow in line with nominal GDP. In particular on the revenue side, we assume that the social security contribution revenues and the private and capital transfers will grow with the population growth rate and the IPCA inflation. On the expenditure side, we assume that the amount of net acquisitions of non-financial assets will be equal to the fiscal space defined as the Gross Operating Balance net of amortization and other investments, while the interest payments profile is given by the Secretary of Finance of the State of Bahia. The fiscal account classification used is the Government Finance Statistics (GFS) system recommended by the IMF. On the debt side, the outstanding stock of debt is indexed by the projected IGP inflation. The fundamental macroeconomic variables that are affecting the paths of the debt and the fiscal projections such as the inflation rate and the nominal GDP growth rate are detailed in the Fiscal and Debt Annex- Annex 4.

Fiscal Accounts and Debt Projections

54. **Using the Government Finance Statistics (GFS) fiscal classification and the assumptions for the fiscal projections presented in the previous section, the projections of the fiscal accounts of the State of Bahia for 2011-2016 show a sustainable trend.** The fiscal balances, i.e. the primary fiscal balance, the overall balance and the gross operating balance are all expected to record surplus for the projected period. The primary balance is projected to reach 9.1 percent of NCR in 2011 before decreasing in the following years.

55. **The Net Consolidated Debt of the State of Bahia is gradually decreasing over time, remaining largely below the limit set by the Federal Government.** Given the information on the amortization and the interest payments schedule for 2011-2016, the stock of debt is expected to decrease to reach 16 percent of Net Current Revenues by 2016 while interest payments are expected to follow a downward trend (see Annex 4 for figures and tables).

Fiscal Responsibility Law Indicators Projections

56. **The fiscal and debt sustainability analysis shows a sustainable path for the main Fiscal Responsibility Law indicators for 2011-2016.** Hence, the net consolidated debt per NCR and the debt service as a share of NCR will remain below the limits set by the Federal Government. The Net Consolidated Debt to NCR indicator is expected to decrease by more than 60 percent between 2010 and 2016. Given the amortizations and the interest payments profile, the debt service per NCR follows a downward trend from 2011 onwards.

III. THE GOVERNMENT'S PROGRAM AND PARTICIPATORY PROCESSES

THE GOVERNMENT PROGRAM

57. **The Program of the Government of Bahia is based upon the Strategic Vision¹² prepared by the State Secretariat of Planning (SEPLAG).** This strategic vision aims to take advantage of the window of opportunity for exporting commodities by improving the State's competitiveness to attract new investments in different areas (mining, agro-business, logistics, energy, etc.) to support economic diversification and growth. Meanwhile, to sustain the competitiveness of Bahia's industry the strategic vision stresses the importance of supporting technological innovation to: (i) invest in new niches (green economy); (ii) prepare students for the workplace (technical and higher education); (iii) ensure quality and innovation; (iv) support productive inclusion; and (v) understand social services (health, education, disaster risk management, civil defense and security) as relevant elements for growth and development.

58. **Elements of the Strategic vision are incorporated into a Participatory Multi-Annual Plan (PPA-P).** During 2011, the PPA for 2012-15 was developed through a consultative process with meetings in 26 regions of the State of Bahia. Participation was open to all citizens, civil society organizations and elected officials in the regions, and also included processes for indicating thematic priorities through the internet. The PPA was sent for approval to the legislative assembly in August 2011.

59. **The Government's program under the PPA-P is organized around three strategic axes:** (i) Social Inclusion and affirmation of rights; (ii) Sustainable Development and Infrastructure for Development; and (iii) Democratic Management of the State. Some of the key policies and strategies under each of these axes are shown below and are fully aligned with the program supported under the proposed DPL.

Social Inclusion and Affirmation of Rights

Education

60. **The State of Bahia and its municipalities have low internal efficiency in education and poor learning outcomes.** Although enrollment across all levels of basic education has increased in recent years, it still remains slightly below the national average and below the regional average for the North-East. Education is a shared responsibility between the State and the municipalities - 83 percent of all the schools in Bahia are municipal. Therefore the State education authorities are committed to improving accountability for results between the State and the Municipalities through the establishment of partnership agreements called *Pacto com Municípios*¹³ (Pact with Municipalities).

¹² Bahia: visão estratégica, Secretaria do Planejamento - Superintendência de Planejamento Estratégico, 2011.

¹³ *Pacto com Municípios* was previously called *Pacto pela Educação* (Pact for Education). The latter formulation was used in the decree No. 12.792, dated April 28, 2011, published in the Borrower's Official Gazette on April 29, 2011.

61. **The Secretariat of Education has established *Todos pela Educação* (All for Education), an ambitious plan to guarantee the right to learn for all students in Bahia public schools.** The plan covers all levels of education. It is organized around 10 priorities that provide a roadmap for state interventions in the education sector. The plan is also a vehicle for mobilizing additional state teaching resources and scientific knowledge to improve the academic performance and proficiency of students in state and municipal schools. The plan's main two outcome indicators are: (i) increasing the pass rate to 90 percent for students enrolled in the first cycle of fundamental education, 85 percent in the second cycle, and 80 percent in secondary education by 2014; and (ii) achieving the Basic Education Development Index (IDEB) targets set by the Ministry of Education in 2011 and 2013. Overall, the plan seeks to increase the quality of education, improve internal efficiency, and prepare the state's youth to become active citizens and enter the labor market.

62. **Monitoring progress in learning outcomes is a key condition for the success of the Pact with the Municipalities-*Pacto com Municípios*.** The Secretary of Education is currently developing testing instruments and protocols to carry out a standardized evaluation of learning outcomes in Portuguese and Mathematics for students enrolled in second grade (the program is called *Avalie Alfa* or Literacy Evaluation). The first standardized evaluation will be conducted in 2012 for an estimated 300,000 students in the 217 municipalities that have signed the *Pacto com Municípios* in 2011. The results of the evaluation will be distributed to all the students. The Secretary of Education will also compile and distribute the results by class, school and municipality in order to benchmark school performance. This evaluation will be repeated each year to monitor the progress made by municipalities to improve learning outcomes for second graders. The Secretary of Education will identify 25 percent of the participating municipalities, which have made little progress and/or municipalities who are consistently in the bottom 25 percent for learning outcomes. These municipalities will benefit from more intensive targeted support, such as: (i) additional teaching and learning materials; (ii) training for teachers; and, (iii) pedagogical support from State and municipal education advisors. The Secretary of State and these municipalities will agree to more evaluation on what works and does not and they will tailor interventions on the most successful activities supported by the program *Pacto com Municípios*. The standardized evaluation of students in second grade and the identification of lagging municipalities as well as the provision of additional support for this group of municipalities will constitute a disbursement condition for the second tranche of the operation.

Health

63. **In the health sector, the key interventions are in the area of primary health care.** The State Health Secretariat initiatives have focused on: (i) expanding the Family Health Program coverage; (ii) expanding access to the health services in all municipalities, based on the reorganization of primary health care system; (iii) organizing the state health care system in municipal, micro-regional, regional and state levels, (iv) fostering capacity building and training of health professionals to develop a new practice - Family Health Strategy - FHS; (v) providing technical, scientific and technological support to perform the activities carried out by the professionals of the FHS throughout the state; (vi) monitoring and evaluating the model implementation; and (vii) providing and improving health information related to primary health care, by means of systematic dissemination of data and information to the family health teams,

health sector managers and the civil society. These systematic interventions by the State Health Secretariat will result in the publication of the State Policy for Primary Health Care in early 2012. The policy aims to promote the reorganization of health care practice and new approaches, fostering public-health actions at all levels of the system. The project intends to improve the quality and expand the coverage of primary health care in priority areas, especially for maternal health care.

64. **Several actions have been taken to reduce maternal mortality in Bahia**, such as: (i) The State developed a State Policy for Maternal and Infant Health Care to be approved and implemented in 2012; (ii) The State restructured Maternal Health Care Guidelines including clinical pathways to target priority conditions; (iii) The State is promoting seminars on maternal and infant health care: "Weaving the *Rede Cegonha*"¹⁴, for launching the State *Rede Cegonha*; and (iv) The State established the *Rede Cegonha* Forum, which also includes Municipal Health Secretaries, health professionals, system users and providers to discuss, analyzes and proposes alternatives to address maternal and infant health care issues.

Social Inclusion

65. **Given the levels of poverty and extreme poverty, the Government of the State of Bahia has an ambitious poverty reduction program differentiated by income and economic activity.** The state's programs build upon the Federal Government's Brazil *Sem Miséria- Brazil without Extreme Poverty*, an initiative that aims at articulating and strengthening income transfer programs, access to public services, and productive inclusion. The implementation of the program hinges on the CadÚnico, which is the registry for social programs created in 2001. Over the last decade the CadÚnico had been used almost exclusively as the registry for *Bolsa Família*. However, it is now fulfilling its intended broader role as an instrument for all social programs to identify and characterize people and families in poverty in all Brazilian municipalities. Indeed, it is now seen as a means to promote convergence of Government initiatives aimed at low-income individuals. Given its central role as the sole registry for beneficiaries of targeted social programs, the quality and comprehensiveness of the CadÚnico are essential.

66. **The State of Bahia's Social Development Secretariat "Secretaria de Desenvolvimento Social e Combate à Pobreza" (SEDES) is working with municipalities to identify mechanisms to strengthen the network of Social Assistance Reference Centers (Centros Referencial de Assistência Social- CRAs) that will be the point of attention for all the programs under Brasil Sem Miséria.** These Centers, which are responsible for provision and coordination of the social assistance services, also deal with documentation issues and help the qualified population to access *Bolsa Família* and other social assistance programs. The State has 552 CRAs in 412 municipalities (out of a total of 417 municipalities in the State) and 184 CRAs located in 182 municipalities.

67. **Under the Cash transfer activities SEDES is responsible for managing and updating the Cadastro Único (CadÚnico) in cooperation with the municipalities and Caixa**

¹⁴ *Rede Cegonha* or "Stork Network" is a strategy of the Ministry of Health, which has as objectives: (i) a new model for mother and child assistance at birth; (ii) improved health care network; and (iii) reduction of maternal and neonatal mortality rates.

Econômica Federal. Through CadÚnico, SEDES can identify the poor and the extreme poor, and support other sectoral state agencies in targeting the most vulnerable groups. SEDES manages several programs aiming at increasing food supply to vulnerable groups. Also SEDES is responsible for managing productive inclusion programs including the “*Vida Melhor*” (Better Life) program that focuses on developing entrepreneurship for poor urban families; program for poor fishermen, and for small rural producers and other vulnerable groups. SEDES aims at universalizing the benefits for the poor and consolidating the *Sistema Único de Assistência Social* (Unique System of Social Assistance) and the Food Security System at the State level. To obtain these objectives SEDES is working very closely with the municipalities to improve their management capacity for carrying out an active search (*busca ativa*) of the poor and developing social programs accordingly.

68. **The State incentives to the municipalities are in line with the Federal Government’s initiative to reduce extreme poverty.** Recently, following the Federal Government strategy the State is signing co-financing plans with the municipalities to improve their capacity to implement the social assistance programs. The municipalities with the poorest IGD-M are the ones with less capability to improve the CadÚnico and register the poor population. The co-financing plans will provide funds and TA for the municipalities to improve their management capacity in the social assistance sector. The co-financing plans intend also to provide support for these municipalities to do the “*busca ativa*”, active search to identify the ones not registered in the CadÚnico and able to be included in the “*Brasil Sem Miséria*” Program.

Productive Inclusion

69. **The main objective of the State productive inclusion policy is to foster regional development and integration, in particular for lagging regions.** The State Secretariat for Development and Regional Integration (SEDIR), through its Company for Rural Action (CAR), has, since 2006, with Bank support, carried out well over 2,000 demand-driven community-level investments in rural water and sanitation, in addition to initiatives aimed at greater productivity and market participation for small-scale producers across rural Bahia. Ongoing partnerships with the Federal Government in support of these goals include the National Program to Strengthen Family Agriculture (known as PRONAF), the Federal Sanitation Program (FUNASA) and the National Program for Agrarian Reform (INCRA). The PPA-P proposes technical support to rural producers through seed capital, technical assistance and rural extension across selected producer chains to enable greater market participation, specifically for institutional niches, such as the National School Feeding Program (PNAE), as well as private markets.

Public Security

70. **Crime and Violence.** The State Government intends to strengthen its capacity to respond to violence by implementing a cross sectoral anti-crime policy (*Pacto pela vida- PPV*). The PPV recognizes that the problem is not simply one of policing but a comprehensive multisectoral one, and therefore created an inter-secretarial unit including representatives of health, education, and employment secretariats as well as public security. However, formulation of effective multisectoral prevention policies and programs requires close coordination among the different sectors and actors. The PPV recognizes several institutional weaknesses that need to be tackled

to address the problem of violence effectively: (i) overall weakness in the coordination, formulation, implementation, monitoring, and evaluation of public policies; (ii) the introduction of new policies in a non-structured fashion not supported by recent research or evidence; and (iii) the general disconnect between planning, budget, monitoring, and execution.

71. **An inter-secretarial committee will oversee the PPV, meeting weekly to analyze the most recent patterns of crime and propose policy measures and address the problem through multiple sectors in an effective and sustainable manner.** Under the committee, a number of boards or sub-committees will look at specific aspects of crime to identify patterns and possible solutions. To support the work of the committees, a number of forums are organized with the participation of civil society organizations and local businesses to identify problems and solutions. The PPV's management structure reports to the Governor and has the power to require secretariats to act where necessary. Overall, the PPV represents a model for cross-sectoral coordination, involving a focus on results and the use of monitoring and evaluation to feed directly into policy-making and implementation. The sub-committee for crime and violence prevention through social development is tasked to coordinate social programs and interventions—led by the Social Defense System-- that will complement other programs and interventions implemented through PPV to effectively achieve the overall objective of reducing and preventing lethal violent crime (CVLI).¹⁵

Gender, Race and Ethnicity

72. **Gender.** A core development objective of the Government of Bahia is to promote gender equality through the social and economic inclusion of women. To this end, the creation of the Secretariat for Women (*Secretaria das Politicas das Mulheres*) from a superintendent's office in the Secretariat for the Promotion of Equity is a concrete action aimed at increasing the capacity of the State to develop and implement more gender equality policies. As a result, the transformation into a permanent secretariat improved the organizational structure, human and financial resources, which resulted in direct budget allocations for specific projects on productive inclusion and violence prevention in the PPA equitable policies.

73. **The Women's Secretariat has two main overarching sectoral themes in their efforts to address gender inequalities in Bahia:** (i) reducing levels of all forms of violence against women and improve service delivery to victims; and (ii) promote women's economic autonomy across the State through employment programs.

74. **However, the Secretariat for Women recognizes institutional weaknesses that need to be addressed to promote gender equality more effectively:** (i) overall institutional and organizational weakness related to planning, budgeting, monitoring, and execution of programs and policies and (ii) it is imperative to effectively mainstream gender across other sectors. Therefore, the Secretariat of Women will elaborate a State Gender Equality Policy that will

¹⁵ This sub-committee will be composed of the following sectors: the Secretariat of Culture, the Secretariat of Social Development and Poverty Reduction, the Secretariat of Education, the Secretariat of Justice, Citizenship and Human Rights, the Secretariat for Women's Affairs, the Secretariat of Promotion Racial Equality, the Secretariat of Health, the Secretariat of Public Safety, the Secretariat of Labor, Employment Income generation, and Sports. Other sectors that currently are not members of the SDS-- Secretariat of Urban Development and the Secretariat of Infrastructure-- will be invited to participate in the sub-committee

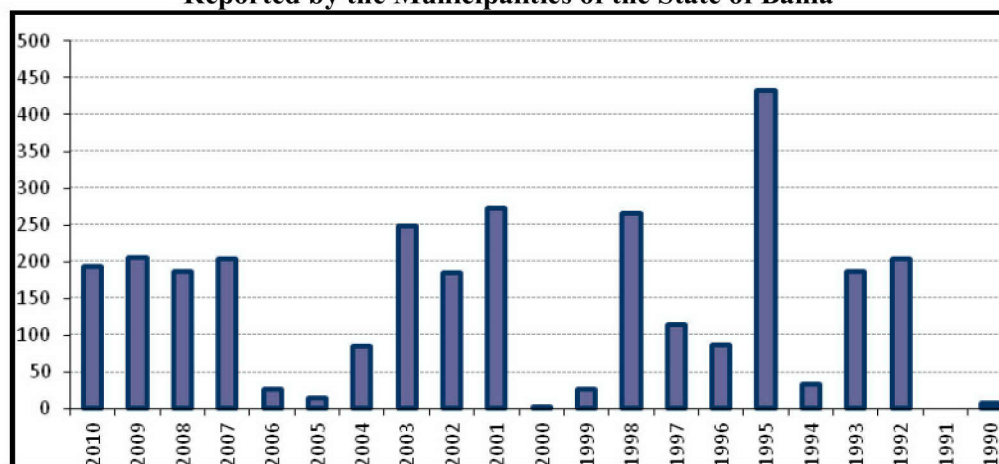
incorporate gender programming across key sectors. The State of Bahia is undertaking several initiatives to strengthen the institutional capacity of SecMulher and enable it to promote and implement gender equality policies. They include: (i) revamped institutional and organizational arrangement; (ii) increased coordination with line secretariats to mainstream gender in state programs; (iii) introduction of an overarching policy framework to promote sustainable gender equality policies; and (iv) a strategic management action plan to standardize the delivery and types of services offered to women victims of violence.

Sustainable Development and Infrastructure for Development

Environment

75. **Disaster and Risk Management.** Although the State of Bahia is not prone to overwhelming catastrophes such as earthquakes or hurricanes, it endures frequent small disasters mainly associated to extreme weather events. Rural areas are affected by droughts and forest fires while urban areas suffer from landslides and flooding. The cumulative effect of these events is slowing down development and the poor suffer the most, as they are the most vulnerable and the most exposed to these hazards. Disasters reported by the municipalities during the last 20 years, shows an average of over 140 disasters per year for the State of Bahia (Figure 4). There is no systematized information about the impact of disasters in the State, but only in the Municipality of Lauro do Freitas, a municipality with over 50,000 households, 3,500 houses are currently being built (equivalent to 7 percent of households) for poor families displaced by recent disasters or located in high risk areas. Recently, Bahia has been affected by a drought, reportedly the worst in 47 years, which led to designate state of emergency in 235 municipalities. In some municipalities, the drought was accompanied by floods, compounding response challenges.

Figure 4: Total Number of Disasters per Year Reported by the Municipalities of the State of Bahia



Source: Relatório das Ocorrências de Desastres por Municípios - Estado da Bahia. DMD/SEDEC/MI. Brasília, novembro de 2011.

76. **The Civil Defense, Bahia's main institution for dealing with natural disasters relies largely on the municipalities, many of which unfortunately have low capacity.** The Civil Defense State System was established in 1991 and is coordinated by the Civil Defense Coordination (CORDEC), which today is part of the State Secretariat for Social Development

and Poverty alleviation (SEDES). It has an Inter-institutional Commission as an advisory body and relies on the municipal civil defense structures for operation. The GOB recognizes the risks of disasters (landslides, droughts, forest fires, flooding) and is decided to work towards the reduction of their impact through the strengthening of the Civil Defense System (CDS) for increased efficiency and effectiveness. The CDS is being restructured under the ongoing Government program to promote mainstreaming of natural disasters management. A new inter-institutional coordinating body will be in charge of adopting a State Policy and an action plan on the subject. In addition, a new sub-regional structure will be established with 26 nodes (corresponding to “*Territórios de Identidade*”) grouping municipalities with similar risks. These nodes will be equipped and trained to provide support to local municipalities. This is a more feasible and cost effective alternative than providing support to more than 400 municipalities. At the same time, CORDEC is undertaking a capacity building program to help municipalities have functional Civil Defense Commissions and train municipal commission members in disaster prevention preparation and response. The program is intended to reach all municipalities of the State and will take all year 2012. Finally, a strategy is also being developed to support the capacity of volunteer brigades so that they can better support the CDS in fire prevention, public awareness and firefighting.

Logistics and Communication

77. Transport. Road transport dominates the sector with 95 percent of the freight moved on a road network of 143,000 km. Despite a significant rail network (1,500 km) and an extensive maritime coastline (1,200 km) including the three major ports of Salvador, Aratu and Ilhéus, railroad transport and short sea shipping still remain marginal. This situation may progressively change in the coming years, with major infrastructure being built as part of PAC2, such as the East – West railroad (Ferrovia Leste – Oeste) and the new *Porto Sul* port. In parallel, a network of logistics centers is being established. In 2010, the agriculture and industry sectors represented more than 35 percent of the Bahia GDP; these sectors are important consumers of transport services. With a view to greening the transport matrix and making the sector more sustainable in the long run, the Government of Bahia aims at putting in place the adequate transport and logistics framework in order to develop further the agriculture / livestock and industry sectors, fueling the State economic growth. *This strategy includes improving the road infrastructure, while seeking a better balanced transport modal matrix, making the most of rail and water-based transport opportunities. Such strategy will require as strong coordination between the many logistics stakeholders, private and public, federal/ State/ municipal levels. Furthermore, the GOB has demonstrated interest in improving logistics and the institutional framework for transport to support economic growth by integrating logistics, transport coordination, planning and networks connectivity. Addressing urban and metropolitan logistics issues, factoring in urban mobility and social demands, are a particular challenge in this respect.*

78. The IADB and the World Bank have been supporting the State of Bahia in rehabilitating a portion of those roads. Latest estimates indicate that, in 2011, approximately 70 percent of the State highway network, on which main transport flows are concentrated, are in good or regular condition, but leaving 30 percent still in poor condition, and thereby impacting the cost of road transport. Predictability and sustainability of road maintenance and rehabilitation

funding is a key issue to ensure an adequate level of service for road users. Addressing this funding issue should be an integral part of the transport and logistics strategy.

79. **The Government program also includes the adoption of a modernized organizational structure for DERBA, oriented towards management by results.** DERBA (*Departamento de Estradas e Rodagens do Estado da Bahia*) is the Government entity, reporting to SEINFRA, in charge of: (i) maintaining and developing the State road network, in a total area of approx. 20,000 km in an area of 560,000 km²; (ii) supporting municipalities to maintain their municipal road networks and (iii) promote the construction and maintenance of State road, air and waterways terminals. In 2011, DERBA's human resources amounted to about 1,200 staff, at headquarters in Salvador and in the 20 regional residencies, with a total budget of around R\$380 million (approx. 70 percent of SEINFRA's budget). This proposed action builds on the on-going Bank investment loan (Bahia Integrated State Highway Management Project – PREMAR). Such modernization would be a major step forward towards results orientation in public sector management of sectoral secretariats and could be used as a pilot for the whole Bahia administration.

Democratic Management of the State

Planning and strategic management

80. **Planning and budgeting** in the State of Bahia has been characterized by annual budgets that were both unrealistic, with overestimation of revenues, and did not reflect the priorities of the secretariats or those of the Government as a whole. There was also poor coordination between agencies. The result has been that not only were resources not allocated according to priorities, but that the resources available were spent inefficiently and ineffectively. To deal with these problems the Government initiated the program “*Compromisso Bahia*” in 2007. This program focused on improving the quality and the efficiency of expenditure. It is implemented through the establishment of an inter-secretarial group known as the “Office for the quality of Public Spending” attached to the Secretariat of Administration. While the measures taken under the “*Compromisso Bahia*” program were effective in improving management in limited areas and in reducing specific items of expenditure, they did not address the wider problem of coordination of policies within the Government and of linking expenditure to priorities.

81. **To address the inefficiencies and lack of strategic focus in the budget, the Government is carrying out a major review and restructuring of the business processes at the center of Government.** The objective of this restructuring is to develop modern institutions that allow an integrated management of its processes in a transparent and responsive way and strengthening the implementation capacity for service delivery. The current State planning system will be replaced by a new institutional system (*Sistema Estadual de Planejamento e Gestão Estratégico* – SEPEGE). The program will eventually result in a new model of business processes and institutional structures in order to align planning, management and budgetary processes. The reforms will also be closely linked to reforms to reporting and accounting and management of human resources. The reform program has already resulted in a detailed diagnostic of the existing planning system being prepared, and reform proposals are currently under discussion among the principal cabinet secretariats.

Modernization of Financial and Human Resource Management

82. **Public Financial Management and Costing.** In addition to the restructuring of planning and budgeting processes, the State is also modernizing budget execution and financial management processes. This is being carried out principally through the development of a new Government Financial Management Information System (FIPLAN) which integrates the existing accounting, planning and budget preparation systems. One of the principal benefits of the new system will be to enable the state to account and report on the basis of International Public Accounting Standards. The Government is currently preparing a detailed roadmap for new business processes, training and introduction of technological requirements (including new financial management system FIPLAN) for IPSAS. On costing, although Bahia is the only state with a state-wide costing system (ACP), it is currently not appropriate for budget preparation nor does it provide useful information for managerial and planning decisions within secretariats. As part of the modernization process, the Government is starting a process to upgrade the system so that it can provide useful information on the cost of public services and allow managers within the public sector to assess trade-offs between Government programs and to benchmark service delivery costs across secretariats.

83. **Human Resource (HR) Management.** The overall objective of the reforms in HR management is to develop a workforce with the skills, capacity and incentives to deliver results in the public sector, and to ensure that managers can have the flexibility to ensure that the appropriate staff is available. Since 2007, as part of the modernization of public administration the State has been introducing numerous reforms to its HR policy including the re-introduction of competition for public positions, the re-registration of public sector workers and the introduction of elements of performance management into most secretariats. The reforms were introduced into public sector job careers covering 60 percent of public sector workers (including education and health workers). The reforms introduce the principle and practice of meritocratic appointment and promotion of civil servants, and in the medium term will be combined with active workforce planning, management and capacity building. In addition, the Government plans to establish a network of public servants trained as consultants and advisers to spread good management practices throughout the state. Finally, these reforms are to be underpinned by a major reform of the HR system, whereby HR management will be focused on ensuring the principles of meritocratic appointment and promotion will be combined with active workforce planning, management and capacity building. The State articulated a human resource management policy¹⁶ in April 2010, which focused on a managerial approach to HR management, designed to professionalize the public service and orient it to results and service delivery. In addition, the idea is to provide both a managed wage bill and improve career management in order to encourage professionalism, development of talent, teamwork and sharing of experience and knowledge. The management of the public service is to be a transparent rules based system, which promotes meritocracy and the well-being of individual officials.

¹⁶ Minuta da Política de Gestão de Pessoas do Poder Executivo do Estado da Bahia, Secretaria de Administração, abril 2010.

84. **Tax Administration.** Tax collection is characterized in Bahia by a great degree of concentration. ICMS receipts account for 87 percent of tax revenues and the largest 50 ICMS taxpayers account for 50 percent of ICMS collection. Moreover, the largest ICMS taxpayer is responsible for 28 percent of all ICMS revenue. Another characteristic of Bahia's tax administration is the extensive use of tax expenditures, due to the pervasiveness of tax competition among Brazilian states. Bahia in particular is very affected due to the proximity to the states of Espírito Santo and Pernambuco, well known for their profligacy in tax expenditures.

85. **The Secretariat of Finance of the Government of the State of Bahia (SEFAZ) is strengthening the effectiveness of tax administration through measures to recover tax arrears, reduce gaps in legislation, expand crosschecks of information with the Federal Authorities and increasing audits and enforcement.** For example, it has signed agreements with the National Tax Department and the Public Prosecutor's office. Finally, SEFAZ is working to simplify legislation and taxpayer registration system and integrate it with the federal and municipal systems to improve enforcement and reduce the time the judicial process takes to resolve disputes. The Government of Bahia is pursuing a two-pronged strategy: first, to improve the effectiveness of tax administration by rationalizing and expediting procedures on the recovery of tax arrears. SEFAZ has already estimated the cost of recovering unpaid taxes and has adopted alternative methods to recover tax arrears with values below the cost threshold. The Government aims to increase enforcement of arrears payments, a function that clearly needs improvement. Enforcement takes a long time and it has not been able to bring down the excessively high stock of arrears. Currently, the amount of tax arrears is equivalent to one year's tax revenue. The complete revamping of the enforcement system will be based upon a comprehensive assessment of the system's weaknesses with a focus on: (i) legal framework; (ii) organization and management; (iii) work process; and (iv) IT systems. The second element of the strategy is to deepen integration with the national tax authority and other Government bodies involved in tax legislation enforcement. SEFAZ has been adhering to the Synchronized Taxpayer Register System, led by the National Tax Department and has partnered with the Public Prosecutor's office to extend punishment to delinquent taxpayers to the criminal sphere.

86. **Public Private Partnerships.** The State of Bahia is a pioneer in the area of PPPs in Brazil and is committed to actively attracting private partnerships for public investments. The state law on PPP was passed in 2004 and a follow-up law focused on the PPP payment system was passed in 2009. Bahia signed the first PPP contract in water and sewage in Brazil and the second in the country overall. The PPP program is very well structured and managed. They have a clear and established procedure to screen PPP proposals. Contracts have a risk matrix with a clear distribution/ sharing of the risks between the two sides. Guarantee mechanisms to the private partners are in place, diminishing the non-payment risk. All deliverables are audited by an external party prior to the payment by the Government. The Government is currently in the process of elaborating and adopting a manual on best practices on PPP contract monitoring. This manual will be enacted by a Government decree and thus will bind all Government officials. The bottleneck of contract monitoring is a general constraint faced by all Government bodies in Brazil not only in PPP contracts. This difficulty is aggravated on PPP contracts due to its complexity and structure that many times include performance linked payments. Some of the drawbacks are being addressed by including in contracts a requirement to hire independent auditors/ verifiers of the private partner's tasks.

87. **Bahia’s PPP program is very active and it currently has three effective PPP contracts in place.** The first one is a water and sewage contract. The second one is for a hospital with a very innovative output results-based framework. The last contract is for rebuilding, operating and maintaining the soccer stadium that will be used for the World Cup. Bahia has five additional projects under different stages of preparation in their pipeline. Projects under appraisal include subway and BRT lines for Salvador, prisons, health diagnostic centers and logistic platform for the São Francisco region.

IV. BANK SUPPORT TO THE GOVERNMENT’S PROGRAM

RATIONALE FOR BANK INVOLVEMENT AND LINK TO CPS

88. **Brazil and the World Bank Group have a long-standing partnership.** The Country Partnership Strategy (CPS) for Brazil¹⁷ recognizes significant achievements in tackling development challenges using innovative approaches, and contributing to shaping the global policy agenda. The CPS also responds to the demand for more flexible and efficient products that are better suited to the country’s evolving needs, while maintaining a focus on key long-range development issues.

89. **The Bank acknowledges the highly decentralized nature of the Brazilian Federation, and therefore the very important role Sub-national Governments play in addressing the country’s main development challenges.** Improving the capacity of Sub-national Governments to implement national development policies is key for maximizing their impact, “fine-tuning” their design and reducing regional inequalities.

90. **The objective of the proposed operation is to support the Government of the State of Bahia (GOB) program to reduce social inequality, develop more efficient institutional infrastructure and logistics, and strengthen public sector management.** The proposed operation is fully consistent with and closely linked to the objectives of the CPS 2012-2015 which emphasizes reducing extreme poverty, vulnerability and exclusion, promoting growth through sustainable resource use, and improving competitiveness as key pillars for achieving sustainable development and inclusive growth. The focus of the proposed DPL would be social and productive inclusion, more efficient social, physical and institutional infrastructure, and stronger planning and management of the public sector, all of which are key pillars of the CPS for achieving sustainable development and inclusive growth.

91. **Bank financing, as well as its technical capacity, can support Bahia in its efforts to make growth more inclusive and reduce poverty.** Indeed with the bank financing the Government intends to increase its capacity to invest in its strategic programs, thus leveraging the fiscal space created by the State’s growing gross operating balances. Bank technical capacity in the areas supported by the DPL through supervision as well as through complementary technical assistance activities will further strengthen the capacity of the Government to structure and implement its reform program, and to align policies across different levels of Government.

¹⁷ CPS 2012-2015 (Report No. 63731-BR), discussed by the Executive Directors on November 1, 2011.

COLLABORATION WITH THE IMF AND OTHER DONORS

Collaboration with the IMF

92. **Since the International Monetary Fund (IMF) does not work directly with State Governments there has been no direct collaboration with the IMF on this specific operation.** However, the Bank and Fund teams work very closely on the overall Brazil program. This is consistent with the Joint Management Action Plan (JMAP), which, in order to improve coordination at the country level, called for Bank and Fund staff to consult at least annually in the preparation of their work programs. Brazil country teams from the Bank and the Fund have also been meeting regularly.

Collaboration with Other National and International Partners

93. **The major external financing agencies operating in Brazil are the Inter-American Development Bank (IADB), the Andean Development Corporation (CAF) and the World Bank.** The IADB and CAF both work to contribute to the process of economic and social development in Latin America and actively carry out projects in Brazil. CAF has concentrated its efforts on: (i) supporting municipal Governments; (ii) regional integration; (iii) socio-economic development; (iv) infrastructure; and (v) the private sector. The IADB has been working with States and Municipalities through programs to support public sector management.

CHOICE OF INSTRUMENT AND RELATIONSHIP TO OTHER BANK OPERATIONS

94. **DPL vs. Investment Lending.** The operation supports a set of policy reforms embodied in the State of Bahia Strategic Vision Plan to which the State Government, an autonomous legal entity, is committed. A DPL is therefore the appropriate vehicle. The state's reform program is robust and embodies cross-cutting themes, such as strengthening social and productive inclusion, building up the social, physical and institutional infrastructure and improving governance and public sector management. The Government's program and priorities provide a solid ground for confidence that the operation will contribute to poverty reduction.

95. **In addition, IBRD support to the State of Bahia has been so far only in the form of investment loans mainly in infrastructure with some components of social inclusion and health.** In particular, the Bank has had a long partnership with the State Government in the areas of rural development, interurban transportation, water management, urban infrastructure and health. As such having a policy loan would be complementary to previous IBRD support by strengthening the State's policy and institutional framework, which could increase the effectiveness of the Bank's investment lending. See Box 2 on linkages with existing operations.

96. **One-tranche DPL vs. two-tranche DPL.** A two-tranche DPL was found to be more suitable for two reasons. First, it would allow the bank and the State Government to establish a longer term engagement on a broad set of policy issues and with a view to supporting key elements of the Government's program. Second, this consideration takes on added importance given the modest capacity of the Government which would require continued Bank support.

97. **Two-tranche DPL vs. programmatic DPLs.** Brazil's rigorous fiscal control regime, which has greatly contributed to enhancing fiscal discipline since the late 1990s, imposes relatively high transaction costs on processing subnational loans. Each loan would have to go through a rigorous process of reviews and approvals by federal agencies. This process could take months or longer and introduces a high degree of uncertainty regarding the timing of loan approval. The state Government would like to reduce the transaction cost of the loan so that they can focus on the implementation of the reform program, and as such would prefer a two tranche to a programmatic DPL as it would allow them to submit one process of approval rather than multiple ones. In addition, multiple processes require a longer time which might delay the processing of the loan and the implementation of the reform program.

98. **The two-tranche design has two main types of advantages:** (a) it provides adequate incentives for the implementation of the supported reform program (the first tranche supports the initial stage of the reform plan to be further implemented with Bank support under the second tranche), (b) it avoids the long process of Government approval of Bank operations that delays loan preparation considerably. However, the main risk is that the second tranche release could be delayed if the pace of reform is slow due to capacity constraints in the Government.

99. **The State operation is linked with four ongoing investment loans, in infrastructure, social inclusion and health.** Those projects are relevant to the design of the proposed DPL for many reasons. They are supporting the Government in the same areas; as such complementarities and continuity were key to inform the design of the new operation. This was achieved by ensuring that the same teams were involved in this operation and has allowed better information flow, coordination with the Government, and operation design. See Box 2 on linkages with existing operations.

100. **DPLs are most effective when accompanied with technical assistance activities as such the Bank is discussing with the Government complementary technical assistance under existing investment loans so as to further support the Government in the implementation of their reform program.** The Bank is currently discussing with the Government how to provide additional resources to the State Government of Bahia through additional financing and/or restructuring of existing Technical Assistance components in the ongoing investment operations. This would allow having a TA component effective during preparation and implementation which would mitigate the risk of delay in the second tranche due to capacity constraints. The Bank is also considering providing technical assistance through supervision and through partnerships with other Bank departments such as WBI on PPPs.

ANALYTICAL UNDERPINNINGS

101. **Results from sectoral studies informed the focus and design of the DPL (see Table 4 for a summary of analytical work underlying the operation).** For example, the poverty assessment identifies the underlying cause of Bahia's high rural poverty as low agricultural productivity, arising from a lack of modern production technology, basic infrastructure, technical assistance to improve productivity, and organized marketing facilities. In addition, the Health Sector Study of Bahia, in line with State Health Reports and data analysis of national information

systems, identifies maternal mortality as one of the most serious public health challenge in Bahia, and highlights the importance of continued support to expand primary health care coverage, since it is estimated that 90 percent of maternal deaths could be avoided through timely and quality health care. In the education sector, the World Bank report, *Achieving World Class Education in Brazil*, emphasizes the need to strengthen the performance of teachers, support children's early development, and reform secondary education, while the crime and violence country study for Brazil concludes that prevention activities are generally more cost-effective than control actions. This will be the key area of support under the DPL through strategic policy actions to expand social development interventions.

102. **The design of support to the Governments Gender Program is aligned with findings from the WDR on Gender, the Brazil Gender Review, and on state-level analysis by the World Bank.** (See Gender and Poverty in the State of Bahia, 2011 in the project files). The Brazil Gender Review, which documents findings of a review on gender issues in Brazil, acknowledges gender as an important issue in increasing socioeconomic well-being, and reducing poverty, while the latter report describes the gender challenges in Bahia and the poverty profile of the state. Furthermore, the DPL will reflect relevant findings from the on-going study on Gender and Agency in Brazil, and resulting implications for the sector.

Table 4: Analytical Underpinnings

Area	Related Study
Poverty Analysis	Attacking Brazil's Poverty, World Bank 2001 Making the poor count takes more than counting the poor: A quick poverty assessment of the State of Bahia, World Bank 2004
Productive Inclusion	Rural poverty alleviation in Brazil : toward an integrated strategy, World Bank 2003 Rural development and poverty alleviation in Northeast Brazil, World Bank 2002
Gender	Brazil Gender review: issues and recommendations, World Bank 2002 Gender and Agency in Brazil (ongoing)
Crime and Violence	Crime, violence and economic development in Brazil : elements for effective public policy, World Bank 2006 "Crime and Violence in Central America: A development Challenge" World Bank Study 2011
Public Private Partnerships	How Brazil's first public-private health partnership is transforming the country's health system, Andrea Azeredo in <i>Health San Francisco (2010)</i>
Urban	Brazil - Inputs for a strategy for cities: a contribution with a focus on cities and municipalities, World Bank 2006 Determinants of city growth in Brazil, World Bank 2005
Health	<i>Revista Saúde da Bahia, Diagnóstico da situação de saúde estado da Bahia-2008</i> (Document prepared for the State Health Plan, 2008-2011) Decentralization of health care in Brazil: A Case Study of Bahia, World Bank 2003
Education	Development Plan for Education: <i>Todos pela Educação</i> , Bahia State Secretariat of Education, 2011 Education in Numbers 2009: Educação em números Statistical Yearbook 2009: Anuário Estatístico Brazil: Secondary Education: Time to Move Forward. World Bank, 2000 Impact study: Consórcio Bahia Maior, <i>Avaliação de Impactos do Projeto de Educação da Bahia – Relatório Final</i> . 2006 Achieving World Class in Education: The Next Agenda. Brazil Country Study World Bank, 2011.
Public Sector Management	Redesenho do Sistema Estadual de Planejamento do Estado da Bahia, Terceiro Produto Diagnóstico, agosto de 2011, Secretaria de Planejamento do Estado da Bahia Minuta da Política de Gestão de Pessoas do Poder Executivo do Estado da Bahia, abril 2010, Secretaria da Administração, Superintendência de Recursos Humanos

Box 2: Linkages with existing operations

Transport: Bahia Integrated State Highway Management Project (P095460) – PREMAR

The Bank has been supporting the State of Bahia program in the transport sector since 2006, through a US\$186 million Sector Investment and Maintenance Loan project that focuses on State paved highway rehabilitation, with an aim to reducing logistics costs and to stimulate higher economic growth. The objective is being achieved through: (a) rehabilitation and maintenance of key sections of the state paved road network, and (b) support to a set of key institutional improvements in the road sector to ensure the sustainability of physical achievements. Policy actions under the proposed DPL are aligned to the strategic goal to improve logistics and the institutional framework for transport to address the key challenge of the transport sector, the poor condition of the road networks, and will focus on modernizing the regulatory framework for transport logistics. PREMAR includes in particular a series of institutional strengthening activities, such as the elaboration of the Bahia transport and logistics master plan and the diagnostic DERBA (Bahia road agency) strengths and weaknesses, that will complement the policy actions proposed in the proposed DPL.

Health: Bahia Integrated Health and Water Management Project (P095171)

The proposed DPL complements support provided under the Integrated Health and Water Management project with a continued focus on the expansion of primary health care, to address maternal mortality-widely recognized as one of the most serious public health challenges in Bahia. The Bahia Integrated Health and Water Management Project supports the State's higher objective of improving the Human Development Index (HDI) by reducing the Infant Mortality Rate through a strategy that combines water and health sector interventions. The project, at a cost of US\$60 million, has two Components: Component 1, aims to reduce *post-neonatal* mortality and morbidity by increasing access to clean water, sanitation and basic healthcare in municipalities most affected by infectious intestinal diseases; as well as interventions related to reduce *neonatal mortality*, while component 2 provides support for strengthening the institutional capacity of the State's management, monitoring and evaluation in the water, health, and planning sectors.

Social and Productive Inclusion: Bahia State Integrated Project- Rural Poverty (P093787)

The Bahia State Integrated Project: Rural Poverty, also known as *Projeto de Combate a Pobreza no Interior da Bahia "Produzir II"* aims to increase social and economic opportunities for the rural poor in Bahia by: (a) improving their access to basic social and economic infrastructure and services; (b) enhancing small-scale farmers' productive activities and their linkages with national and international markets, using community-driven development techniques; and (c) scaling up the impact of public investments on rural poverty by using the skills, social capital and experience of the project Municipal Councils, Community Associations and Producer Organizations to improve the relevance, efficiency, sustainability, targeting and outcomes of non-project State and Federal investments in rural Bahia. The DPL supports as a first tranche condition the adoption of the Governmental Decree formalizing the State's Productive Inclusion Program, which will finance socio-economic infrastructure and productive investments under viable business plans across prioritized value chains. Additionally, new Laws on Technical Assistance will complement institutional development activities, supported by *Produzir II*, specifically technical assistance and training activities aimed at strengthening Community Associations and Producer Organizations in their roles of identifying, preparing, operating and maintaining investments promoting productive inclusion and training the project Municipal Councils for their supervisory role in implementation.

Urban: Bahia Poor Urban Areas Integrated Development Project – Viver Melhor II (P081436)

The DPL program also complements investments to reduce urban poverty, supported under *Viver Melhor II*. The implementation of proposed DPL policy actions under the productive inclusion, transport and disaster risk management components is expected to enhance efforts undertaken under *Viver Melhor II*. It is envisaged, for example, that support under the DPL program to risk mapping efforts of the state will promote the inclusion of risk mapping in urban planning and is expected to lead to the design and implementation of sound infrastructure and housing programs. Activities financed under support for productive inclusion should provide for sustainable access to basic rural infrastructure to increase the productivity and market access of small-scale rural producers. – diminishing 'push factors' for rural-to-urban migration. *Viver Melhor II* aims to address the challenges of rapid urbanization and informal housing development that are in part caused by rapid rural-to-urban migration.

LESSONS LEARNED

103. **The Bank is well placed to support the State of Bahia in its efforts towards improved equity, efficiency and governance.** As a subnational, two-tranche DPL, the operation is similar in design and nature to other Bank operations with Brazilian State Governments. The relevant projects are Alagôas (*Fiscal and Public Sector Reform*, 2009), Rio Grande do Sul (*Fiscal Sustainability for Growth*, 2008), Minas Gerais (*Partnership for Development*, 2006), Rio Municipality (*Fiscal Consolidation for Efficiency and Growth*, 2010), Rio State (*Fiscal Efficiency, Competitiveness, and Human Development*, 2010), Rio de Janeiro (*Metropolitan Urban and Housing DPL*, 2011), and Pernambuco (*Expanding Opportunities and Enhancing Equity*, 2012). These experiences with Subnational Governments have provided strong foundations for this operation in many ways. The preparation and supervision of these operations gave the Bank substantial experience in the kind of subnational fiscal and public-sector management reforms supported under this proposed DPL. The *Fiscal Consolidation, Human Development and Competitiveness* DPL and the *Rio Municipality Fiscal Consolidation for Efficiency and Growth* DPL allowed the bank to support the alignment of health and education policies at different levels of Government, namely state and municipalities. As part of project preparation and supervision, the Bank has been fostering increased dialogue on technical issues among civil servants of these Subnational Governments on debt management, project monitoring, and public investment management. This initiative allows for sharing experiences and learning from peers that may be especially helpful to new reformers.

104. **A two-tranche rather than a programmatic approach was chosen to prompt the Bank and the State Government to agree on conditions for both tranche disbursements at the outset, rather than leaving longer-term reforms for a subsequent operation.** The current administration has made progress in important policy areas, including provision of health and education services and improvements in fiscal discipline that create the conditions for a stable macroeconomic environment. The Project's time frame and disbursement mechanisms have been designed to reduce the risk of wavering political commitment in the future. The Project would disburse entirely within the term of the current administration. It focuses on procedural and administrative reforms that will be self-sustaining.

105. **A third lesson from recent experience is the need for in-depth communication with the State during the proposed operation's preparation and implementation.** The Bank has worked closely with Bahia's administration to define the reform measures to be supported by the DPL and to put in place arrangements to assist their implementation over the medium term. Furthermore, the State has strongly supported the two-tranche design because of the stronger commitment that the conditions for release of the second tranche would generate.

106. **Finally, the Bank's experience with state DPLs has demonstrated the importance of coordination with the Federal Government.** The operation was initiated with the concurrence of the National Treasury and was prepared as a DPL in full coordination between the State Government and the National Treasury. See Box 3 for a discussion of good practice principles.

Box 3. Application of the Good Practice Principles on Conditionality to the Proposed Bahia DPL

Principle 1 – Reinforce Ownership: The operation has strong ownership at the highest levels of state and Federal Governments. All secretariats involved in the DPL have shown commitment to the Government’s medium-term reform program and the policies supported by the DPL.

Principle 2 – Agree up-front with the Government and other partners on a coordinated accountability framework: The Bank’s support is summarized in a brief and focused policy matrix with observed and expected results.

Principle 3 – Customize the accountability framework and modalities of Bank support to address country circumstances: Brazil’s rigorous fiscal control regime has contributed much to enforce fiscal responsibility since the late 1990s and has provided a powerful framework to ensure all borrowing, including from IBRD, is consistent with a sustainable fiscal environment.

Principle 4 – Choose only actions critical for achieving results as conditions for disbursement: The Bank’s policy matrix uses a limited number of prior actions. They are part of a comprehensive policy reform plan with a solid track record.

Principle 5 – Conduct transparent progress reviews conducive to predictable and performance-based financial support.

V. THE PROPOSED DEVELOPMENT POLICY LOAN

OPERATION DESCRIPTION

107. **The objective of the proposed operation is to support the State of Bahia’s program to reduce social inequality, develop more efficient institutional infrastructure and logistics, and strengthen public sector management with a two-tranche Development Policy Loan (DPL).** The first tranche of US\$350 million will be disbursed once the loan goes into effect. It is contingent upon the Government completing policy actions set forth in the loan agreement. The second tranche of US\$350 million is contingent upon the Government taking additional policy actions, which will also be set forth in the loan agreement. The three policy areas supported by this DPL are: (i) improving social and productive inclusion; (ii) developing social, physical, and institutional infrastructure for sustainable development; and (iii) strengthening public sector management. These policy areas are described in the next section and in more detail in Tables 5 and 6. The World Bank and GOB have tentatively agreed upon the prior actions listed as conditions for presenting the DPL to the Bank’s board for approval and first tranche disbursement and on the policy actions listed as conditions for the second tranche disbursement (Annex 1).

108. **Through its policy dialogue the Bank will support a broad set of policy actions that goes beyond the prior actions and second- tranche conditions of this DPL and covers the operation’s three targeted areas.** Following good practice principles on conditionality, the operation’s policy matrix will use a limited number of prior actions that have been chosen according to their importance in achieving results (see Box 3). These actions are part of a comprehensive reform plan with a solid track record of implementation. The broader Government program supported in the DPL is included in Annex 2: Bahia DPL Government’s Policy Matrix. The Policy matrix supported in the DPL as condition for disbursement is presented in Tables 5 and 6.

**Table 5. Summary of Proposed Operation’s Objectives, Policy Areas and Prior Actions
First Tranche Disbursement**

The table includes only disbursement conditions which are also in bold font in Annex 2: Bahia DPL Government Policy Matrix- Results Indicators.

Objectives	Prior Actions for Loan Disbursement
Policy Area 1. Improving Social and Productive Inclusion (Equity)	
Education Improve accountability for results between the State and the Municipalities	Prior Action 1. The State Secretariat of Education has implemented the <i>Pacto Pela Educação</i> (Official Decree No 12.792) by signing partnership arrangements with municipalities to improve the quality of education and internal efficiency of schools for students in second grade in the first cycle of fundamental education.
Health Improve the quality and expand the coverage of primary health care in priority areas focused on maternal mortality reduction	Prior Action 2. The State Secretariat of Health has published the State-and-Municipal Health Committee Resolution defining strategies, guidelines and standards on primary health care activities in the State of Bahia (<i>Resolução da Comissão Intergestores Bipartite – CIB</i>)
Social and Productive Inclusion Foster economic development in the lagging regions and improve the access to and the quality of social services to the extreme poor	Prior Action 3. The State of Bahia has issued a decree formalizing the State’s Productive Inclusion Program and the State of Bahia’s Legislative Assembly has enacted two laws in support of productive inclusion which provide: (i) Technical Assistance and (ii) Debt Restructuring for Family Farms
	Prior Action 4. The State of Bahia Secretariat of Social Development (SEDES) has issued a Resolution of the Social Assistance Council that approves the criteria for co-financing of social assistance activities with municipalities. SEDES has implemented social assistance co-financing plans with the 50 municipalities with lowest IGD-M* (Municipal management development index) <i>*IGD-M is an index of decentralized management efficiency that measures the institutional and program management of the Bolsa Família and CadÚnico program</i>
Gender Promote gender equality as means of increased social inclusion and equitable growth in the State of Bahia	Prior Action 5. The State of Bahia has established the Secretariat for Women Policies (<i>Secretaria das Políticas para as Mulheres</i>) --Lei 12.212 (May 4, 2011) and included in the PPA law programs under said Secretariat with a total value of R\$13 million
Policy Area 2. Developing Social, Physical, and Institutional Infrastructure for Sustainable Development (Efficiency)	
Disaster Risk Management Reduce the impact of disasters (landslides, droughts, forest fires, flooding).	Prior Action 6. The State of Bahia has established a coordinating committee consisting of representatives from the its office of Chief of Staff (Casa Civil) and selected secretariats to manage emergency response actions to drought occurring within its territory, as evidenced by Decree No. 13.796, dated March 21, 2012, published in the Official Gazette on March 22, 2012.
Policy Area 3. Strengthening Planning and Management of the Public Sector (Governance)	
PPPs Improve the institutional framework for Private Sector participation through Public Private Partnerships (PPPs)	Prior Action 7. The State of Bahia has issued a decree to regulate the request for private sector participation in early project stages

**Table 6: Summary of Proposed Operation’s Objectives, Policy Areas and Conditions
Second Tranche Disbursement**

The table includes only disbursement conditions which are also in bold font in Annex 2: Bahia DPL Government Operation Policy Matrix.

Objectives	Second Tranche Conditions for Loan Disbursement
Policy Area 1. Improving Social and Productive Inclusion (Equity)	
Education Improve accountability for results between the State and the Municipalities	Condition 1. The State Secretariat of Education has (i) monitored the implementation of the impact of the <i>Pacto pela Educação</i> in participating municipalities by evaluating test results of standardized evaluation provided to second grade students in the subject matter of Portuguese language, and by recording the passing rate of students in second grade (ii) disseminated the results per school from monitoring the implementation of the impact of the <i>Pacto pela Educação</i> to the respective schools; (iii) identified the 25% least performing participating municipalities based on such results; and provided learning materials and additional pedagogical support to the schools located in those municipalities.
Health Improve the quality and expand the coverage of primary health care in priority areas focused on maternal mortality reduction	Condition 2. The State of Bahia has issued and published a decree approving the State Policy on Primary Health Care.
Crime and Violence Prevention Improving State Government capacity to respond to violence.	Condition 3. The State of Bahia has adopted and implemented: (i) a strategic action plan aimed at improving its institutional capacity to target and implement social crime and violence prevention programs in Municipalities prioritized by <i>Pacto pela Vida</i> ; and (ii) a strategic plan to strengthen its crime and violence data collection, management, and analysis system
Policy Area 2. Developing Social, Physical, and Institutional Infrastructure for Sustainable Development (Efficiency)	
Disaster Risk Management Reduction of the impact of disasters (landslides, droughts, forest fires, flooding).	Condition 4. The State of Bahia has: (i) (A) submitted to its Legislative Assembly, for approval thereby, a draft law, to adopt, or (B) adopted, through the Borrower’s executive branch, as the case may be, a regulatory framework, for re-structuring its coordinating body for disaster risk management, including the establishment of regional units with trained staff and equipment, as evidenced by a letter from the State duly received by the Legislative Assembly or a copy of said regulatory framework established through the State’s executive branch, as the case may be; and (ii) (A) completed pilot risk-mappings of two (2) sites located in the metropolitan area of the State of Bahia’s capital, as evidenced by a report issued by the State’s coordinating body referred to in (i) (A) above, which shall include the maps produced as part of such pilot risk-mapping; and (B) Created and implemented a program to support the capacity of self-established volunteer brigades, as evidenced by the necessary measures adopted by the State of Bahia.
Transport Improve logistics and the institutional framework for transport to support economic growth	Condition 5. The State of Bahia has issued a decree creating the Bahia Logistics Advisory Committee and the committee is operational
Policy Area 3. Strengthening Planning and Management of the Public Sector (Governance)	
Planning and Budgeting Strengthening of Management for results Strengthening of the Multi-annual and cross sectoral approaches to public policy	Condition 6. The State of Bahia has adopted institutional arrangements or proposed for adoption to the legislative assembly legal arrangements for the development of the annual State Budget to ensure the alignment of the annual budget with the strategic priorities of the State Government and reduce ad hoc modifications to the annual budget during execution

Objectives	Second Tranche Conditions for Loan Disbursement
Financial and Human Resource Management Coherent, efficient and transparent management of financial and human resources	Condition 7. The State of Bahia’s Finance Secretariat has proposed amendments to State legislation and adopted regulations for the introduction of accrual based International Public Sector Accounting Standards Condition 8. The State of Bahia has submitted to its Legislative Assembly a draft law or amendment, or has adopted the adequate regulatory framework, for implementing management processes for human resources aimed at allowing workforce planning, career management and extension of merit based promotion performance management systems
Tax Administration Increase State revenue performance	Condition 9. The State of Bahia has cross-checked data based on the access to taxpayer information on donations, inheritances, and assets, and assessed taxpayers with incongruent tax fillings and as a result of assessment has taken action to collect overdue tax.

POLICY AREAS

Policy Area 1: Improving Social and Productive Inclusion (Equity)

A. Education

109. **Government policy objectives.** The main objectives of the State of Bahia are to address the dual problem of low internal efficiency in the education sector and poor learning outcomes. It also acknowledges the need to improve education quality and efficiency as part of the State Government strategy and Brazil’s overall strategy of reaching OECD PISA level learning outcomes in all states by 2021. In addition, it has shorter term targets of: (i) increasing the pass rate to 90 percent for students enrolled in the first cycle of fundamental education, 85 percent in the second cycle, and 80 percent in secondary education by 2014; and (ii) achieving the Basic Education Development Index (IDEB) targets set by the Ministry of Education in 2011 and 2013, through the implementation of the *Todos pela Educação* program.

Challenges

110. **Enrollment across all levels of basic education increased steadily in recent years, but it remains slightly below the averages for the nation and the North-East region.** Approximately 90 percent of all children between 6 and 14 years of age had completed an eight-year basic education cycle in 2008. At the bottom end of the spectrum, 58 percent of the children between 4 and 5 years of age were enrolled on a two-year preschool cycle—still far from the universal enrollment mandated by the 1998 Constitution. At the top end of the spectrum, net enrollment rates show that Bahia trails the national and regional averages for access to secondary and tertiary education. Only 35.3 percent of youths between 15 and 17 years of age are enrolled in secondary education, well below the nation’s 50.4 percent. In addition, up to 35 percent of the youths between 15 and 17 years of age are not enrolled in any type of schools. A mere 7.2 percent of those between 18 and 24 years of age are enrolled in higher education, compared to 13.7 percent at the national level. The State and the municipalities share education responsibility in Bahia, with the municipalities having jurisdiction over 83 percent of all schools. In terms of students, 61 percent are enrolled in municipal schools, but this share rises to 87 percent in the first cycle of basic education and 74 percent in the complete cycle of basic education.

111. **An age/grade distortion affects all levels of basic education because many children repeat grades or even drop out of schools before completing fundamental education.** The average passing rate in the first cycle of fundamental education is 66.8 percent in state schools and 75.3 percent in municipal schools. Passing rates in the upper cycle of fundamental education and in secondary education are all in the low and mid-70 percent. Average dropout rates exceed 12 percent for fundamental education; in secondary education, they are above 21 percent in state schools and 14 percent in municipal schools. As a consequence, 20 percent of the children enrolled in secondary education are over-aged by two years or more.

112. **Learning outcomes in Bahia are poor across all levels of education, albeit slowly improving. Bahia is one of the worst performers among Brazil's 27 states on the IDEB tests.**¹⁸ Bahia came last in the last three editions of IDEB for 4th graders—2005, 2007 and 2009. Nonetheless, IDEB scores improved between 2005 and 2009. The largest improvement was in the first cycle of fundamental education, with IDEB scores increasing from 2.7 in 2005 to 3.8 in 2009. Education quality suffers from various constraints on the environment for effective learning. These include substandard educational infrastructure, a large number of untrained teachers, insufficient instructional time, inadequate teaching methods, a lack of instructional and teaching materials in local languages, and a lack of policy coordination between federal, state, and municipal Government to improve performance.

113. **Specific measures supported by the DPL:** The DPL will support as a prior action the implementation of the *Pacto Pela Educação* by signing partnership arrangements with municipalities to improve the quality of education and internal efficiency of students in second grade in the first cycle of fundamental education. The partnership agreements between the state and municipalities are aimed to expand coverage and provide a schooling environment conducive to effective learning in the earlier grades. As a second tranche condition, the DPL will support the implementation of the Pacto; in particular, (i) the monitoring of the impact of the Pacto in participating municipalities by evaluating test results of standardized evaluation provided to second grade students in the subject matter of Portuguese language, and by recording the passing rate of students in second grade; (ii) the dissemination of the results per school from monitoring the implementation impact of the *Pacto pela Educação* to the respective schools; (iii) and the identification of the 25 percent least performing participating municipalities based on such results; and the distribution of learning materials and additional pedagogical support to the schools located in those municipalities.

114. **The expected result indicators is an increase in the number of partnership agreements signed by the State with the municipalities increases from 217 in 2011 to 329 by 2013.** The expected outcome indicator is that the percentage of correct responses in the standardized test in language instruction (Portuguese) for students in second grade in the 329 municipalities enrolled in the Pact with Municipalities (*Pacto com Municípios*) and in the State schools offering second grade, increases to 64 percent in 2013 compared with 59 percent in 2011 baseline. A second outcome indicator is that the percentage of students who complete the second grade in the 329 municipalities enrolled in the Pact with Municipalities (*Pacto com Municípios*) increases to 85 percent in 2013 compared with 79.5 percent in 2010 baseline.

¹⁸ National standardized test of students in 4th, 8th and 11th grades combined with a measure of student flow.

115. **The policy will support improved coordination of education policies across the three levels of Government: federal, state and municipalities.** The State must work with municipalities through partnership agreements because 85 percent of the first-cycle students are enrolled in municipal schools. Under the *Pacto com Municípios* partnership, the State will mobilize additional resources for the municipalities. The State will distribute teaching materials, give municipalities access to a new digital e-learning platform, provide professional development opportunities for teachers in municipal schools, and test learning outcomes of students in the second grade. Ensuring that all students 8 years of age and enrolled in second grade of municipal schools master basic skills in mathematics and Portuguese. The policy will support improved coordination of education policies across the three levels of Government: federal, state and municipalities. The municipalities will set up a team to oversee the agreement, deploy teachers with adequate profiles in the first two grades, assess the performance of the students to identify those at risk of falling behind, provide extra teaching support after school hours (extending the school day) for students with learning difficulties, create dedicated reading spaces and classroom reading corners, and support teacher participation in-service training provided by the State.

B. Health

116. **Government policy objectives.** The performance of the State of Bahia in the health sector has recently improved with the implementation of focused Government actions, such as the Family Health Program (FHP). As a result, the coverage of primary health care delivery has markedly increased, especially for rural and poor populations. The State Health Secretariat has consistently increased resources allocated to primary health care service deliveries, which in absolute terms and proportionally reached 14 percent of the total budget in 2010, which means 2-percent points over the Constitutional requirements.

117. **Challenges.** The expansion of the Family Health Program (FHP) has occurred so far in places where the supply of health services is inadequate in relation to the health needs of the population. In the largest cities, with a great offer of health care services and a large concentration of people, the introduction of Family Health Program did not generate any impact on the reorganization of the State Health Care System. Most of the specialized health facilities still function without any coordination with primary care units.

118. **In this context, the current challenge for the State Health System is to expand primary health care coverage within the municipalities while reorganizing the system.** This reorganization would occur through the reallocation of physical, financial and human resources activities to attend the prerogatives of the new model. This challenge requires overcoming political and financial obstacles involving changes in current practices related to management, medical assistance, human resources allocation, health facilities renewal conditions, as well as the introduction of managerial procedures to increase efficiency and effectiveness.

119. **In the State of Bahia, about 99 percent of the municipalities have insufficient access to Family Health Teams (2,690 teams). Currently 90 percent of the population in the State of Bahia use the Federal Unified Health Public System.** The Family Health Program coverage was 60.35 percent of the population in 2010 (with approximately 8.5 million beneficiaries). Coverage increased 16.7 percent from 2006 to 2010 and is expected to reach 64 percent by 2014, growing 2.4 percent annually.

120. **Many obstacles remain for the primary health care improvement to translate into a reduction of maternal and infant mortality rates.** In 2009, 31 percent of the women deaths were associated to pregnancy, delivery and postpartum assistance. The Maternal Mortality Ratio (MMR) indicates a serious gap and despite all the investments made it remained stubbornly steady from 2003 to 2008. In 2008, the MMR in Bahia was 77.9/100,000 live births, a ratio considered too high according to well-performing states in Brazil, like São Paulo, Santa Catarina and Distrito Federal, which show MMR around 41.0/100,000 live births.

121. **In Bahia, 54 percent of maternal deaths are due to direct obstetric causes, mostly gestational hypertension-related deaths pointing to the importance of maternal and prenatal care.** Analyzing indirect obstetric deaths, it appears that the leading causes are circulatory-related diseases, respiratory-related diseases and AIDS. Furthermore, unsafe abortion is a serious public health issue in Bahia with negative consequences on the maternal deaths rate. The highest curettage rates are in the North and Northeast regions in Brazil (4.5 and 5.5/1,000 women respectively). During 2009, 23,867 women were admitted to hospitals as a result of mishandled abortions.

122. **Specific measures supported by the DPL:** The DPL will support as a prior action the publication of State-and-Municipal Health Committee Resolution defining strategies, guidelines and standards on primary health care activities, which are fundamental for the expected State Policy on Primary Health Care. It means, among other institutional initiatives, the organization of the system establishing official rules/protocols on the medical care provided during pregnancy and delivery which has an enormous potential to reduce infant and maternal mortality. At least half of all infant deaths and most maternal deaths are due to events related to pregnancy and delivery, according to data from the Information System on Live Births (SINASC; <http://www.datasus.gov.br>).

123. **The operation will also support as a second tranche condition the approval of the State Policy on Primary Health Care decree, prioritizing systemic mechanisms to provide quality health care access.** The expected results for the actions supported are to expand the coverage of primary health care and increase the proportion of pregnant woman enrolled by primary health teams. In particular, expected results include improved early catchment and risk classification of pregnant woman, quality supply of antenatal and delivery care, and increased provision of basic routine tests during gestational period. As an expected outcome, a 2 percent reduction of the maternal mortality ratio annually is expected by 2014.

C. Social and Productive Inclusion

Productive Inclusion

124. **Government policy objectives:** The Government of Bahia's objectives in productive inclusion are to foster regional integration and the economic development of lagging regions of Bahia. This would be achieved through increasing the productivity and market participation of small-scale producers, as well as increasing their access to basic infrastructure, including water and sanitation. The Government has been particularly active in responding to the demand of community-driven initiatives through technical assistance and financing support.

125. **Challenges:** The State of Bahia accounts for up to 20 percent of Brazil’s rural poverty. More specifically, families operate 87 percent of Bahia’s farms, with mean holdings of less than five hectares. These family farms, principally in the semi-arid region of Bahia, engage in low-productivity agriculture with minimal value-added processing. Chronic water scarcities, along with inadequate sanitation, perpetuate this low productivity and inhibit deeper market participation for these family farmers. While productivity-enhancing technologies are available, both scarce rural extension services and rural financial bottlenecks limit their effective uptake. Finally, family agriculture’s participation in markets, both institutional (e.g., PNAE¹⁹) and private, have been hindered by poor rural logistics, weak market intelligence, low innovation uptake, and an inability to reach sufficient scale to respond to market demands.

126. **Specific measures supported by the DPL:** The proposed DPL would support as a prior action the formalization of the State’s Productive Inclusion Program and the enactment of two laws in support of the Productive Inclusion Program which provide for technical assistance to and debt restructuring for family farms. The expected result is an increase in the targeted number of rural producers benefiting from technical assistance under the State Program for Productive Inclusion from zero to 150,000 producers by 2015. An expected outcome of the action is an increase in small rural producers’ participation in institutional markets, namely the National School Feeding Program PNAE across the seven productive chains prioritized under the State Program for Productive Inclusion. Another expected outcome is an increase of the weighted average across municipalities of PNAE sales of rural producers (as percentage of total PNAE sales) from a baseline of 5 percent in 2011 to a target of 20 percent by December 2014.

Social inclusion

127. **Government policy objectives:** A core objective of state social policy is the eradication of extreme poverty, defined as per capita income of R\$70 a month in line with the Federal’s Government’s initiative *Brazil Sem Miséria*- Brazil without Extreme Poverty. The Government of the state of Bahia recognizes the importance of strengthening its management of the “*Centros Referencial de Asistencia Social*” CRAS and the CadÚnico in achieving this objective.

128. **Challenges.** The large number of the extreme poor and a history of poor management in social assistance are big issues facing the state of Bahia. With more than 59 percent of the 16.2 million extreme poor in Brazil living in the North-East, Bahia is the state with the largest number of extreme poor. More than 50 percent of its population is registered in the CadÚnico and 14 percent if the population is classified as extremely poor (about 1.4 million). Bahia has roughly the same number of extreme poor as the whole South-East region and twice the number in the South and Centre-West regions together. Obviously, to be successful any strategy to reduce extreme poverty in Brazil needs to work effectively in Bahia and the other states of the North-East. One of the challenges to achieving this in a state like Bahia is poor management capacity. The decentralized form of management existing in Brazil implies federal, state, and municipalities share responsibility in the decision-making processes and implementation of programs, like *Bolsa Familia*. The 1988 Constitution established the shared responsibility and the division of labor with respect to social policies between federal entities. For many years

¹⁹ The National School Feeding Program (PNAE), which allows for 30 percent of school meal purchases to be sourced from family agriculture.

though the role of the states was marginal. Over the last year there has been a move towards what has been called “*federalismo social*”²⁰ (social federalism), with *Brasil sem Miséria* and the law establishing the Unique System of Social Assistance (SUAS) strengthening the role of the states in complementing the actions of federal and municipal Governments.

129. **Specific measures to be supported by the DPL.** The proposed DPL will support as a prior action that the State of Bahia Secretariat of Social Development (SEDES) has issued a resolution of the Social Assistance Council that approves the criteria for co-financing of social assistance activities with municipalities. The co-financing plans will provide funds and TA for the municipalities to improve their management capacity in the social assistance sector and also to provide support for these municipalities to active search for not registered yet eligible poor households in the CadÚnico. The expected result is an increase in the household registrations to the CRAS and in the *Cadastro Único* in the 50 most vulnerable municipalities (with the lowest IGD-M) of 20 percent from 2011 to 2014. Another result of the program supported is a five percent increase in the information available on school attendance in the 50 municipalities with the lowest IGD-M.²¹ An expected outcome is an increase in the coverage rate of the CadÚnico in the 50 municipalities with the lowest IGD-M.

D. Crime and Violence Prevention

130. **Government policy objectives:** The Government’s objective is to improve its capacity to respond to violence and crime, especially lethal violence. To achieve this objective the Government has launched a flagship cross-cutting program, “the pact for life” *Pacto pela Vida* (PPV) with a strong emphasis on the prevention of crime and violence through social development interventions.

131. **Challenges:** Lethal violence has increased threefold over the past decade, making Bahia the state in the Northeast Brazil where levels of violence and homicides have increased the most in the past decade about 400 percent since 2000. Bahia currently ranks as the third worst state in the Northeast and the 5th in Brazil in terms of homicides with 70.1 homicides per 100,000. This compares to a national homicide rate of around 26.4 per 100,000 in 2008. Youths 15 to 24 years old are the cohort most affected by the spike in violence. Other forms of violent crime have recently escalated in Bahia. For example, and rapes increased by around 30 percent from 2009 to 2010. The causes of high levels of violent crime in Bahia are strongly associated with socio-economic issues; high levels of unemployment, especially youth unemployment, poverty and inequality are among the most salient ones.

132. **The current epidemic of lethal violence can be blamed on the rapid increase in crack-cocaine consumption and trafficking in Bahia in the past three years.** The drug is associated with 80 percent of the total number of homicides.²² Violence associated to crack cocaine is a highly concentrated phenomenon both demographically and geographically. Eighty

²⁰ Marcelo Neri in Valor Economico, December 27th, 2011.

²¹ IGD-M is an index of decentralized management efficiency that measures the institutional and program management of the *Bolsa Família* and *CadÚnico* program

²² http://www.istoe.com.br/reportagens/74678_CIDADE+AMEDRONTADA ;
<http://www.crimecongresso2010.com.br/portal/site/80-dos-homicidios-na-bahia-estao-ligados-ao-trafico-de-crack/>

percent of all homicides are concentrated in 20 municipalities in Bahia. It affects youths disproportionately, especially those with poorer backgrounds but is rapidly expanding to the middle classes because of its addictiveness and affordable price.²³

133. **The State Government has responded to the problem by recognizing that reduction of crime and violence is as much an issue of public sector management and social policy rather than just of law enforcement.** As such, the implementation of a cross sectoral anti-crime policy with a balanced approach of prevention and enforcement interventions (*Pacto pela vida-PPV*) is expected to be more effective than enforcement alone. The emphasis on prevention of violent crime through targeted social policy is geared to address the root causes of the problem. More importantly, prevention interventions will ensure the long term reduction and prevention of violent crime. To this end, the Government is establishing task forces and setting up a system of monitoring indicators and internal coordination of all the sub-committees that form the PPV structure. The planning of programs and interventions to prevent crime and violence through social development will be based on: (i) the systematic collection and analysis of data on crime and violence and (ii) participatory meetings with communities in those areas prioritized by the Government to reduce and prevent lethal violent crime (CVLI). To date, the PPV has held meetings with communities in the following locations: *Calabar, Nordeste de Amaralina and Fazenda Coutos*.²⁴

134. **Specific measures supported under the DPL:** The DPL will support the adoption and implementation of strategic action plans in specific areas of the PPV directly related to prevention with a second tranche condition on the adoption and implementation of strategic action plans for: (i) improving its institutional capacity to target and implementing social crime and violence prevention programs in Municipalities prioritized by Pacto pela Vida; and (ii) strengthening its crime and violence data collection, management, and analysis system. A result indicator is an increased number of priority municipalities that receive prevention programs/interventions through initiatives of the Sub-committee of crime and violence prevention through Social Development CSPA from a baseline of 4 municipalities in 2011 to a target of 20 municipalities by 2014. In terms of expected outcome, the DPL will monitor improved capacity and coordination within PPV for the implementation of crime prevention interventions through social development and improved targeting of prevention interventions in all 20 municipalities prioritized by PPV.

E. Gender

135. **Government's policy objectives.** A core development objective of the Government of Bahia is to promote gender equality through the social and economic inclusion of women. To this end, the creation of the Secretariat for Policies for Women (*Secretaria das Políticas das Mulheres*) -Lei 12.212 (4th May 2011) from a superintendent's office in the Secretariat for the Promotion of Equity is a concrete action aimed at increasing the capacity of the State to develop and implement gender equality policies. The transformation into a permanent secretariat also significantly improved in terms of organizational structure, human and financial resources,

²³ <http://www.tribunadabahia.com.br/news.php?idAtual=88424>

²⁴ Meeting with communities in Fazenda Coutos was held in December, 2011.

which resulted in direct budget allocations for specific projects on productive inclusion and violence prevention in the PPA (*Plano Plurianual 2012-2015*).

136. **Challenges:** Gender outcomes can be grouped in three interlinked dimensions: endowments, economic opportunities and agency. While poverty levels have declined in Bahia during the past decade, poverty among female headed households has been stubbornly higher compared to those households headed by males. In 2009, the poverty rate among female heads of household was 13 percent compared to 11 percent for their male counterparts. These numbers are higher in rural areas. Yet, women in Bahia have slightly better education outcomes than their male counterparts. In 2009, the average number of years of education for females in Bahia was 5.9 compared to 5.1 years for males. This is better than the averages for the Northeast Brazil—5.7 and 5.1, respectively- but significantly worse than the averages for Brazil as a whole—6.4 and 5.9, respectively. The contrast is stark between females living in rural areas and those living in urban areas. The percentage of female heads of household living in poverty in the rural areas is almost double their counterparts in urban areas. Females in rural areas only have half the average number of years of education than their peers living in urban areas, 3.5 and 6.5, respectively. Among the most salient constraints to women’s agency in Bahia are: (i) high levels teenage pregnancy²⁵ -- 23.2 percent of live births are births from mothers that are 15 to 19 years old in 2006; (ii) very high levels of violence against women.

137. **The fact that women have, on average, more years of education than their male counterparts is not reflected in comparable outcomes in economic opportunities.** Women’s labor force participation is significantly below that of males: 41.7 percent versus 58.3 percent, respectively;²⁶ and women suffer from higher levels of unemployment. In 2009, the percentage of women unemployed was double that of males—12.8 percent compared to 6.6 percent of males.²⁷ In the metropolitan area of Salvador the total unemployment rate for women in November of 2011 was 19 percent which was by far the highest of all the metropolitan regions in Brazil.²⁸ Women also earn substantially less than men do—their income is, on average, 80 percent of that of males for 2009. This income gap increases with higher levels of education: Women with 12 or more years of education earn 61 percent of men with the same level of education.²⁹

138. **Homicide of women in Bahia has more than doubled in the past decade making Bahia the third worst performer in the Northeast and among the worst in Brazil.** Moreover, Women in Bahia are at far greater risk of other forms of physical and psychological violence by an intimate partner or someone they know. Over 800 women have been raped in the past two years – from January 2009 to December 2010, about 65,000 were threatened and more than 38,000 suffered from bodily injuries³⁰. Violence has serious impacts on women’s well-being and

²⁵ Becoming pregnant before the age of 20 has implications for a woman’s and her child’s opportunities in a society as Teenage pregnancy is often correlated with higher poverty rates and lower economic opportunities of the mother, as well as lower educational outcomes of the child. However there is little empirical evidence on whether these correlations represent causal links and what is the direction of causality.

²⁶ PNAD, 2009

²⁷ PNAD, 2009

²⁸ <http://www.dieese.org.br/pedbd/DadosPed?acao=CONSULTA&tabela=5>

²⁹ IBGE, Pesquisa de Orçamentos Familiares 2008-2009 and PNAD 2009

³⁰ Data from Secretaria da Segurança Pública and Disque 180.

on women's social and economic development. The prevention and protection of the various forms of violence against women need timely and effective assistance ranging from the police and judiciary to health and social services.

139. **The new institutional arrangements will allow the provision of comprehensive services to prevent gender based violence and assist victims.** Under the previous *Superintendencia para a Mulher*, several services had been developed for women victims of violence-- CREAs (*Centro de Referencia Especializado de Assistencia Social*) and the CRAs (*Centro de Referencia da Assistencia Social*). However, only psychological services are offered in these centers to women victims of physical violence. This means that victims of other forms of violence against women would not be able to get assistance. Furthermore, the State currently has 18 centers which are locally restricted to 13 districts out of the existing 27 districts in Bahia. Therefore, victims would have to travel to other counties to get assistance. To address this problem the State wants to expand the number of Centers to all the 27 counties in Bahia and expand and improve the types and the quality of services offered in these centers by implementing a strategic management action plan following the directives of the National Law against Gender Based Violence (*Lei Maria da Penha*).

140. **Specific measures supported by the DPL.** The DPL will support as a prior action, the establishment of the *Secretaria das Politicas para as Mulheres* (SecMulher), the Secretariat of Women into a permanent secretariat with an improved organizational structure and expanded human and financial resources. The expected outcomes of the DPL are improved mainstreaming of gender issues and execution of a State Policy on Gender Equality across sectors and increased coverage and quality of services offered by the reference centers to women victims of violence in the State of Bahia.

Policy Area 2: Developing Social, Physical, and Institutional Infrastructure for Sustainable Development (Efficiency)

A. Disaster Risk Management

141. **Government policy objectives:** The main objective of the Government of Bahia is to improve the institutional coordination for prevention, mitigation and response to natural disasters. The State's strategy is to modernize, strengthen, and restructure the Civil Defense System (CDS), to use available resources effectively and efficiently, and to involve other public institutions and the private sector in disaster risk management.

142. **Challenges.** There is a need to improve institutional coordination and mainstream disaster risk management to reduce the vulnerability and impact of disasters. This was particularly evident during the current drought, reportedly, the worst drought in 47 years, leading to the declaration of a state of emergency in 235 municipalities of the State of Bahia and the loss of 25 percent of the planted crops. Responses to all types of disasters are most likely to improve if addressed by the Government as a whole and in a coordinated fashion. However, this coordination has been a challenge for many years affecting the State capacity to respond, manage and prevent natural disasters. In particular, the water and the agricultural sectors are in charge of preventing droughts; the agricultural and environmental sectors are in charge of preventing and combating forest fires; the infrastructure, planning, and housing sectors are responsible for the

mitigation of landslides and urban flooding. In addition, to this segmentation, limited information collection on past disasters inhibits responses. Historical data about the impact of past events has been collected by the affected municipalities but it is not in digital form. Only the city of Salvador has a landslide hazard map and the Secretariat of Urban Development (SEDUR) has some information about main towns' flooding susceptibility. The seriousness of the issue is not quantified and there is no risk mapping to guide safe urban development or cost-effective mitigation investments.

143. **Specific measures supported by the DPL.** The DPL will support in the first tranche the establishment of a coordinating body consisting of representatives from its office of Chief of Staff (Casa Civil) and selected secretariats to manage emergency response actions to drought occurring within the State's territory. The creation of this coordinating body will strengthen the communication and coordination between the Office of the Chief of Staff and member secretariats, namely, the secretariat of social development and fight against poverty, the secretariat of agriculture, irrigation and agrarian reform, the secretariat of urban development, the secretariat of environment, the secretariat of regional development and integration, as well as the secretariat of institutional relations. The objective of this new committee is first to identify works and services needed to reduce the negative impact of the drought on populations; second, to accompany, control, and evaluate the quality of the State response and assistance to the populations affected by the drought; finally, to coordinate the state response to the drought with municipal and federal entities. Stronger coordination will accelerate mainstreaming of disaster prevention and reduction, avoid duplicity of actions and promote economies of scale, as well as coordinated response at different levels of Government (state, federal and municipal). As a second tranche condition, the DPL will support the restructuring of the State's coordinating body for disaster risk management which will include the establishment of regional units with trained staff and equipment. The second tranche will also support the completion of pilot risk-mappings for two (2) sites located in the metropolitan area of Salvador as well as the provision of training and capacity building to support the self-established volunteer-brigades.

144. **This would be evidenced by pilot risk-mapping implemented in select locations of the metropolitan area; initial Regional Nodes implemented, trained and equipped; and supporting the training and capacity building of self established Regional Voluntary Brigades.** Results indicators are linked to having an operational Disaster Risk Management Policy as evidenced by five regional nodes established and trained by December 2014, a risk-mapping for 2 pilot areas, and ten voluntary brigades trained by December 2014. Expected outcome indicators are reduction of the impact of disasters (landslides, droughts, forest fires, flooding) as well as improved capacity and coordination for prevention, mitigation, preparedness and response to natural disasters. The State would also benefit during preparation of the DPL and/or through complementary TA activities of access to international experiences to prepare its risk mapping methodology and pilot examples to accelerate and increase the quality of its risk mapping. Standardizing and increasing the quality of municipal risk mapping will be key for the adoption of appropriate municipal disaster policies and action plans, but also at State level to design and implement sound infrastructure, housing and disaster reduction programs. Finally, public effort will be complemented with the establishment of active and capable self-established volunteer brigades to assist in disaster prevention and response.

D. Transport

145. **Government's policy objectives.** Government's policy objectives aim at putting in place the conditions for cost-effective and efficient transport and logistics services, so as to support and develop State competitiveness and regional development. In this respect, the State's strategy focuses on modernizing the regulatory framework for transport and logistics, as well as providing a transport infrastructure with a good quality of service. Strengthening network connections and the logistics framework is key to increasing competitiveness and regional development and addressing the challenges facing the state. The transport sector's priorities are therefore: (i) developing infrastructure to support the logistics industry needed for the economic growth of the state; (ii) providing the "Bahianos"- people of Bahia- access to services and quality transportation infrastructure; and (iii) stimulating sustainable urban mobility.

146. **Challenges.** Transport is a particularly important area for metropolitan-wide coordination and integration because responsibilities for this service are shared by the State and the municipalities, and a smooth linkage across jurisdictions in the areas of infrastructure and services is paramount to service quality. Moreover, the State transport network is crossed both vertically and horizontally - industrial production and goods move north and south through the State, while the dynamic agribusiness moves from the agricultural-rich region in the West to the ports and Metro region in the East. The main transport and logistics challenge facing the State is overdependence on road transport. The majority of movement is concentrated in the road sector (92 percent of cargo movement in the State is by road, while the national average is about 60 percent) resulting in a strong dependence on the road for transport (almost 50 times more than the other modalities). Promoting alternative modes of transport would contribute to a greener and more sustainable transport matrix, as it is at the federal level with the *Plano Nacional de Logística e Transportes* (PNLT). Nevertheless, the road network is improving despite shortcomings. Despite having one of the largest road networks in the country, with about 124,000km, 15 percent of which are paved, the network is still considered sparse and poorly connected from an intramodal perspective (road connection between two locations). Currently, there is no policy platform to allow the different actors involved in Transport Logistics to provide advice on policy making related to logistics. The purpose of the Committee will be to define logistics vision and agenda for the Bahia State, propose actions to implement this agenda and monitor progress. The Committee will also propose and advocate for physical, institutional, and regulatory logistics measures to help integrate logistics across neighboring states; assist in generating financing for such projects; and monitor execution by the Government (and private sector) of proposed measures. The Committee will address in particular cross-cutting issues that hamper the development and effectiveness of logistics in Bahia.

147. **Specific measures supported under the DPL.** The DPL supports, as a second tranche condition, the creation and implementation of the Bahia Logistics Advisory Committee. This high level Committee will aim at coordinating between the various stakeholders involved in transport and logistics in Bahia, which currently do not have a platform to contribute to policy making on logistics. The result indicator for the action is that the Bahia Advisory Committee issues 3 resolutions. An expected outcome indicator is a strengthened institutional capacity in logistics for State transport infrastructure management as well as more cost effective logistic supply chains.

148. **The Committee will include various State Government agencies, in particular from the transport demand side (agriculture, industry) and federal instances as well as representatives from the waterborne, rail and air transport sector will be associated.** The Committee would include infrastructure managers, operators and clients from the transport and logistics services. The Committee would be structured as two units – the executive unit responsible for decision making, planning, etc., and a technical unit, responsible for preparing information required for the Committee’s agenda. This technical unit would carry out, or contract out, the analytical activities (surveys, studies, draft proposals, etc.), in order to: (i) help inform the executive unit resolutions and (ii) increase and disseminate transport and logistics knowledge. The technical unit would consist of various transport & logistics specialists from the Secretariat of Infrastructure (SEINFRA), supplemented by other experts as needed. It is envisaged that the SEINFRA’s Transport Superintendancy (*Superintendencia de Transporte – SUPET*) will act as the Committee’s technical unit.

Policy Area 3: Strengthening Planning and Management of the Public Sector (Governance)

A. Planning and Budgeting

149. **Government policy objectives.** The principal objective of Government policy in this area is to redesign the planning, policy and budget process to deal with the fact that annual budgets have tended to be unrealistic (overestimating resources available) and have not reflected the priorities of secretariats, the Government or the citizens of the State of Bahia as described in the PPA. In addition, the Government’s objective is to increase coordination across agencies to foster effectiveness and efficiency of public spending.

150. **Challenges.** While the measures taken under the *Compromisso Bahia* to improve the quality of spending were effective in improving management in limited areas and in reducing specific items of expenditure, they did not address the wider problems of policy coordination within the Government and linking expenditures to priorities. The main challenges recognized now are to: (i) align budget processes at the center of Government with planning and priority-setting; (ii) ensure policy coordination across Government entities; and (iii) ensure an internal focus on results in each secretariat.

151. **Formally, the budget is guided by the multi-annual plan (PPA).** However, the PPA is developed independently of and prior to the discussion of resource availability. The PPA also has a different structure from the budget. This reduces the effectiveness of the planning function and makes it harder to introduce effective monitoring and evaluation mechanisms across sectors. The diagnosis of the problems of planning and budgeting carried out as part of the review of business processes³¹ notes that the annual budget, and the large number of modifications to deal with urgent items in practice overrides the intentions of the PPA.

152. **The process for allocating the annual budget is thus one in which the resource envelope is identified, expenditures are earmarked along with existing personnel**

³¹ Redesenho do Sistema Estadual de Planejamento do Estado da Bahia, Terceiro Produto Diagnóstico, agosto de 2011.

commitments, and other expenditures, particularly investments, are financed as a residual. This process takes place during both budget preparation and budget execution, and numerous in-year adjustments are made to the budget (the Governor has the authority to make changes to any budget line by up to 30 percent without approval from the state Assembly). The organizations depending on the budget can never be sure about the timing and amount of resources available, leading to inefficiency and waste. The reaction to this is the general practice of over-budgeting projects so as to minimize the effects of general cuts in resources during the budget year. In practice, budget execution is driven by a combination of historical inertia and ad-hoc short-term decisions, and has little credibility.

153. **The diagnosis of the problems of the budgeting and planning systems recognizes a number of interrelated factors which have led to the separation of budgeting, planning and policy making.** An important factor has been the compartmentalization of the administration between SEPLAN and the other agents in the system, as well as overlapping and incompletely defined responsibilities. For example, some of the planning and policy functions of SEPLAN have been taken on by the Casa Civil, while the actual allocation of resources is determined by SEFAZ. The result is that the overall function of planning has become discredited – agents within the system can see no relation between plans and reality, and thus the information provided for planning exercises becomes weaker over time and policy making functions have tended to atrophy. At the same time the diagnosis notes that human resources dedicated to coordination have been weakened and reduced thus contributing further to the deterioration of the system. The diagnosis also recognizes that in addition to restructuring the budget and planning institutions, specific actions are required in the area of integrating the work of the budget and planning systems in a new system (see below for a detailed discussion), and also active management of human resources is also required.

154. **The restructuring of the policy planning and budgetary processes is recognized to be a medium term process.** Currently, the consultancy supporting the Government, has produced a diagnosis, and there is now an active discussion within the administration on the required institutional changes to begin to address the problems identified. While these will undoubtedly involve reorganization of both process and institutions, the precise nature of these have not yet been identified and will necessarily emerge from the process of consultation and discussions being carried out currently.

155. **Specific measures supported under the DPL.** The DPL will support as a second tranche condition submission to the Legislative Assembly of a draft law or amendment, and/or adoption of the adequate regulatory framework, for developing the Borrower's annual budget proposals in accordance with procedures aimed at ensuring alignment of the Borrower's annual budget with its strategic priorities in the medium term and reducing ad hoc modifications to the Borrower's annual budget during execution. The process is being overseen by an executive committee including the Secretaries of Administration, Planning and Finance. On the basis of the diagnostic the Government will develop a new model of business processes and institutional structures, in order to align planning, management and budgetary processes. One result of the process of reorganization is expected to be that strategic policy-making and planning capacity will be developed within each secretariat as the credibility of the budget planning process is restored and the compartmentalization of secretariats is broken down. It is also expected that the

budget process itself will be reviewed so as to provide more flexibility (with appropriate accountability) to each secretariat. The implementation of this program is planned to be completed by the end of 2013, and will constitute a disbursement condition for the second tranche of the operation. The expected outcome of the reform supported is alignment of the Budget Policy with Strategic Plan and the PPA and reduced variability of budget outcomes compared to original budget.

B. Financial and Human Resource Management

156. **Government policy objectives:** The State of Bahia seeks to develop and put in place the structural and institutional organization and the financial management systems and procedures needed for fiscal discipline, strategic allocation of resources, and efficient service delivery. One of the main objectives in this area is to establish the institutional and technical basis for the implementation of accrual based International Public Sector Accounting Standards (IPSAS). This reform will allow transparent budget reporting and improved internal control and transparency in respect of expenditure, assets and liabilities and the alignment with best accounting practices through the application of credible, independent accounting standards. In addition more comprehensive information about costs will better support results-based management. To achieve these objectives, the Secretariat of Finance (SEFAZ) has designed a new system (FIPLAN) that integrates the budget planning and execution systems (currently two separate systems) with the accounting system.

157. **Challenges.** The implementation of IPSAS and the development of an integrated financial reporting and management system is part of the wider reorganization of budget planning and execution processes described previously. It involves major institutional and technological challenges as currently planning and budget preparation is managed by the Secretariat of Planning (SEPLAN) in one system (*Sistema Informatizado de Planejamento* or SIPLAN), while budget execution is handled by SEFAZ, using the *Sistema de Informações Contábeis e Financeiras* (SICOF) Integration between the two systems has been superficial and not all information contained in both systems is exchanged. The Government opted to establish the FIPLAN because SICOF has been in place for 15 years and is unable to provide sufficiently detailed reporting, and critically is not integrated with other systems (particularly the accounting systems). The challenge will therefore be as much institutional as technological, in that once the new systems are developed budget management will require close integration between the management of the secretariats of planning and finance, and can help to redress the problem that the priorities of the PPA tend to be overridden during budget execution due to short term needs and emergencies.

158. **The introduction of the new accounting and reporting standards will also entail amendments to the current legal framework** (including particularly the basic law on financial administration for the State -*Lei 2322/66 Disciplina a Administração Financeira, Patrimonial e de Material do Estado*), as well as the accounting and reporting manuals, and extensive training of accounting and financial management staff in the new standards. Success in the implementation of the new institutional arrangements will depend on a cultural change on budget and financial management execution. The system is scheduled for implementation on budget preparation side for June 2012, to allow execution of the 2013 budget under the new system and reporting arrangements. However it is recognized that there is always the risk that unforeseen

problems during the pilot phase in 2012 could lead to the postponement of implementation by up to one year (since the new arrangements can only be fully introduced at the beginning of the fiscal year).

159. **Specific measures supported under the DPL.** The DPL will support as a second tranche condition the proposition of amendments to State legislation and the adoption regulations for the introduction of the new legal, institutional and technical arrangements needed for the implementation of International Public Sector Accounting Standards. These will include the introduction of revisions to law 2322/66 and the necessary regulations and reporting and accounting manuals, as well as the training required. In addition, the operation will support the introduction of the FIPLAN system, which will provide the technological basis for the new arrangements. The new integrated system will also facilitate the bottom-up costing approach to budget programs and actions described in the next section. Finally, the second tranche will require official confirmation that all the necessary amendments to State legislation and regulations for the introduction of accrual based International Public Sector Accounting Standards, have been adopted. As a result indicator, it is expected that Budget preparation and reporting takes place consistent with IPSASs. An expected outcome is increased efficiency in planning and financial management.

Human Resources

160. **Government objectives.** The Government recognizes that effective administration and service delivery will depend upon ensuring the availability of qualified and motivated personnel. The Government's objective is to strengthen human resource (HR) management to increase the quality of public services, maintain a focus on results, and align service delivery with public-policy goals. The Government has begun a series of reforms in HR management, including the introduction of public competitions for public sector positions (which had not taken place for twenty years prior to 2007), the re-registration of existing public servants, and the gradual introduction of performance management in a number of Secretariats. The objective of these reforms is to strengthen meritocratic appointment and promotion of public servants. The new HR system will ensure that there is full information on the qualifications, achievements and progress of all public sector workers. The objective is to provide tools for workforce planning and capacity building as well as better control of the payroll.

161. **Challenges.** Currently, HR practices are overburdened with bureaucratic and administrative processes. There is no centrally available information on the qualifications, experience, and record of public servants, which would allow the selection and appropriate training of personnel within the public service. As a result, much of the training that does take place is often inappropriate or wasted on the wrong people. The state's analysis of its HR policy concluded that the organizational structure of the workforce is poorly distributed, time consuming, and not aligned with the results of Government. In addition it noted that the Personnel Management System is inflexible, with little horizontal coordination, impeding the movement of officials across entities to fulfill needs and that selection and promotion of personnel is not yet fully based on merit and management skills, despite laws and regulations recently established for this purpose.

162. **Specific measures supported under the DPL.** As a second tranche condition, the DPL will support the submission to the Legislative Assembly of a draft law or amendment, and/or adoption of the adequate regulatory framework, for implementing management processes for human resources aimed at allowing workforce planning, career management and extension of merit based promotion performance management systems. To achieve this, the HR system would include full information on the qualifications, achievements, and progress of most public-sector workers, and mechanisms to ensure recruitment reflects likely future demands of the public service, while providing flexibility to managers to reassign workers according to needs within the administration. The new system will also allow better control of payroll by permitting cross-checks with other databases, including those of retired public-sector workers. The new HR system would be based upon new institutional arrangements, and provide the information base for merit based promotions, work-force planning and performance management. While full introduction of the system will take a number of years, by December 2014, it is expected that at least all personnel in the areas of health and public security will be included in and managed by the new system. Expected outcomes of the reforms supported are that personnel receive appropriate training and incentives and managers can identify appropriate personnel for tasks, through active use of a workforce planning system.

D. Tax Administration

163. **Government policy objectives:** Bahia Secretariat of Finance is responsible for tax administration and financial management functions. Its mission is to provide and manage the financial resources needed to make public policies viable and raise citizens' awareness regarding the importance of paying taxes and controlling the use of public resources. The two main objectives in the strategic planning process of SEFAZ are to increase revenues in real terms and achieve fiscal equilibrium. In particular, the Superintendence for Tax Administration's (SAT) objective is to increase revenues by improving its effectiveness, since space for raising tax rates is limited.

164. **Challenges.** Tax administration is characterized by: (i) highly volatile revenues; (ii) limited tax-administration capacity; (iii) accumulated tax arrears from different kinds of taxpayers; (iv) limited capacity for collecting overdue taxes; (v) a weak internal control system; (vi) low levels of tax compliance; and (vii) an obsolete information system made of disconnected pieces. Currently, the tax administration authority is undergoing a major process redesign. Authorities are implementing several actions geared to reduce tax evasion and to facilitate tax compliance, and they are devising new procedures for collecting overdue taxes. The overall challenge is to put in place an institutional framework conducive to reducing tax evasion, increasing collection of overdue taxes and encouraging tax compliance—all of which will help generate the fiscal space necessary to invest in key sectors. Furthermore, the collection of overdue tax involves an additional challenge of coordinating actions between SAT and the State Attorney's Office.

165. **Specific measures supported by the DPL.** The State of Bahia has just implemented a data sharing agreement with the National Tax Department (Receita Federal) to enhance efficiency in tax revenue collection in the State by gaining access to information on taxpayer's donations, inheritances and assets to facilitate identification of fiscal evasion related to taxes on

said donations, inheritances and assets. The DPL will support as a second tranche condition that the State of Bahia has cross-checked data based on the access to taxpayer information on donations, inheritances, and assets, and assessed taxpayers with incongruent tax fillings, and as a result of assessment has taken action to collect overdue tax. As a result of the reform, an increase in tax arrears collection as a percentage of tax revenue is expected from a baseline in 2010 of 1.02 percent to a target of 1.8 percent by December 2014.

E. Public Private Partnerships (PPPs)

166. **Government objectives.** The Government of Bahia has made recent progress in structuring complex infrastructure projects. Bahia has enjoyed good experiences with PPP contracts and is thus aiming to scale up its PPP program. The Government objective is to resort more to PPP to address the state infra-structure and public service gap to unleash the state growth potential. Another Government objective is to create a culture of monitoring contracts, in particular PPP contracts. Currently, state officials give much more emphasis on all stages leading up to the public work, relegating contract monitoring and enforcement as lower priority activities.

167. **Challenges.** Although the program is well managed, it faces two major challenges. One is the difficulty to scale-up the number of projects appraised and taken into the bidding stage and the second challenge is related to contract monitoring.

168. **Specific measures supported under the DPL.** The DPL will support as a prior action, the issuance of a decree establishing a mechanism (*Process of Manifestation of Interest- Procedimento de Manifestação de Interesse-PMI*) to invite private participation in early stages of the process. A result indicator is that at least two PPP PMI processes are undertaken and all new contracts signed include a clause requesting that an independent auditor will be contracted to review the contract. An expected outcome of the reform is increased number of projects structured through public private partnership and better contract monitoring.

169. **The Process of Manifestation of Interest mechanism takes advantage of the expertise, agility and funds from the private sector, while at the same time curbing the problems inherited in unsolicited bids.** Those problems are avoided by requiring the Government agency interested in developing a PPP project to first submit its pledge to a committee made of the Secretaries of Finance, Planning, General Attorney and the Chief of Staff. The pledge must contain a proof of its public interest, preliminary studies carried out by the Secretariat and budget impact estimates. Only after going through this internal screening, the proposing governing agency may be allowed to publish its request for proposals. The Government agency may conduct public hearings of the project in addition to the ones mandated by legislation in latter stages. Once the proposals are received, the Government would not accept them, nor is it bound to carry out the project or reimburse the private sector. On the other hand, private partners are required to renounce any copyright in the material handed in to the Government. The Government has also to publicly disclose the objective criteria by which all proposals will be judged as well as it can resort to support from academia to assess and judge the proposals. Lastly, it is worth stressing that opposed to regular unsolicited bids, the Government

of Bahia will only accept suggested structured operations for projects of its interest, ensuring that projects taken to the bidding stage correspond to Government, not private sector priorities.

VI. OPERATION IMPLEMENTATION

POVERTY AND SOCIAL IMPACT

170. **The World Bank team carried out a poverty and social impact analysis (PSIA) to assess the expected impacts of the policies supported by this DPL operation.** *The PSIA* focused on a desk review of secondary data and primary research that was based on interviews and focus groups consultations with stakeholders and experts.³² It assessed the potential distributive effects of the policies supported by this operation on different socioeconomic groups, focusing on the more vulnerable social groups. The overall conclusion of the PSIA is that the policies supported by this operation address some of the underlying causes and effects of the socioeconomic inequalities that have historically hampered the sustainable development of the state of Bahia.

171. **Poverty and extreme poverty have been sharply reduced in Bahia, but remain high and present significant interregional, gender and race differences.** The state's extreme poverty ratio is double the national average. Poor and extremely poor households are larger and have, on average, more children. By age, extreme poverty affects children and young people more than the elderly. The income sources of extremely poor people are heavily dependent upon Governmental cash transfers. Inequality in household *per capita* income has not changed in the last years and remains high. Poor and extremely poor people are overrepresented in the municipalities in the largely rural semi-arid zone, which lag behind in terms of economic activity and development, job creation, and contribution to growth. The extreme poverty ratio is 17.1 percent in rural areas and 6.4 percent in urban areas. It reaches 13.0 percent in small municipalities compared with 4.4 percent in large ones. Family farmers, Indigenous peoples, and quilombola communities are among the most vulnerable social groups. Traditional gender rules that ascribe the household workload to women contribute to reduce female opportunities to access the labor market as well as to rendering their workload more intensive than that of men. Consequently, labor earnings for men are 58 percent higher than for women, revealing the persistence of sharp gender inequalities and severe challenges faced by the 32 percent of households headed by women in Bahia. Finally, poverty and extreme poverty hit the non-white population much harder and are closely and significantly correlated with educational attainment.

172. **The specific policy reforms supported by this loan address the socioeconomic inequalities previously analyzed.** They are expected to have significant and positive poverty alleviation and social inclusion impacts in Bahia. The poor, extremely poor and most vulnerable social groups may have the most positive gains from reforms in the delivery of public services

³² Secondary data included census data, studies, research reports, and reports on previous consultations with different social groups (women organizations, poor family farmers, *quilombola* communities and Indigenous Peoples) recently carried on by the State Government. The later include recent state plans and policies for indigenous peoples, quilombola communities, women and youth, which have been discussed and defined in participatory ways. Consultations with stakeholders included state and municipal authorities, scholars and experts. The full PSIA document is presented at Annex 5.

and infrastructure. The potential pro-poor effects of DPL supported policy reforms will be firstly felt as a result of improvements in the access and quality of education and health services, the policies designed to promote social and productive inclusion, to control crime and violence, and to mainstream gender and to fight gender based violence.

173. **Pro-poor effects of changes in education are expected from the fact that the “*Todos pela Educação*” Program is designed to improve the level of literacy among first and second grade students enrolled in municipal public schools.** The program addresses the issue of low literacy skills, which is the main cause of poor learning outcomes and performance across all levels of education in public schools. Almost all children from the first and second quintiles of the *per capita* income rankings and most vulnerable social groups attend public schools; they will be the prime beneficiaries of the program as it also targets the poorest of the state’s municipalities. These children will directly benefit from improvements in literacy skills among students of public schools because they will increase their probability of advancing to higher educational levels. Schooling is strongly correlated with better job opportunities and income levels; hence it is expected that poor students from public schools will indirectly gain from improved access to better labor opportunities and will have more chances to earn better incomes. In the long run, the “*Todos pela Educação*” should improve the chances of poor children to escape poverty.

174. **Policy reforms promoted in the health sector also have most positive impacts for the most deprived social groups.** The PSIA demonstrated the potential pro-poor effects of improvements in the access and quality of public health services, which found that infant mortality and maternal mortality ratios remain above national averages and that the lack of medical assistance is the main reason for female mortality in Bahia, reflecting the poor coverage of health services and the low access to simple and low-cost preventive procedures by poor women. Hence, maternal mortality affects mostly poor, young and afro-descendent women, who mostly rely upon public health services. Improving the quality, expanding the coverage of primary public health care in priority areas, and strengthening the state maternal and child care network, are essential policy reforms to reduce maternal mortality and have a clear pro-poor impact. They also lead to a drop in the infant mortality rate, especially early neonatal mortality that hits the children from the most vulnerable groups hardest.

175. **Poor family farmers in lagging semi-arid regions – among whom the *quilombola* population and indigenous peoples are mostly found – and informal urban workers will gain the most from social and productive inclusion policy changes.** Poor family farmers may benefit most from policy reforms related with productive inclusion, which will contribute to increase their productivity and their access to technology, technical assistance, and market. The expected outcome from these policy reforms are increased income and welfare for the poor rural population. Productive and social inclusion policies will make more cash available at the local market of poor and backward municipalities, the economy of these lagging regions will increase, and the municipalities will benefit from increases in tax collection and larger investment ability.³³ The poor urban population and especially female household heads will benefit from

³³ The Government of Bahia has also demonstrated interest in improving logistics and the institutional framework for transport to support economic growth by integrating logistics, transport coordination, planning and networks

policies designed to reduce informality and overcome barriers to women's access to formal labor market, by increased access to full labor rights and social safety policies. Finally, extremely poor families— among which female headed households and non-white population are overrepresented – are also expected to benefit from the outreach of social inclusion policies that will increase citizenship and improve access to social services, social safety networks, and conditional cash transfers programs. Therefore, these policies have the potential to promote equitable growth and reduce poverty.

176. **The “Pacto pela Vida” (PPV) program for controlling crime and violence focuses on reducing lethal violence which particularly affects poor afro-descendent youngsters.** Today, Bahia ranks as the fifth worst state in Brazil for homicides. Youth is the cohort most affected by the spike in violence, which is mainly associated with the increase in crack-cocaine consumption and trafficking and affects non-white youngsters disproportionately, especially those from poorer backgrounds. Poor families in low income settlements in the metropolitan region as well as in other municipalities are expected to gain the most from policies designed to respond to violence and to reduce drug addiction.

177. **The policy reforms of the state Government of Bahia have strengthened its institutional framework aimed at promoting gender equality.** This will be mostly achieved by reducing the barriers to women's access to better labor market outcomes – more job opportunities and better labor incomes. The state has created a Secretariat of Women's Affairs, which is able to advance gender mainstreaming in the public sector and to expand its areas of focus to other key pressing gender issues in Bahia – violence against females, gender education, and health. The contents of these policies have a major pro-poor tendency and they are expected to increase economic, social and cultural opportunities for women, to narrow gender wage and occupational gaps, to promote women's citizenship, and to strengthen their self-esteem. These policies will also help protect women who are victims of domestic or street violence and raise women's awareness of their rights.

178. **DPL supported policy reforms designed to develop social, physical and institutional infrastructure for Disaster Risk Management (DRM).** Low-income families living in informal settlements and in urban areas at risk may benefit most from policies that address vulnerability to natural hazards. The poorer population should benefit the most from DRM policies since it has been historically the social group that lives in the most vulnerable areas of the State, and is most exposed to extreme weather events, losses of assets and interruption in the provision of public services. DRM policies are also expected to contribute to reducing the economic and human costs associated with droughts in the semi-arid zone of the State, reducing the vulnerability of the rural poor to adverse climate events and to forest fires.

179. **The Strengthening of Public Sector Management by means of improved planned and budgeting systems, financial and resource management and public-private partnerships are essential for the State of Bahia to achieve equitable growth, social inclusion and increased economic efficiency.** By adopting new policies of *planning and budgeting* as well as by improving *costing and resource allocation*, the State Government will

connectivity, which will develop further the agriculture/livestock and industry sectors, fostering the state economic growth and broadening opportunities for the poor.

benefit from: (a) reduced transaction costs within the public sector, (b) lower costs of public services, and (c) free resources to be spent according to its strategic priorities. Hence, it is expected that the State Government may increase efficiency in the allocation of public funds, more effectively provide public services and better target programs and projects to benefit the poor. There is also considerable space for enhancing efficiency and effectiveness of the state's *tax administration system*, which may increase compliance and does not imply an increase of tax burden on the poor because it will be based on the modernization and automation of processes and mechanisms. Redistributive and pro-poor effects are expected from increased compliance as the richer segments of the population will finance improved public services and the higher revenues are spent according to existing priorities. Additionally, the policies proposed to improve *human resource management* may raise the quality of public services and are expected to contribute to increased well-being. Finally, the proposed *public-private partnerships* (PPPs) might free public money to be invested in other critical social areas. These investments will improve social and economic infrastructure and increase the well-being of the population and, in the short-term, the construction phase of these undertakings will generate low skilled jobs, increasing the wage income of those workers located in the lower bracket of the income distribution profile.

180. **Therefore, the overall conclusion of the PSIA is overwhelmingly positive.** All the policies considered have clear benefits for the poor, particularly in the medium to long term. Although a few challenges have been pointed out by the stakeholders interviewed, the consultations have indicated no significant opposition to any of the policies being pursued.

ENVIRONMENTAL ASPECTS

181. **The analysis of the environmental effects of the proposed operation indicates that the operation will produce net positive environmental effects in the State of Bahia.** In addition, the State of Bahia's environmental policy framework and institutional capacity has the mandate and capacity to address environment effects in the sectors supported by the operation. The policies and reforms supported by this operation are of great relevance to improve efficiency for Sustainable Development policies. Environmental challenges in Bahia are the result of rapid urbanization rates, long term unplanned occupation, and lack of adequate infrastructure and monitoring. The operation will mitigate existing environmental impacts.

182. **The policies supported by this operation strengthen planning and management of the public sector (Governance) and promote a social and productive inclusion in the lagging regions.** About seventy percent of the total area of Bahia State is in the region of semiarid, along with other biomes such as savanna and forest (Caatinga, Cerrado e Mata Atlantica). Small farmers are in majority located in the semiarid region with poor rural logistics. The main environmental problems identified are related to the disordered growth of Salvador metropolitan region associated with unplanned occupation of environmentally sensitive areas, and also forest fire, illegal deforestation and burning particularly in the semiarid region. Improvements in governance and social sector coordination should generate positive regional effects, improving the enforcement of land use regulations.

183. **The DPL supports specific actions to foster economic development in the lagging regions with a formal Productive Inclusion Program.** The main result under this program is the increase of rural producers benefiting from technical assistance, which may also promote sustainable agriculture practices; with the guarantee of different mechanisms to promote the small producer's environmental licensing activities, as determined by Law n° 12.377/2011, which disposes about the State Policy of Environment Protection and Biodiversity and the Water Resources State Policy. The CTGA - Technical Committee on Environmental Security, linked to the Department of Development and Regional Integration, has been established in order to coordinate and implement environment control, and monitor the environmental licensing of these productive activities.

184. **The proactive approach to Disaster Risk Management may benefit the population living in at-risk areas, and have a positive impact on the preservation of the region's environment.** The DPL also supports actions to strengthen Civil Defense System (CDS) resulting into a reduction of the impact of disasters (landslides, droughts, forest fires, flooding). These may also include providing support to the State in its efforts to consolidate ongoing initiatives to improve efficiencies in the land use management and planning which may have positive direct impacts on environmental conditions, inhibiting the occupation of environmentally sensitive areas and reclaiming preserved areas degraded by unplanned occupation.

185. **The DPL also supports actions to improve the institutional framework for Private Sector participation through Public Private Partnerships (PPPs).** The State of Bahia's Secretariat of Finance has issued a decree that institutes a Manual on PPP contract monitoring, which includes conditions for the bidding process of a public-private partnership, regarding to compliance of environmental legislation and the environmental licensing process of any investment, also in Compliance with federal law (Law n° 11.979/2004).

186. **Environmental management in Brazil is decentralized across the three tiers of Government (federal, state, and municipal).** State policies are in agreement with federal environmental legislation, and also comply with CONAMA Resolution 369/2006, which establishes requirements for the occupation of protected areas (Permanent Protection Areas, APP). The State's Secretary of Environment is responsible for recommending the issuance of environmental licenses by the State Environmental Council (CEPRAM). Environmental licensing eligibility and requirements are defined in Law 12.377/2011.

187. **Bahia has a comprehensive environmental policy framework that addresses environmental licensing and land use planning in environmentally sensitive areas.** The State Secretary of Environment has qualified staff in charge of environmental management and licensing, and issues numerous regulations about specific licensing procedures for small, medium, and large projects in sensitive areas. The new state legislation regarding environmental issues was approved in December 2011 and included a participatory methodology that prioritized discussions with state boards of Environment and Water Resources (CEPRAM and CONERH) and civil society groups, NGOs, Government and business sector. The modernization of the Law reinforces, for example, the quality of environmental control and intensification of supervision;

and has also been defined the State System of Environmental Information (SEIA), already under construction.

IMPLEMENTATION, MONITORING AND EVALUATION

Implementation

188. **The preparation of this operation is being led by the State Secretariat of Finance (SEFAZ)**, which is also responsible for the fiscal consolidation; the work is in close collaboration with the Secretariat of Planning (SEPLAG), the Secretariat of Health (SES), the Secretariat of Education (SEEDUC), the Secretariat of Infrastructure (SEINFRA), the Secretariat or Urban Development (SEDUUR), the Secretariat of Socio Economic Development (SEDES), the Secretariat for Development and Regional Integration (SEDIR), and the Secretariat of Women (*Secretaria das Politicas das Mulheres*).

Monitoring and Evaluation

189. **The operation will be overseen by the State Government of Bahia, through a Project Implementation Committee (PIC) made up of officials from the agencies directly involved in the DPL to be created specifically for this purpose.** The PIC will be responsible for the management and monitoring of the planned actions, with technical and managerial support from other departments of the State, especially Secretaries of Finance, Planning, and Administration as well as the Governor's office (Casa Civil). The PIC will be responsible for defining appropriate management structures for the implementation, monitoring, and supervision of the operation, including all essential technical assistance activities.

FIDUCIARY ASPECTS

Public Financial Management

190. **The constitution of the Federative Republic of Brazil and a well developed legal framework underpins the management of public finances at all levels of Government.** A public accountability law (Lei 4.320 of 1964) regulates financial controls, budgeting and reporting at the federal, state and municipal levels. The Law of Fiscal Responsibility (LRF) of 2000 established particular requirements for macroeconomic and fiscal discipline that define many aspects of the PFM environment. These laws have helped to strengthen accountability and transparency in the management of public finances in Brazil. More recently the Federal Government has embarked on an initiative to adopt international public sector accounting standards (IPSAS) that will improve financial reporting and accountability at all levels in Brazil.

191. **Bahia's PFM system features strong internal rules and controls and a clear definition of responsibilities and institutional arrangements.** Amongst these, SEPLAN is responsible for the upstream processes of planning and budget preparation while SEFAZ is responsible for managing treasury and downstream accounting and reporting processes. There is generally a high level of transparency with respect to financial information in Brazil. This is

made possible through the use of the internet and other public media channels to disseminate information on plans and budgets, regular financial reports and annual financial statements.

192. **The Government's commitment to a strong PFM system is evidenced in its development strategy.** This recognizes transparency, accountability and the increased efficiency of public expenditures as key elements necessary to ensure equitable economic growth in the State. To achieve these, the Government has undertaken reforms to enhance efficiency, transparency and accountability in the use of public funds. These reforms have been aimed at strengthening linkages between strategic planning and the budget preparation process, increasing capacity for the accounting and internal audit functions and upgrading its information systems.

193. **The State has consistently been able to prepare detailed financial statements within stipulated deadlines.** The obligations relating to the preparation of these financial statements are clearly described in relevant laws and regulations, and the State's internal controls generally ensure that these are adhered to. Key contributing factors include the clarity with which the law describes obligations in relation to the preparation of these financial statements, and the diligence with which they are applied. Their financial systems also enable them to.

194. **As mentioned above, Brazil has established a timetable for the adoption of international public sector accounting standards (IPSAS) in all federal entities by 2013.** The adoption of IPSAS is intended to improve the quality and relevance of financial information available for decision making by public sector managers. This would enhance transparency and accountability in the management of public resources while supporting the State's objective of enhancing the efficiency of the management of these resources. The State of Bahia is undertaking a number of steps to prepare for the implementation of the new accounting requirements. It established a steering committee to coordinate activities in this area and embarked on a program of sensitization for all its officials on the management changes that will be necessary. It is undertaking a training program to ensure the availability of the skills and knowledge required. To support the introduction of the new accounting regime, the State has accorded a high priority to the implementation of the new Integrated Financial Management information system (FIPLAN) whose software was procured under an agreement with the State of Mato Grosso and is in the process of adaptation. A separate multidepartmental committee is in charge of the coordination of user needs and of monitoring the progress in the implementation of the system. The new system is expected to facilitate the introduction of the new accounting regulations while enhancing the capacity of the state's information systems to collect, maintain and generate the financial data necessary for the preparation of financial statements.

195. **The internal audit function is carried out by the *Auditoria Geral do Estado*, a department in the Finance Secretariat (*Secretaria da Fazenda*).** The department has sufficient access to other Government departments to enable it to undertake its audits. Its recommendations are generally implemented, partly as a result of its close collaboration with the State audit institution, the TCE (see below). An earlier plan to upgrade the function by elevating its status to that of a secretariat would further enhance the independence of the function. However, this plan has not yet been approved by the State legislature. Its other challenges include the lack of sufficient staffing resources. Audit work is planned systematically using audit risk matrix.

196. **Bahia's *Tribunal de Contas do Estado* (TCE) has a mandate to audit all state resources.** It is considered one of the strongest state audit institutions in Brazil. It has enjoyed the support of the IADB, the World Bank and other international institutions over a number of years aimed at introducing modern audit practices and bringing its approach in line with international standards. In this regard, it has played a leading role in promoting the exchange of knowledge and experiences with other TCEs.

197. **As a result of the above review, the Bank is satisfied that the PFM environment in the State of Bahia is adequate to support the proposed operation.** In addition, the Government's development strategy and actions undertaken to implement reform actions are a satisfactory reflection of its commitment to improving the PFM environment.

Foreign Exchange Control Environment

198. **The IMF undertook a Safeguards Assessment of the Central Bank of Brazil in October 2002 and updated it in March 2004.** It concluded that the Central Bank does not present widespread vulnerabilities that could compromise the safeguarding of Fund resources. The Bank has also reviewed the financial statements of the Central Bank to assess the extent to which the foreign exchange control environment continued to be adequate. As part of this review, the Bank examined the Financial Statements for the years ended December 31, 2006 to 2010. These included Explanatory Notes to the financial statements and a report of the independent audit carried out by an international firm of auditors. All the audit reports contained an unqualified opinion on the financial statements for all years. The Explanatory Notes, an integral part of the Financial Statements, provide an extensive explanation of the Central Bank's risk management policies, including those related to financial instruments held to manage the international reserves. In relation to operational risks, the Notes state that the Central Bank "uses internal control systems, which are considered adequate for its activities." The Bank's conclusion based on this review was that the control environment governing the Central Bank's operations within which the loan's foreign exchange would flow continued to be adequate.

DISBURSEMENT AND AUDITING

199. **The proceeds of the loan will be disbursed against satisfactory implementation of the Development Policy lending program and will not be tied to any specific purchases.** Once is effective, disbursements of the loan will be made by the Bank into an account maintained by the State in *Banco do Brasil* in New York. *Banco do Brasil* is a commercial bank that is deemed acceptable to the World Bank. This commercial bank is an acceptable financial institution for the Bank as it is: (a) financially sound; (b) authorized to maintain the account in the currency agreed between the Bank and the Borrower; (c) is audited regularly, and has received satisfactory audit reports (reviewed December 31, 2010 Financial Statements audited by KPMG); (d) able to execute a large number of transactions promptly; (e) is able to perform a wide range of banking services satisfactorily; (f) is able to provide a detailed statement of the account; (g) is part of a satisfactory correspondent banking network; and (h) charges reasonable fees for its services. The account is denominated in foreign currency and does not form part of the foreign exchange reserves. However, the Central Bank will be informed of the deposit of this amount. Once the funds are deposited in the account, *Banco do Brasil* will credit an equivalent amount of money

into an account of the State in the same bank that finances budget expenditures. The State will provide a confirmation to the Bank that: (i) the loan proceeds were received into the foreign currency denominated account, and (ii) an equivalent amount was credited to the account that finances budgeted expenditures. Such a confirmation will be sent to the Bank within 30 days after payment. If the proceeds of the loan are used for ineligible purposes as defined in the Development Loan Agreement, the Bank would require the State to refund the amount. Due to the conclusions related to the adequacy of the State's public financial management environment, no additional fiduciary arrangements will be put in place for the operation.

RISKS AND RISKS MITIGATION

200. The proposed operation is considered to have moderate to substantial risks.

201. Economic and fiscal risks are related to prudent management of the Bahia fiscal position in an uncertain global environment. Fiscal aggregates are very vulnerable to ICMS revenues which are concentrated in very few areas and are highly sensitive to macroeconomic fluctuations in Brazil and partners countries. As such Bahia's revenues are vulnerable to developments in Europe, the slowing of the US growth as well as a potential hard landing from China. Bahia is also vulnerable to natural disasters such as the on-going drought which may affect productions and revenues in areas affected. The risk is mitigated by the reform supported in this DPL to increase institutional coordination and capacity to respond, manage and prevent natural disasters. In addition Bahia is vulnerable to a reduction of FPE transfers stemming from changes in the rules concerning the distribution of revenues from several federal taxes across states. Currently the sharing rule for FPE is being discussed at the Federal and subnational level along with royalties and ICMS reform. Royalties' reform, the most advanced of the reforms, is expected to result in a distribution design with an advantage over the current situation. Changes to the allocation formula of royalties, as presented in the bill of royalties³⁴ provide for an increasing distribution of royalties to all states, potentially offsetting potential revenue losses from FPE and tax reform. In addition, implementation of the changes will be gradual, minimizing the total net effects on revenue collection. The risk related to lower FPE transfer is also mitigated by the fact that Bahia is free not to agree to any proposal that will translate in a loss. Risk to the ICMS is mitigated by the significant increase in the State's tax collection over the last four years, due to both economic growth and to key efficiency reforms and by the commitment of the State Government to implement more fiscal reforms in tax administration, including those supported in this DPL. Additional fiscal pressures exist due to structural increases in expenditures related to health and security (among other sectors), investment expenditures related to the World Cup, and personnel expenditures in general. The reforms in public sector management supported by this operation are designed to mitigate these risks by improving efficiency as well as prioritization of expenditures.

Political and institutional risk

202. In an environment of fiscal competition among Brazilian States, the Federal Government has initiated a discussion with all states about possible institutional changes related to the ICMS. ICMS accounts for approximately 24 percent of the State's total revenues

³⁴ A revision to the distribution criteria of royalties is well advanced, having passed the Senate in October 2011.

and 87 percent of tax revenues. ICMS has benefited from rapid growth in retail and wholesale sales. Concerns remain in two main aspects: (i) the ‘old economy’ tax base coverage focused on petroleum and energy and relative little coverage of the fast-growing services sector, and iii) Electronic transactions- *Comércio Eletrônico*. The federal Government is considering possible institutional changes to address this issue. It is too early to assess any potential model of compensation. As a mitigation measure, the States that are likely to loose from the fiscal reform will be compensated.

203. The modest institutional and technical capacity of the GOB may affect the implementation and delivery of planned investment and social programs and may delay the disbursement of the second tranche. In this regard, the reforms supported by the operation to revamp public sector management for greater integration of budgeting, management and planning; and modernize human resources management will be crucial. Another institutional challenge is related to weak coordination of policies in the Government to align Government priorities with expenditures as well as to align policy at different Government levels to be more effective in the delivery of public services especially in health, education, crime and violence, social and productive inclusion, and gender programs. Finally, the State needs to partner with the private sector through PPPs and through subcontracting which are becoming increasingly important for efficient service delivery and call for improving the institutional framework for public private partnerships. These risks are mitigated by the implementation of reforms supported in this DPL and their irreversible nature. The Bank will also need to support the reform agenda by providing, first, advice and support through policy dialogue during the DPL preparation and supervision, and second through complementary technical assistance in the policy areas supported by the DPL. In this context, the Bank is discussing with the Government the possibility of restructuring existing investment loans as well as using DPL supervision for this purpose.

Risk to the Implementation of Sectoral Reforms Supported by the DPL

204. The implementation of the cross sectoral reform program supported by the DPL is subject to moderate to substantial risks. Beyond capacity, a second issue is related to political risk. Several actions are related to signing agreements and plans with the municipalities, however in 2012 municipalities will elect new mayors and inasmuch as the new incoming administrations do not share the priorities of their predecessors the implementation and/or the funding of the reform program supported by the DPL might be affected. This risk will be mitigated by ensuring that reforms supported are crucial to municipalities so as to reduce their vulnerability to changes in leadership. An additional mitigation measure lies in public sector reforms supported by this DPL that will improve the alignment between the state priorities and budget allocation so that on the state side funding is stable in the medium term. A third mitigation measure is the full alignment between the program supported and the state’s PPA. Table 7 below makes a detailed presentation of sectoral risks and risks mitigation measures.

Table 7: Risks for Sectoral Subcomponent Supplied by the DPL

Risk	Risk Mitigation Measure
<p>Education: <i>Pacto com Municípios</i> –Pact with the Municipalities could not succeed in improving learning outcomes in the time frame of the Project.</p>	<p>Ensuring that the Secretary of Education carries out a yearly standardized evaluation of learning outcomes in Portuguese for students in second grade in the participating municipalities. These evaluations will enable the state to benchmark the performance of schools and municipalities. Additional monitoring and evaluation will contribute to identify the interventions of the Program which have the most impact. Finally, the Secretary of Education will increase and vary the interventions for the lagging municipalities to impact on their student performance.</p>
<p>Health: Insufficient capacity to implement the reforms at the state and municipal’s levels could affect the respective results indicators. The implementation of the Family Health Program could be affected if the political and budgetary commitment to the program is not preserved over time. This is particularly relevant as the program is set independently from the state health system and its monitoring is not yet fully satisfactory. Political differences between municipalities may interfere with the regionalization process.</p>	<p>Technical assistance to the state and municipalities would mitigate this risk. It should be targeted to municipalities and institutions with lower capacity to improve management and technical capacity. So far, the Family Health Program has received strong commitment from municipal and state assemblies as well as from key institutional and civil society stakeholders. The State’s ongoing reforms to strengthen linkages between the state’s priorities and associated budgets in the multi-annual planning and to implement a system for monitoring and evaluation of main programs are mitigating measures. Working closely and continuously with state/municipal coordination committees will help minimize the risk caused by affiliation to different parties, and encourage state coordination.</p>
<p>Social and Productive Inclusion: <i>Social inclusion:</i> Low capacity of the municipal Governments in preparing the co-financing plans for Social Assistance.</p>	<p>Technical assistance to strengthen the State’s ability to assist and train municipalities and take advantage of the existing federal actions to support municipalities will help mitigate this risk.</p>
<p><i>Productive Inclusion:</i> Reduced efficiency of investments financed under the State’s Productive Inclusion Program due to: (i) technically weak economic and financial analyses; and (ii) poor coordination among public and private sector partners across value chains.</p>	<p>Activities under the proposed TAL or the existing Bahia State Integrated Project: Rural Poverty, implemented by CAR, would enhance the State’s capacity to conduct sound technical, economic and financial feasibility assessment of prioritized value chains under the Productive Inclusion Program. The Program’s multi-sectoral Steering Committee (<i>Comite Gestor</i>) would also benefit from these activities.</p>
<p>Gender: The Secretariat of Women is fairly new and has limited institutional capacity and modest resources despite becoming a permanent secretariat; as such its capacity to implement ambitious policy mainstreaming of gender priorities across sectors or to achieve the objectives of the PPA is limited. Limited Political and budgetary commitment to mainstream gender issues across sectors and prepare State Policy on Gender.</p>	<p>Technical assistance to strengthen the institutional capacity and framework of Secretariat for Women would be crucial. Conducting periodic institutional capacity assessments and technical workshops will help strengthen the management capacity and organization to respond to demands. Providing institutional arrangements such as the Grupo de Gestao Integrada and incentives for increased coordination across key sectors such as health, education, security, labor, etc. would be key to allow the Secretariat to promote gender mainstreaming. Gender issues have received strong political commitment from the Governor and are in the PPA.</p>
<p>Crime and Violence Prevention: Lack of coordination among different sectors and actors represented in the different subcommittees could affect Multisectoral crime and violence prevention programs.</p>	<p>The operation’s support to the cross sectoral committee will encourage coordination in the decision making process.</p>

Risk	Risk Mitigation Measure
<p>Targeting of interventions is weak as a result of limited data collection and analysis.</p> <p>Crime and violence rises due to exogenous factors (such as expansion of drug traffic from other areas).</p>	<p>The new institutional structure of the PPV will support evidenced based and sustainable policies to tackle crime and violence.</p> <p>The operation will support existing crime and violence data collection and monitoring system strengthening as well as capacity to analyze and interpret crime data. Second, technical and capacity building workshops will also mitigate this risk. Third, studies were commissioned to provide guidance on how to strengthen the capacity of PPV to collect and analyze data on crime and violence.</p>
<p>Disaster Risk Management:</p> <p>The institutional weakness of CORDEC, which serves more than 400 municipalities with a mere 30 staff of which only 5 are disaster professionals- could jeopardize the restructuring of the civil defense system.</p> <p>Delays in the construction of the basic cartography of the State which is expected to be ready in early 2013 could affect the construction of the pilot risk maps.</p>	<p>Technical assistance loan as well as increased resources allocation to CORDEC will help strengthen the capacity of the institution.</p> <p>Reducing the scope of the original mapping from a full State mapping down to a pilot mapping in some metropolitan locations helped mitigate this risk.</p>
<p>Transport:</p> <p><i>Bahia Logistics Advisory Committee</i></p> <p>Risk that the Bahia logistics advisory committee is captured by SEINFRA, and is not representative enough of the whole sector.</p> <p>Risk of delay to prepare the Committee institutional arrangements and having it operational.</p> <p>Risk that the Bahia logistics advisory committee lacks the sufficient human and budgetary resources to be operational.</p> <p>Risk that the resolutions taken by the Bahia are ineffective or not taken into account.</p>	<p>Start consultation early with the stakeholders and Design a balanced governance system that may include academics.</p> <p>Benchmark best practices; set up a small task-force with expected main stakeholders representatives, and start consultation early with the stakeholders on draft decree and get feedback.</p> <p>Define early a work plan to budget resources; target excellence for the analytical outputs, and increase resources.</p> <p>Include follow-up mechanisms in the Committee's design and disseminate information and organize media event.</p>
<p>Planning and Budgeting:</p> <p><i>State Planning and Budget System</i></p> <p>Insufficient political commitment to reform efforts and / or insufficient technical capacity could lead to abandonment.</p> <p>Internal resistance to required reorganization of institutions and processes could block further reforms.</p>	<p>Bank support through the proposed DPL and complementary TA helps enhance commitment to reform and provides technical guidance.</p> <p>Operation supports consultations and workshops at all levels as new proposals are developed.</p>
<p>Financial and Human Resource Management:</p> <p><i>FIPLAN and new reporting and accounting systems</i></p> <p>Lack of capacity and complexity of training requirements could lead to postponement of introduction of new system</p> <p>Technological or contractual problems could slow development of the FIPLAN system</p>	<p>Bank support through the proposed DPL and complementary TA provides guidance and helps organize necessary capacity building.</p> <p>Bank support provides guidance and TA.</p>
<p><i>Introduction of new HR management</i></p> <p>Fully meritocratic system could be blocked by political resistance in some secretariats</p> <p>Technological or contractual problems could slow development of</p>	<p>Operation supports consultations and workshops at all levels.</p> <p>Bank support provides guidance and TA.</p>

Risk	Risk Mitigation Measure
the HR system	
<p>Tax Administration: Lack of coordination between Government agencies and IT preparedness.</p>	<p>The supported policy actions demand coordination between the state tax administration (SAT) and the National Tax Department (SRFB). The Bank will support the State efforts to improve such coordination</p>
<p>PPPs: Due to the small size of the PPP unit it could fail to comply with planned schedules and have difficulties to improve contract monitoring</p>	<p>The Government is planning to scale up the PPP program and seek additional help from the private sector in the initial stages of projects.</p>

ANNEX 1: LETTER OF DEVELOPMENT POLICY

Estado da Bahia

**GABINETE
DO
GOVERNADOR**

**Ofício nº 13/2012-GE.
Salvador, 20 de janeiro de 2012.**

Assunto: Carta de Desenvolvimento de Políticas.

**Dr. Robert B. Zoellick
Presidente
The World Bank
Washington, DC**

Senhor Presidente,

Esta carta apresenta o **Programa de Inclusão e Desenvolvimento Sócio Econômico do Estado da Bahia – PROINCLUSÃO** que tem como objetivo o fortalecimento dos programas estruturantes do Governo da Bahia relativos ao esforço da inclusão social e produtiva, ao desenvolvimento de infraestrutura social, físico e institucional para o crescimento sustentável, e ao fortalecimento do planejamento e gestão do setor público. Acreditamos que as políticas definidas nesse programa constituem significantes iniciativas a serem apoiadas pelo Banco Mundial através do DPL.

CONJUNTURA ECONOMICA BAIANA

A Bahia tem acompanhado o dinamismo da economia brasileira. O PIB do estado registrou um aumento de 7,5% em 2010, a segunda maior taxa de crescimento de toda a série histórica deste índice. Tal número sintetiza a recuperação da economia estadual diante dos efeitos da crise financeira mundial, intensificados a partir de 2008, quando cresceu a taxas mais baixas. Contribuíram para este resultado as expansões nos setores da agropecuária(8,5%), impulsionadas pelo recorde na safra de grãos, na indústria (8,4%), com destaque para o crescimento de 14,6% da construção civil, e no setor de serviços (6,9%), notadamente devido ao dinamismo do comércio, que cresceu 11,2% ao ano.

Principal responsável pela expansão do setor de serviços, o comércio varejista baiano apresentou crescimento de 10,1% no volume de negócios em 2010, frente à elevação da taxa nacional de 10,9%. Este desempenho deve-se não apenas aos efeitos do crescimento econômico estadual e nacional, mas também ao aumento de liquidez da economia (e a conseqüente expansão do crédito para financiamento do consumo), ampliação dos prazos para parcelamento dos financiamentos, melhoria de rendimento dos consumidores, aumento do emprego formal e desonerações de impostos.

Estado da Bahia

**GABINETE
DO
GOVERNADOR**

Ofício n.º 13/2012 - GE, fl. 02

A performance recente da indústria baiana mostra que esta vem se recuperando do arrefecimento ocorrido durante a crise de 2007/2009, aproveitando as oportunidades surgidas no mercado mundial, especialmente com a expansão da demanda da economia chinesa por commodities industriais e agropecuárias.

A elevação atual da produção industrial foi influenciada, principalmente, pelo resultado positivo em sete dos oito segmentos da indústria de transformação, que cresceu 7,1% em 2010. Os maiores impactos positivos foram observados em (a) refino de petróleo e produção de álcool (22,6%), (b) alimentos e bebidas (8%), oriundos do aumento da produção de cerveja e óleo de soja, e (c) metalurgia básica (9,3%), por conta da crescente produção de barras, perfis e vergalhões de cobre e vergalhões de aço. Esse desempenho positivo da indústria de transformação da Bahia deriva, ainda, do maior volume de investimentos atrelados aos setores de petróleo e extrativo mineral, assim como da manutenção da procura internacional por celulose.

A agropecuária baiana, por sua parte, vem se mostrando uma atividade competitiva, diversificada e com participação sustentada na economia estadual. No período entre 2007 e 2009, o crescimento real do complexo do agronegócio foi até maior do que o do PIB baiano: 7,7% contra 6,6%. A expansão do setor nos últimos anos deriva, principalmente, dos recordes consecutivos na produção de grãos, sobretudo soja, milho e algodão. Entre os fatores que estimulam a elevação nas safras destas commodities estão: a alta nos preços dos próprios grãos e a crescente demanda internacional por esses produtos.

No comércio exterior, a Bahia atingiu, em 2010, superávit de US\$ 2,26 bilhões na sua balança comercial. As exportações alcançaram US\$ 8,9 bilhões, com acréscimo de 26,8% em relação ao ano anterior. As importações, por sua vez, cresceram 41,8%, perfazendo volume de US\$ 6,6 bilhões. Apesar de positivo, o desempenho das exportações foi afetado pela valorização cambial, cujo efeito foi um incremento de 16,7% nos preços relativos. Destaca-se, entretanto, a ampliação das vendas para os países emergentes e a retomada das compras dos EUA. No biênio 2009-2010, os principais destinos das exportações baianas foram os Estados Unidos (absorvendo 15% do total exportado), China (13%), Argentina (12%) e Holanda (7%).

Desenvolvimento Social

A pobreza é um fenômeno complexo e multidimensional, resultado de processos econômicos, sociais, culturais e políticos entrecruzados. Ela se manifesta tanto nas assimetrias de acesso aos serviços e bens, quanto na frágil inserção da população mais pobre no sistema produtivo. A persistência da pobreza constitui o principal entrave para o desenvolvimento em bases sólidas e para a garantia do princípio da equidade. Se a insuficiência de renda é um importante sinalizador de vulnerabilidade das pessoas, ela não é o único. Fatores sociais, geográficos e biológicos ampliam ou diminuem os efeitos desta carência sobre os indivíduos. Além de um rendimento capaz de suprir as necessidades básicas, é preciso garantir às pessoas pobres instrução, acesso à terra e a insumos para produção, saúde, moradia, justiça,

Estado da Bahia

**GABINETE
DO
GOVERNADOR**

Ofício n.º 13/2012 - GE, fl. 03

apoio familiar e comunitário, crédito e acesso a oportunidades de trabalho e desenvolvimento pessoal.

Em um país com o passivo de desigualdades e de exclusão social como o Brasil, não se pode pensar em desenvolvimento sem considerar como um objetivo prioritário a eliminação da pobreza absoluta e uma repartição mais redistributiva dos resultados do crescimento econômico.

Segundo o Instituto de Pesquisa Econômica Aplicada (IPEA), com base na pesquisa Nacional por Amostra de Domicílios (PNAD) de 2009, 14% da população baiana vivia em condições de extrema pobreza. Os pobres, ao mesmo tempo, somavam 39%. Em que pese os índices de pobreza absoluta e pobreza terem caído nos últimos anos, em torno de 1,9 milhão de baianos ainda podem ser considerados como extremamente pobres. São consideradas extremamente pobres as pessoas com renda domiciliar per capita inferior à linha de indigência ou miséria. A linha de extrema pobreza aqui considerada é a estimativa do valor de uma cesta de alimentos com o mínimo de calorias necessárias para suprir adequadamente uma pessoa, com base em recomendações da FAO e da OMS. Segundo o IPEA, pobreza extrema pode ser definida como o estado de privação de um indivíduo cujo bem-estar é inferior ao mínimo que a sociedade a qual ele pertence julga obrigada a garantir. São consideradas pobres as pessoas na população total com renda domiciliar per capita inferior à renda mínima definida pela linha de pobreza. A linha de pobreza aqui considerada corresponde ao dobro da renda. O Instituto Brasileiro de Geografia e Estatística (IBGE), com base nos dados do universo preliminar do Censo Demográfico 2010, também procurou mensurar a parcela da população que se encontra em situação de extrema pobreza. Neste caso, a linha de extrema pobreza foi estabelecida em R\$ 70,00 per capita, considerado o rendimento nominal mensal domiciliar. No Brasil, foram identificadas 16,3 milhões de pessoas em situação de extrema pobreza. A Bahia – com 2,4 milhões – é o Estado brasileiro com o maior número de pessoas nesta condição.

O Índice de Desenvolvimento das Famílias (IDF), com base nos dados do CadÚnico do Ministério do Desenvolvimento Social (MDS), permite uma melhor aproximação da situação da pobreza em que se encontra parcela significativa da população baiana. Como lembra o MDS, “o IDF é um indicador sintético que mede o grau de desenvolvimento das famílias [numa escala que vai de 0 a 1], possibilitando apurar o grau de vulnerabilidade de cada família do CadÚnico, bem como analisar um grupo de famílias ou definida como linha de indigência.

A concentração espacial dos setores mais dinâmicos da economia, a má distribuição da renda e da riqueza, o analfabetismo e os baixos níveis de instrução, o desemprego e a insegurança alimentar podem perdurar mesmo em conjunturas de crescimento acelerado. E isto é ainda mais verdadeiro quando este crescimento se dá num contexto de abertura econômica, reestruturação produtiva e flexibilização das relações de trabalho. O combate à situação de pobreza na Bahia dependerá de ações de governo que contrabalancem as tendências inerentes a esses processos, que considerem a multicausalidade do problema e a necessidade de intersetorialidade, convergência e articulação nas ações de diversos agentes. Nessa direção, o Governo do Estado definiu uma estratégia de Desenvolvimento Social, entendida como ações

Estado da Bahia

**GABINETE
DO
GOVERNADOR**

Ofício n.º 13/2012 - GE, fl. 04

voltadas para a melhoria da qualidade de vida e inclusão socioeconômica da população em situação de pobreza, se fortalece enquanto política pública no Brasil e na Bahia, desdobrando-se em seis tipos de ações: assistência social, transferência de renda, segurança alimentar e nutricional, formação, garantia de acesso à infra-estrutura social (água, energia elétrica, transporte e saneamento) e inclusão produtiva. Parte fundamental dessa estratégia são os programas de transferência direta de renda. O principal deles é o Programa Bolsa Família (PBF), cujo objetivo é assegurar o direito à alimentação adequada, promovendo a segurança alimentar e nutricional e contribuindo para a conquista da cidadania pela população mais vulnerável à fome. O PBF se pauta em três dimensões: alívio imediato da pobreza, contribuição para redução da pobreza sistêmica, intergeracional, e articulação com ações e políticas complementares: acesso ao conhecimento e ampliação da escolaridade, geração de trabalho e renda, garantia de direitos sociais como acesso à documentação civil e segurança, entre outras. No ranking nacional, a Bahia é o estado que conta com o maior número de cadastrados no PBF e o maior número de beneficiários, é, conseqüentemente, a unidade federativa que recebe maior volume de recursos. Isso não significa dizer que todo o público potencial do programa já esteja sendo atendido. O Governo da Bahia precisa qualificar a atuação no que lhe cabe em relação ao Programa, garantindo: (a) a identificação e inserção do público mais vulnerável (população de rua, povos tradicionais, pessoas sem registro civil); (b) implantação da “busca ativa” para incluir no CadÚnico as famílias que continuam fora da rede de proteção e promoção social; (c) qualidade do cadastro para, inclusive, dificultar os desvios, e, por fim, (d) acompanhamento às condicionalidades (compromissos assumidos pelas famílias beneficiárias do PBF nas áreas de Saúde, Educação e Assistência Social). Na Bahia, segundo dados da PNAD/IBGE de 2009, 41,2% dos domicílios se encontravam em situação de insegurança alimentar e nutricional, dos quais 8,9% ainda em situação de insegurança grave, ou seja, conviviam com a fome. Essa situação levou o Governo do Estado a direcionar um conjunto de ações para assegurar o direito à alimentação adequada, na perspectiva de salvaguardar condições mínimas de sobrevivência. Outra questão importante para as políticas de desenvolvimento social é a garantia dos serviços socioassistenciais básicos para proteção social às famílias e/ou indivíduos em situação de risco, de vulnerabilidade social e com vínculos fragilizados e/ou rompidos. Faz-se necessário garantir, a partir da rede socioassistencial, a oferta de serviços de proteção em quantidade satisfatória e melhorar o acesso aos seus benefícios. A melhoria da qualidade de vida da população do estado passa, necessariamente, pelo abastecimento de água em quantidade e qualidade adequadas ao consumo humano. Ao mesmo tempo, a energia elétrica acessível contribui para a redução da pobreza, por favorecer ao aumento da renda familiar e facilitar o acesso aos demais serviços públicos. A garantia de uma infra-estrutura social se completa, ainda, com o acesso ao saneamento, à moradia e ao transporte. Nas áreas rurais, a democratização do acesso à terra é outro elemento importante para as políticas de desenvolvimento social. A ação prioritária é a regularização fundiária, ou seja, garantir o título da terra aos produtores. O reconhecimento legal da posse de um imóvel rural é o primeiro passo para a garantia hipotecária, que abre as portas do financiamento agrícola, sendo também o documento exigido para a concessão de aposentadoria rural. Com vistas a democratizar o acesso à terra, deve ser intensificado, no âmbito estadual, o processo de assentamento de reforma agrária e a concessão de crédito fundiário.

Estado da Bahia

**GABINETE
DO
GOVERNADOR**

Ofício n.º 13/2012 - GE, fl. 05

Os assentamentos devem dispor de toda a infra-estrutura mínima para uma moradia digna, com acesso à água, saneamento, energia elétrica, meios de comunicação e transporte. Outras ações vitais para a reforma agrária são o suporte às atividades produtivas nos assentamentos e o apoio às associações responsáveis pelos assentamentos rurais. Elementos importantes para o delineamento dessas ações de desenvolvimento social são a utilização do IDF como mecanismo de planejamento da aplicação dos recursos, bem assim os dados do CadÚnico e do cadastro do Sistema Único de Assistência Social (CadSuas), para definição do público-alvo. Além disso, deve-se priorizar a família como unidade de atendimento, com o objetivo de valorizar essa instância de organização social, reduzir a fragmentação dos benefícios e aperfeiçoar o monitoramento do gasto público em políticas sociais. Cabe enfatizar que a política estadual de combate à pobreza será construída em consonância com o “Plano Brasil sem Miséria”, sob a coordenação do MDS e em conjunto com outros ministérios. Seu objetivo é acabar, até o fim de 2014, com a pobreza extrema no Brasil. O Plano é direcionado aos brasileiros que vivem em lares cuja renda familiar é de até R\$ 70 por pessoa. Este critério deverá orientar a definição do público prioritário dos programas de Desenvolvimento Social na Bahia.

INFRAESTRUTURA LOGÍSTICA E DE TELECOMUNICAÇÕES

Ponto estratégico na política de infra-estrutura, o setor logístico tem sido essencial para o desenvolvimento de países que buscam competitividade no mercado mundial. Afinal, os investimentos na implantação de uma rede integrada de transportes e serviços logísticos, que interligue as áreas de produção às de consumo e exportação, têm impactos diretos no fortalecimento e nos ganhos de eficiência do setor produtivo e no desenvolvimento regional equilibrado, gerando, conseqüentemente, maior competitividade econômica. A logística integrada virou a grande ação estratégica para os países emergentes que objetivam ampliar sua competitividade no mercado internacional e vêm estimulando vários fundos de investimento a direcionarem recursos para projetos no setor. Neste contexto se enquadram os investimentos da China e da Índia, novos grandes demandantes mundiais de commodities produzidas em países como o Brasil. Um estudo do Banco Mundial, com 155 países e mais de mil operadores logísticos internacionais, mostrou que a infra-estrutura brasileira passou do 61º lugar para o 41º de 2007 a 2009, um dos maiores avanços registrados no ranking. Apesar desse resultado e da crescente participação do investimento privado nacional e estrangeiro, a Associação Brasileira da Infra-estrutura e Indústrias de Base (ABDIB) estima que o Brasil precisará investir, por ano, cerca de R\$ 168 bilhões em infra-estrutura durante o próximo quinquênio. Deste montante, R\$ 25,2 bilhões deverão ser destinados ao setor de transporte e à logística. Esta questão é também crucial para as expectativas de crescimento da atividade produtiva na Bahia, que já concentra uma produção agrícola considerável e começa a implantar empreendimentos de mineração. Além disso, a consolidação de portos e ferrovias em outros estados do Nordeste potencializa a disputa, com a Bahia, de investimentos privados e fluxo de mercadorias, o que reforça a necessidade de investimentos na logística baiana. A consolidação de projetos estruturantes que tenham a capacidade de promover um grande salto de qualidade na logística de transporte poderá firmar a Bahia como um importante pólo industrial e de serviços.

Estado da Bahia

**GABINETE
DO
GOVERNADOR**

Ofício n.º 13/2012 - GE, fl. 06

GESTÃO DEMOCRÁTICA DO ESTADO

Outras diretrizes importantes dizem respeito ao aumento do controle do gasto público e melhoria do desempenho da administração financeira, assim como a promoção de medidas normativas e administrativas, objetivando a redução do impacto negativo do déficit previdenciário na capacidade de investimentos do Estado com recursos próprios do Tesouro.

O programa Modernização da Gestão Pública tendo por escopo a inovação da gestão pública, visando a elevar o padrão de eficiência e efetividade do serviço público por meio de soluções integradas e otimizadas de gestão e de tecnologias da informação, contribuindo para a excelência na prestação de serviços à sociedade e para o alcance pleno das políticas públicas.

Outro enfoque estratégico é a consolidação da cultura da qualidade do gasto público, disseminando para todas as unidades do Poder Executivo a importância dessa iniciativa, monitorando e avaliando os resultados e convidando também o cidadão a participar do esforço voltado ao combate do desperdício.

O fortalecimento da gestão estratégica de pessoas através da profissionalização do servidor público, promovendo ações de reconhecimento, capacitação e desenvolvimento de talentos, com foco no mérito para ascensão social, permeia grande parte dos atributos programáticos do programa de Modernização da Gestão Pública. O programa Relação Governo-Sociedade assegura, através do diálogo social, o acesso à informação, estimulando a participação cidadã e o controle social da gestão do governo. Tem como diretrizes estratégicas (i) a transparência das ações de governo, (ii) a mediação dos conflitos e negociação das demandas dos movimentos sociais e (iii) o fomento e apoio à organização da sociedade civil, por meio dos conselhos e associações.

Completa esse estratégia, o programa Pacto Federativo que visa à ampliação da efetividade na implantação das políticas públicas, pelo fortalecimento da cooperação federativa e qualificação da relação com os membros dos demais Poderes nas diversas esferas de governo.

O Governo do Estado tem demonstrado de forma inequívoca, através implementação de um conjunto de políticas estruturantes, a disposição de enfrentar e resolver os principais entraves ao desenvolvimento econômico, promovendo a inclusão social, mas para acelerar esse processo pretende buscar a colaboração do Banco Mundial para execução daquelas ações direcionadas à geração de inclusão e inovação social e produtiva (equidade), ao desenvolvimento da infra-estrutura social, física e institucional e ao desenvolvimento sustentável (eficiência) bem como o fortalecimento do planejamento e da gestão do setor público (governança). A concessão de empréstimo (DPL) no valor de US\$ 700 milhões e possível assistência técnica em projetos são as formas da cooperação almejada.

As principais políticas e programas objeto do apoio pretendido, estão detalhados a seguir consolidados em três áreas:

Estado da Bahia

GABINETE
DO
GOVERNADOR

Ofício n.º 13/2012 - GE, fl. 07

Política Área 1 – Equidade - Melhorando a Inclusão Social e Produtiva

Aborda os temas **Educação** - Melhorar a responsabilização, pelos resultados entre o Estado e os Municípios através estabelecimento de acordos de parceria (Regime de Colaboração) entre o Estado e os municípios para a implementação do Programa Estadual *Pacto pela Educação*, com o objetivo de melhorar a qualidade da educação e eficiência interna de alunos da segunda série do primeiro ciclo do ensino fundamental.

Saúde – Melhorar a qualidade e expandir a cobertura de cuidados primários de saúde em áreas prioritárias e implementar e desenvolver a rede de cuidado materno-infantil do estado para redução da mortalidade materna, consolidando assim a Rede de Atenção Primária no Estado, com foco na qualificação da assistência pré-natal em todos os municípios baianos, definindo as estratégias, diretrizes e normas para ações de atenção primária no estado e, adesão do Estado da Bahia à Política Nacional de Redução da mortalidade materna e neonatal (Rede Cegonha).

Inclusão social e produtiva - Fomentar o desenvolvimento econômico das regiões menos desenvolvidas e melhorar os serviços sociais ofertados para população em situação de extrema pobreza, proporcionar o acesso permanente à infra-estrutura rural básica, para aumentar a produtividade e o acesso dos pequenos produtores rurais ao mercado, reforçar a capacidade da rede de CRAS (Centros Referencial de Assistência Social) para identificar e registrar famílias no CadÚnico e Decreto formalizando o Programa de Inclusão Produtiva. As ações executadas permitirão a reestruturação da dívida para a agricultura familiar e pagamento de juros, em apoio à inclusão produtiva e a regulamentação de critérios para co-financiamento das atividades nos municípios.

Gênero - Promover a igualdade de gênero como meio de inclusão social e crescimento equitativo no estado da Bahia. Firme nesse propósito o Governo do Estado criou em 2011 a Secretaria de Políticas para as Mulheres e, no seu plano plurianual para o período 2012-2015 destinou volume de recursos no total de R\$ 13 milhões. A proposta é reforçar institucionalmente a Secretaria criando condições de trabalho que visa a promoção da igualdade de gênero e redução da violência às mulheres. E através da criação de um Grupo de Gestão Integrada, composta de titulares de secretarias da área social, elaborar uma política abrangente para igualdade de gênero para o Estado da Bahia e implementar o 3º Plano de Ação para as Mulheres.

Crime e violência - Melhorar a capacidade do Governo do Estado para responder à violência. Encontra-se em execução o Programa Pacto pela Vida-PPV que tem como objetivo implementar uma política de segurança pública transversal e integrada, que proteja a cidadania e garanta os direitos humanos, reduza os índices de criminalidade, violência e vulnerabilidade das comunidades, com base em ações construídas de forma pactuada junto à sociedade. Através da Lei Estadual nº 12.357 de 26/09/2011 foi criada a sub-comissão de prevenção de crime e violência através do Desenvolvimento Social (CSPS), que institui o Sistema de Defesa Social (SDS) e Pacto pela Vida. Já se encontra em preparação diagnóstico

Estado da Bahia

**GABINETE
DO
GOVERNADOR**

Ofício n.º 13/2012 - GE, fl. 08

preparatório para o Plano PPV realizado, evidenciado pela criação de forças-tarefa do PPV, um sistema de indicadores de acompanhamento e metodologia de identificação de problemas e a elaboração de um estudo sobre a vigilância da violência na Bahia em todos os setores.

Política Área 2 – Eficiência - Desenvolvimento de infra-estrutura social, física e institucional para o Desenvolvimento Sustentável

Aborda os temas **Transporte e logística**, - Melhorar a logística e a estrutura institucional de transporte para apoiar o crescimento econômico. Integrar logística, coordenação de transportes, planejamento e redes de conectividade. Compromete-se o Governo do Estado a criar, através de Decreto publicado em Diário Oficial um Comitê Consultivo de Logística da Bahia e adoção, pela Secretaria Estadual de Infra-estrutura de política de gestão para resultados,

Moradia e desenvolvimento urbano - Ampliar o acesso à habitação e à propriedade da terra. Tem como estratégia, o fortalecimento da gestão, o planejamento e a capacidade institucional da Secretaria de Desenvolvimento Urbano – SEDUR com o objetivo, dentre outros, a implementação do Plano Estadual de Regularização Fundiária e Titulação, o fortalecimento da capacidade de planejamento e gestão da equipe de Regularização Fundiária da SEDUR, bem como, a implementação de um sistema de informação de habitação do Estado e estruturação de investimentos regionais por meio de consórcios municipais.

Gestão de riscos de desastres - Reduzir o impacto dos desastres (deslizamentos, secas, incêndios florestais, inundações). A estratégia é o Fortalecimento do Sistema de Defesa Civil (CDS) para aumentar sua eficiência e eficácia através criação, por Decreto publicado no Diário Oficial do Estado, de um órgão para coordenação e gestão de riscos de desastres com representantes de todos os setores e núcleos regionais, e realizar o mapeamento de riscos do Estado.

Política Área 3 - Gestão - Fortalecimento do planejamento e da gestão pública

Aborda os temas **Gestão Pública** - Adotar novos processos de gestão para execução do Orçamento Estadual, que assegurem o alinhamento do orçamento às prioridades estratégicas do Governo Estadual; fornecer incentivos para a participação ativa de titulares das Secretarias no processo de desenvolvimento do Orçamento; de modo a reduzir a quantidade de modificações durante a execução. Capacitação das unidades orçamentárias em políticas de planejamento, de modo a viabilizar um orçamento mais alinhado com o Plano PluriAnual, reduzindo as variações orçamentárias em relação ao orçamento aprovado. Melhorar os mecanismos de monitoramento dos cidadãos na execução do PPA – Participativo. Os processos de revisão orçamentária e de planejamento serão totalmente documentados. Pretende-se uma redução de 80% nas modificações orçamentárias.

Estado da Bahia

**GABINETE
DO
GOVERNADOR**

Ofício n.º 13/2012 - GE, fl. 09

Gestão Financeira e de Recursos Humanos - Implementar o sistema integrado de gestão financeira (FIPLAN), desenvolvendo um roteiro detalhado para novos processos de negócios, treinamento e inovações tecnológicas. Implementar alterações na legislação e regulamentação para introdução de competências com base nas Normas Internacionais de Contabilidade do Setor Público, de modo a melhorar a eficiência do planejamento e da gestão financeira. Atualizar o sistema de custos (ACP) para fornecer estimativas de custo de prestação de serviços públicos, inclusive através do desenvolvimento de metodologia de custeio específica para os serviços públicos. Projeta-se a implementação do novo sistema de custeio (ACP), integrado ao FIPLAN, em 02 secretarias de estado. Implementar uma nova abordagem para a gestão de recursos humanos juntamente com um novo sistema informatizado de RH. Adotar novos processos de gestão de RH para permitir o planejamento da força de trabalho, a gestão de carreira e avaliação de mérito com base em sistema de gestão de desempenho, de modo que os gestores possam identificar o pessoal necessário para cada tarefa.

Administração Tributária - Melhorar a eficácia da administração fiscal, através da expansão dos acordos com a Receita Federal do Brasil (RFB), de forma a assegurar à Secretaria da Fazenda (SEFAZ) o acesso às informações referentes à propriedade de bens, doações e heranças de contribuintes, assim como da avaliação completa do sistema de execução fiscal, de modo a identificar as fragilidades e propor reformas na sua estrutura legal, organização e gestão, processos de trabalho e sistemas de TI. Serão identificados novos cruzamentos de dados, a serem implementados com a Receita Federal, proporcionando um maior rendimento no desempenho das receitas. Como resultados, pretende-se que a execução de dívidas de médio prazo seja melhorada e o estoque da dívida ativa seja reduzido, viabilizando um aumento na arrecadação e um maior cumprimento das obrigações fiscais pelos contribuintes.

Gestão de Parcerias Público-Privadas (PPP) - Melhorar a estrutura institucional para a participação do setor privado através de Parcerias Público-Privadas (PPP). Trata-se de implementar as melhores práticas para tirar vantagem da participação do setor privado nos estágios iniciais do projeto (PMI) e elevar a eficácia no monitoramento dos contratos. Pretende-se a publicação de decretos para regulamentar o pedido de participação do setor privado nos estágios iniciais do projeto e para instituir um manual de monitoramento de contratos de PPP para o Estado da Bahia. Como resultados, pelo menos dois novos contratos de PPP serão originados da PMI, e os novos contratos assinados terão uma cláusula exigindo que um auditor independente seja contratado para a sua revisão. Pretende-se um aumento no número de projetos estruturados por meio de PPPs e a melhoria no monitoramento dos respectivos contratos.

Considerações Finais

Trata-se, portanto, de um conjunto articulado de objetivos que, uma vez alcançados, deverão constituir um círculo virtuoso no qual o alcance de um dos objetivos do presente projeto termina por alimentar os demais e deverão orientar o Estado da Bahia na direção do desenvolvimento sustentável.


JAQUES WAGNER
Governador

LETTER OF DEVELOPMENT (UNOFFICIAL TRANSLATION)

Official Communication /2012-GE

Salvador, January 2012

Subject: Letter of Development Policy

Mr. Robert B. Zoellick
President
The World Bank
Washington, DC

Mr. President:

This letter presents the **Social and Economic Inclusion and Development Program for the State of Bahia – PROINCLUSÃO**. Its objective is to strengthen the restructuring programs adopted by the state Government in a bid to achieve inclusion in the social and productive spheres, develop the social, physical, and institutional infrastructure needed for sustainable growth, and strengthen public sector planning and management. We believe that the policies outlined in this program represent significant initiatives to be supported by the World Bank through the LDP.

THE ECONOMIC SITUATION IN THE STATE OF BAHIA

Bahia has kept pace with the dynamic growth in the Brazilian economy. State GDP increased by 7.5 percent in 2010, the second highest growth rate in the history of this index. This figure reflects the recovery of the state's economy from the effects of the global financial crisis that intensified beginning in 2008, when state growth was lower. Contributing to this result are expansions in agriculture (8.5 percent) spurred by a record grains harvest; in industry (8.4 percent), led by the 14.6 percent growth in construction; and in the services sector (6.9 percent), notably due to the dynamic performance of retail trade, which grew at 11.2 percent.

The primary factor in the expansion of Bahia's services sector was retail trade, which exhibited a 10.1 percent growth in business volume in 2010, compared with the 10.9 percent rise in the national rate. This performance was due not only to the effects of the economic growth that occurred at both state and national levels, but also to an increase in liquidity in the economy (and the consequent expansion of consumer credit), which permitted a lengthening of the terms for installment payments. Other factors include higher consumer income, an increase in formal employment, and tax relief.

Recent performance by Bahia's industry demonstrates that it has been recovering from the slowdown observed during the crisis of 2007-2009. Industry is taking advantage of opportunities that have arisen on the world market, especially the growth in demand from China for industrial and agricultural commodities.

The current increase in industrial production was influenced principally by favorable results in seven of the eight manufacturing sectors, which grew by 7.1 percent in 2010. The biggest positive impacts were observed in: (a) petroleum refining and alcohol production (22.6 percent); (b) food and beverages (8 percent)—because of an increase in beer and soybean oil output; and (c) basic metalworking (9.3 percent), because of rising production of copper bars, shapes, and rods, as well as steel bars. This performance by Bahia's manufacturing sector is also a consequence of a rise in the volume of investments tied to the petroleum and mining sectors, as well as maintenance of global demand for cellulose.

Bahia's agriculture, for its part, has been shown to be competitive and well diversified and has maintained its share of the state's economy. Between 2007 and 2009, the real growth rate in agribusiness was even higher than that of Bahia's GDP: 7.7 percent, compared with 6.6 percent. The expansion in the sector in recent years was largely attributable to consecutive record harvests of grains, especially soy, corn, and cotton. Among factors that have spurred larger harvests of these commodities are higher prices for the grains themselves and rising global demand for those products.

In terms of foreign trade, in 2010 Bahia posted a balance of trade surplus of US\$2.26 billion. Exports amounted to US\$8.9 billion, 26.8 percent above the previous year. Imports, in turn, jumped 41.8 percent, to US\$6.6 billion. Although favorable, export performance was impaired by an increase in the exchange rate that produced a 16.7 percent increase in relative prices. Particularly noteworthy, however, were an increase in sales to emerging economies and the resumption of purchases by the USA. During the two-year period 2009-2010, the principal destinations of Bahia's exports were the United States (accounting for 15 percent of total exports), China (13 percent), Argentina (12 percent), and the Netherlands (7 percent).

Social Development

Poverty is a complex and multidimensional condition that results from cross-cutting economic, social, cultural, and political processes. It manifests itself both in asymmetrical access to goods and services and a fragile insertion of the poorest strata of the population into the productive system. The persistence of poverty is the principal obstacle to development based on solid foundations and to the guarantee of observance of the principle of equity. Although insufficient income is an important indicator of the vulnerability of individuals, it is not the only one. Social, geographical, and biological factors can aggravate or diminish the effects of this factor on individuals. People need to be guaranteed not only an income sufficient to meet basic needs, but education, access to land and inputs for production, health, housing, and justice, support from families and the community, as well as access to credit and opportunities for employment and personal development.

In a country like Brazil that bears the burden of inequalities and social exclusion, it is impossible to contemplate development without considering, as a priority objective, the elimination of absolute poverty, accompanied by a more redistributive allocation of the fruits of economic growth.

According to the Institute of Applied Economic Research [*Instituto de Pesquisa Econômica Aplicada* IPEA], based on the National Household Sample Survey [*Pesquisa Nacional por Amostra de Domicílios* PNAD] for 2009, 14 percent of Bahians were living in extreme poverty. At the same time, the poor accounted for 39 percent of this population. Although indices of absolute poverty and poverty have fallen in recent years, about 1.9 million Bahians can still be considered extremely poor. Those whose per capita household income falls below the poverty line or indigence threshold are considered to be extremely poor. The extreme poverty line used in this document is the estimated value of a basket of foods having the minimum number of calories needed to adequately feed a person, based on FAO and WHO recommendations. According to the IPEA, extreme poverty can be defined as the state of privation of an individual whose wellbeing is below the minimum level that the society to which he belongs considers itself obligated to provide. Persons in the total population whose per capita household income is lower than the minimum income defined by the poverty line are considered to be poor. The Brazilian Institute of Geography and Statistics (IBGE), using data from the preliminary universe of the Demographic Census of 2010, also sought to measure the portion of the population that is extremely poor. In this case, the extreme poverty line was fixed at R\$70.00 per capita, considered as the nominal monthly household income. In Brazil, 16.3 million people were identified as living in extreme poverty. Bahia—with 2.4 million residents—is the Brazilian state that has the highest number of people in that situation.

The Family Development Index [*Índice de Desenvolvimento das Famílias* IDF], based on data from the Consolidated Register for Social Programs [*Cadastro Único* or *CadÚnico*] developed by the Ministry of Social Development (MDS), allows us to better assess the situation of poverty in which a significant portion of Bahia's population lives. As the MDS observed, "the IDF is an artificial indicator that measures the degree of development of families, and enables us to determine the degree of vulnerability of each family in the register, as well as to analyze a group of families.

The spatial concentration of the most dynamic sectors of the state's economy, the poor distribution of income and wealth, illiteracy and low levels of education, unemployment and food insecurity, may all persist even during periods of economic growth. This is even truer when this growth occurs in a context of economic openness, restructuring of production, and increased flexibility in labor relations. Alleviation of poverty in Bahia will require the Government to take actions to offset the tendencies inherent in these processes, actions that take into account the myriad causes of the problem and the need for intersectoral measures and the harmonization and coordination of the activities of various agents. The state Government has outlined a social development strategy along these lines. The strategy is understood as including actions aimed at improving the quality of life and achieving socioeconomic inclusion of the population that is living in poverty. It will be reinforced as public policy both in Brazil as a whole and in Bahia. The strategy is divided into six areas of action: social assistance, income transfers, food and nutritional security, training, guaranteed access to social infrastructure (water, electricity, transportation and sanitation), and inclusion in the production sector. Programs for direct transfers of income are fundamental parts of this strategy, the main one being the *Bolsa Família* or Family Allowance Program (PBF). That program is intended to ensure the right to proper nutrition by promoting food and nutritional security and contributing to the full exercise of individual rights and freedoms by the population most likely to suffer hunger. The PBF has three dimensions: immediate poverty alleviation, thereby contributing to a reduction in systematic and intergenerational poverty, and coordination with complementary actions and policies; access to knowledge and higher school attendance rates, along with opportunities for job and income creation; and the guarantee of social rights such as access to civil documentation and security, among others. In terms of national ranking, Bahia as a state has the highest number of persons registered with the PBF program and the highest number of beneficiaries. Consequently, it is the state that receives the highest volume of funds. This does not mean that the entire potential target population of the program is already being served. The Government of Bahia needs to improve its performance of the activities entrusted to it with regard to the PBF so as to ensure: (a) identification and inclusion of the maximum number of vulnerable members of the public (the homeless, indigenous peoples, those without identification documents); (b) adoption of the "active search" approach in order to include in the *CadÚnico* families who remain outside the protection and social advancement network; (c) the quality of the register—for example, in order to curb misappropriation and, lastly (d) monitoring of conditionalities (commitments assumed by PBF beneficiary families in the areas of health, education, and social assistance). In Bahia, according to data from the 2009 PNAD/IBGE, 41.2 percent of households were experiencing food and nutritional insecurity, and 8.9 percent of these were in a situation of severe insecurity, i.e., they were living with hunger. This finding led the state Government to direct a set of actions toward ensuring the right to a proper supply of food in order to safeguard minimum conditions for survival. Another important question for social development policies is how to guarantee that basic social assistance measures will be taken to protect at-risk families and/or individuals, those socially vulnerable, or those having weakened and/or broken social ties. It is important to guarantee, using the social assistance network, a satisfactory volume of protection services and to improve access to their benefits. Improvement in the quality of life of the state's population necessarily involves developing a supply of water in sufficient volume and quality for human consumption. At the same time, accessible electricity helps reduce poverty by fostering an increase in family income and facilitating access to other public services. The guarantee of a social infrastructure is also completed by access to sanitation, housing, and transportation. In rural areas, the provision of equal access to land is another important element in

social development policies. Priority action focuses on land ownership legitimization, i.e., guaranteeing that farmers have title to land. Legal recognition of possession of a property is the first step toward obtaining mortgage guarantees that open the doors to agricultural financing. Valid title is also required for those applying for agricultural retirement programs. In order to provide equal access to land, the process of agrarian reform and awarding of land-related credit must be stepped up at the state level.

Settlements must be fully equipped with the basic infrastructure needed for decent housing, with access to water, sanitation, electricity, communications and transportation. Other actions vital to agrarian reform include support to the production activities carried out in the settlements and support for the associations that are responsible for the rural settlements. Elements important to the delineation of these social development actions include the use of the IDF as a means of planning the use of resources, as well as the data from the *CadÚnico* and the Social Assistance Consolidated System [*Sistema Único de Assistência Social CadSuas*] to identify the target population. Furthermore, the family should be given priority as the unit to be served, in order to give due recognition of that unit of social organization, reduce fragmentation of benefits, and improve the monitoring of public spending on social policies. It should be emphasized that state policy aimed at eliminating poverty will be designed in accordance with the plan known as “Plan for a Brazil Without Extreme Poverty” [*Plano Brasil sem Miséria*] being coordinated by the MDS in conjunction with other ministries. Its objective is to end extreme poverty in Brazil by end-2014. The plan is directed toward Brazilians who live in homes where family income does not exceed R\$70.00 per person. This criterion should guide the definition of the priority public to be served by social development programs in Bahia.

LOGISTICAL AND TELECOMMUNICATIONS INFRASTRUCTURE

Logistics, a strategic area of infrastructure policy, have been essential to the development of countries that desire to be competitive on the world market. Investments in the installation of an integrated network of transportation and logistical services that connects production to product consumption and exportation points ultimately have a direct impact on strengthening efficiency gains by the productive sector as well as on balanced regional development, thereby increasing economic competitiveness. Integrated logistics have become the major strategic action to be taken by emerging countries that want to improve their competitiveness on the international market. They also have encouraged various investment funds to direct resources to sector projects. In this context are investments by China and India, which are huge sources of new demand on the world stage for commodities produced in countries like Brazil. A World Bank study of 155 countries and more than 1,000 international logistics operators showed that the ranking of Brazil’s infrastructure rose from 61st to 41st between 2007 and 2009, one of the greatest advances recorded. Despite that result and increasing private national and foreign investment, the Brazilian Association of Infrastructure and Basic Industries [*Associação Brasileira da Infra-estrutura e Indústrias de Base ABDIB*] estimates that Brazil will need to invest about R\$168 billion a year in infrastructure during the next five years. Of this amount, R\$25.2 billion will need to be allocated to transportation and logistics. This issue is also crucial to the projected increase in Bahia’s production, which is now concentrated on sizeable farm production and is beginning to include mining. In addition, the consolidation of ports and railroads in other states of Brazil’s Northeast is enhancing their ability to compete with Bahia for private investments and the handling of flows of goods, which makes the need for investments in Bahia’s logistics even greater. The consolidation of restructuring projects that can promote significant improvement in the quality of transportation logistics could position Bahia as an important industrial and services hub.

DEMOCRATIC MANAGEMENT OF THE STATE

Other important guidelines pertain to an increase in control over public spending and improvement of the performance of financial administration, as well as promotion of regulatory and administrative measures in order to blunt the negative impact of the social security deficit on the ability of the state to use its own Treasury funds to make investments.

The Public Management Modernization [*Modernização da Gestão Pública*] program was developed to bring innovation to public management. It is intended to raise the standard of efficiency and effectiveness of Government service by introducing integrated and optimized management solutions as well as information technology, thereby contributing to excellence in the provision of public services and the sound execution of public policies.

Another strategic focus is consolidation of the culture of quality in public spending by making all units of the Executive Branch aware of the importance of this initiative, monitoring and evaluating the results, and also inviting citizens to participate in the effort to eliminate resource waste.

Strengthening strategic management of personnel by improving the professional qualifications of public servants through the promotion of actions leading to recognition, training, and development of skills, with a focus on merit as a means of advancement, is present in a significant part of the programmatic initiatives of the Public Management Modernization program. The Government-Society [*Governo-Sociedade*] program ensures access to information through social dialogue, thus encouraging citizen participation and societal control over Government management. The strategic guidelines of this initiative are as follows: (i) transparency in Government actions; (ii) conflict mediation and negotiations of the demands of social movements; and (iii) fostering and supporting the organization of civil society through councils and associations.

Completing this strategy is the Federative Pact [*Pacto Federativo*] program that seeks to expand effectiveness in the establishment of public policies by strengthening cooperation among Brazil's states and validating the relationships with the members of the other branches of Government at the various levels.

The state Government has unequivocally demonstrated, by implementation of a set of restructuring policies, its willingness to address and resolve the principal obstacles to economic development and promote social inclusion. However, to accelerate this process it intends to seek the assistance of the World Bank in order to carry out actions aimed at inclusion and social and productive innovation (equity), the development of the social, physical, and institutional infrastructure and sustainable development (efficiency), as well as strengthening public sector planning and management (governance). The granting of a (DPL) loan of US\$700 million and possible assistance with projects are the forms of assistance sought.

The principal projects and programs that are the object of the desired support are described in detail below, consolidated into three areas:

Policy Area 1 – Equity – Greater Social and Productive Inclusion

This area addresses **Education**. Improve accountability for results between the state and the municipalities through establishment of partnership agreements (Cooperation Regime) between the state and cities for implementation of the state program entitled Pact for Education [*Pacto pela Educação*], in order to improve the quality of education and the internal efficiency of students in the second year of the first cycle of elementary education.

Health – Improve quality and expand coverage of primary health care in priority areas. Implement and develop the State Maternal and Child Healthcare Network in order to reduce maternal mortality, thereby consolidating the State Primary Health Care system in the state with focus on improving antenatal care in all Bahia’s municipalities by defining the strategies, guidelines, and standards for primary health care. The state of Bahia would adopt the National Policy for Reduction of Maternal and Neonatal Mortality [*Política Nacional de Redução da Mortalidade Maternal e Neonatal (Rede Cegonha)*].

Social and Productive Inclusion – Foster economic development in the less developed regions of the state and improve the social services offered to people living in extreme poverty. Provide permanent access to the basic rural infrastructure in order to increase productivity and access by small rural producers to the market. Reinforce the capabilities of the Social Assistance Reference Centers network [*Centros Referencial de Assistência Social CRAS*] in order to identify and register families with the *CadÚnico*. Issue a decree formalizing the Productive Inclusion Program [*Programa de Inclusão Produtiva*]. The actions carried out will permit the restructuring of family farm debt and debt servicing, in support of productive inclusion and the regulation of criteria for co-financing of the activities in the municipalities.

Gender – Promote gender equality as a means of achieving social inclusion and equitable growth in the state of Bahia. Given its commitment to this objective, the state Government in 2011 created the Secretariat of Women’s Policies [*Secretaria de Políticas para as Mulheres*] and, in its multiyear plan for 2012-2015, allocated R\$13 million in funds to that agency. The proposal is to strengthen the secretariat institutionally by creating working conditions aimed at promoting gender equality and reducing violence against women. By establishing an Integrated Management Group [*Grupo de Gestão Integrada*] composed of the heads of secretariats in the social area, draft a comprehensive gender equality policy for the state of Bahia. Implement the 3rd Action Plan for Women.

Crime and Violence – Improve the ability of the state Government to respond to violence. A program entitled “Pact for Life” [*Pacto pela Vida PPV*] is now under way. Its objective is to implement a cross-cutting and integrated public safety policy that protects the general public and guarantees human rights as well as reduce criminality, violence, and community vulnerability by employing measures developed in tandem with society. Under State Law No. 12.357 of September 26, 2011, a subcommittee on prevention of crime and violence was created through Social Development (CSPS), which instituted the Social Defense System (SDS) and the Pact for Life. An initial diagnosis of the PPV Plan is currently being done, as evidenced by the creation of PPV task forces, a system of indicators for monitoring, methods for identifying problems, and the drafting of a study on guarding against violence in all parts of Bahia.

Policy Area 2 – Efficiency – Development of the Social, Physical, and Institutional Infrastructure for Sustainable Development

This area addresses **Transportation and Logistics**. Improve logistics and the institutional structure of transportation in order to support economic growth. Integrate logistics, coordination of transportation, planning, and connectivity. The state Government is committed to creating, by means of a decree to be published in the Official Gazette, a Consultative Committee on Logistics for Bahia [*Comitê Consultivo de Logística da Bahia*] and to ensuring that the State Infrastructure Secretariat adopts a policy on management for results.

Housing and Urban Development – Expand access to housing and land ownership. The strategy involves strengthening the management, planning, and institutional capabilities of the Urban Development Secretariat (SEDUR), with the purpose, among others, of implementing the State Plan for Land Ownership and Title Normalization [*Plano Estadual de Regularização Fundiária e Titulação*], strengthening the planning and management skills of SEDUR's Land Ownership Normalization team, as well as implementing a housing information system for the state and structuring regional investments via municipal consortia.

Disaster Risk Management – Reduce the impact of disasters (landslides, droughts, forest fires, floods). The strategy involves strengthening the Civil Defense System (CDS) in order to increase its efficiency and effectiveness by creating, via a decree to be published in the Official Gazette of the State, an agency for disaster risk coordination and management composed of representatives of all the regional sectors and units, and to develop a map of risks for the state.

Policy Area 3 – Management – Strengthening of Public Planning and Management

This area addresses **Public Management**. Adopt new management procedures for executing the state budget, procedures that assure that the budget is aligned with the strategic priorities of the state Government. Create initiatives for active participation by heads of secretariats in the process of developing the budget so as to curb the number of modifications made during its execution. Train budget units in planning policies so as to produce a budget that is better aligned with the Multiyear Plan (PPA), thereby reducing the number of changes with regard to the approved budget. Improve the participatory mechanism by which citizens monitor the execution of the PPA. Budget revision and planning procedures will be fully documented. An 80 percent reduction in budget amendments is sought.

Financial Management and Human Resources – Implement the integrated financial management system known as FIPLAN, developing a detailed new routine for handling transactions, and involving training and technological innovation. Implement changes in legislation and regulations in order to introduce competencies on the basis of international standards of public sector accounting, so as to improve the efficiency of financial planning and management. Update the costs system [*Apropriação de Custos Públicos* ACP] in order to furnish estimates of the cost of providing public services, including by the development of specific methodology to calculate the cost of public services. It is anticipated that the new operating costs system (ACP) integrated with the FIPLAN will be implemented in two state secretariats. Implement a new approach to human resource management, along with a new computerized personnel system. Adopt new procedures for personnel management in order to permit workforce planning, management of career paths, and evaluation of merit using a performance management system so that managers can identify the personnel needed for each task.

Tax Administration – Improve the effectiveness of fiscal administration by expanding the existing agreements with the Federal Revenue Service of Brazil (RFB) in order to ensure that the Secretariat of Finance (SEFAZ) has access to data pertaining to taxpayers' asset holdings, donations, and inheritances. Conduct a full evaluation of the tax execution system in order to identify weaknesses and propose reforms in its legal structure, organization, management, working procedures, and IT systems. New methods of cross-checking data will be identified, to be implemented with the RFB in order to produce a greater yield in revenue performance. The anticipated results include improvements in the collection of medium-term debts and the reduction in tax arrears, which will lead to an increase in revenue collection and greater taxpayer compliance with fiscal obligations.

Management of Public-Private Partnerships (PPP) – Improve the institutional structure that enables the private sector to participate through Public-Private Partnerships (PPP). This will involve implementing best practices in order to take advantage of private sector participation in the initial stages of the project (PMI) and increase the effectiveness of contract monitoring. It is intended that decrees will be published to regulate demand for private sector participation in the initial stages of the project and to adopt a manual for Bahia state monitoring of PPP contracts. In terms of results, at least two new PPP contracts will come out of the PIM, and the new contracts that are signed will include a clause that requires an independent auditor to be retained to review them. It is intended to increase the number of projects structured via PPPs and to improve the monitoring of the respective contracts.

Final Comments

We have presented a well-coordinated set of objectives which, once achieved, should constitute a virtuous circle in which the attainment of one of the objectives of this project ultimately feeds the others and should place the state of Bahia on a path to sustainable development.

JACQUES WAGNER

Governor of the State of Bahia

ANNEX 2: BAHIA GOVERNMENT POLICY MATRIX- RESULTS INDICATORS

"Prior Actions and Second Tranche Conditions supported in this operation are in bold and listed in the Table 5 and 6. The broader action set included in plain font reflects the Government plan and are NOT disbursement conditions for this operation."

Objectives	Strategy	Tranche I Prior Actions	Tranche II Conditions	Results Indicators	Expected Outcomes in the medium term
Policy Area 1. Improving Social and Productive Inclusion (Equity)					
Education Improve accountability for results between the State and the Municipalities	Establishing partnership agreements (<i>Regimen de Colaboração</i>) between the State and the municipalities for implementing the State program	The State Secretariat of Education has implemented the <i>Pacto Pela Educação</i> (Official Decree No 12.792) by signing partnership arrangements with municipalities to improve the quality of education and internal efficiency of students in second grade in the first cycle of fundamental education.	The State Secretariat of Education has (i) monitored the implementation impact of the <i>Pacto pela Educação</i> in participating municipalities by evaluating test results of standardized evaluation provided to second grade students in the subject matter of Portuguese language, and by recording the passing rate of students in second grade (ii) disseminated the results per school from monitoring the implementation impact of the <i>Pacto pela Educação</i> to the respective school; (iii) identified the 25% least performing participating municipalities based on such results; and provided learning materials and additional pedagogical support to the schools located in those municipalities.	<ul style="list-style-type: none"> • Number of partnership agreements signed by the State with the municipalities increases from 217 in 2011 to 329 by 2013 	<ul style="list-style-type: none"> • The percentage of correct responses in the standardized test in language instruction (Portuguese) for students in second grade in the 329 municipalities enrolled in the Pact with Municipalities (<i>Pacto com Municípios</i>) and in the State schools offering second grade, increases to 64 percent in 2013 compared with 59 percent in 2011 baseline. • The percentage of students who complete the second grade in the 329 municipalities enrolled in the Pact with Municipalities (<i>Pacto com Municípios</i>) increases to 85% in 2013 compared with 79.5% in 2010 baseline.

Objectives	Strategy	Tranche I Prior Actions	Tranche II Conditions	Results Indicators	Expected Outcomes in the medium term
<p>Health Improve the quality and expand the coverage of primary health care in priority areas focused on maternal mortality reduction</p>	<p>Strengthen the primary health care network in the state of Bahia, focused on qualification of antenatal care in all the municipalities</p> <p>Develop the maternal and child health care network in the State of Bahia</p>	<p>The State Secretariat of Health has published the State-and-Municipal Health Committee Resolution defining strategies, guidelines and standards on primary health care activities in the State of Bahia (<i>Resolução da Comissão Intergestores Bipartite – CIB</i>)</p>	<p>The State of Bahia has issued and published a decree approving the State Policy on Primary Health Care</p>	<ul style="list-style-type: none"> • Increase in the proportion of pregnant women enrolled by primary health care teams <p>Baseline: 46.67% (2010) Target: 50% (2014)</p> <ul style="list-style-type: none"> • Increase in the proportion of pregnant women with timely antenatal care <p>Baseline: 41.42% (2010) Target: 45% (2014)</p>	<ul style="list-style-type: none"> • Expanded coverage of primary health care <p>Baseline: 60.35% (2010) Target: 64% (2014)</p> <ul style="list-style-type: none"> • 2% reduction of the maternal mortality rate* annually as of 2014 <p>Baseline: 77.9 maternal deaths for each 100,000 live births</p> <p><i>* The indicator refers to maternal mortality that occurs during the pregnancy and child birth and excludes violence and accident causes.</i></p>
<p>Social and Productive Inclusion Foster economic development in the lagging regions and improve the access to and the quality of social services to the extreme poor</p>	<p>Providing sustainable access to basic rural infrastructure to increase the productivity and market access of small-scale rural producers</p> <p>Strengthen the capacity of the Social Assistance Reference Centers CRAS (<i>Centros Referencial de Assistência Social</i>) network to identify and register households in the national unified registry CadÚnico</p>	<p>The State of Bahia has issued a decree formalizing the State's Productive Inclusion Program and the State of Bahia's Legislative Assembly has enacted two laws in support of productive inclusion which provide:</p> <p>(i) Technical Assistance and (ii) Debt Restructuring for Family Farms</p> <p>The State of Bahia Secretariat of Social Development (SEDES) has issued a Resolution of the Social Assistance Council that approves the criteria for co-financing of social assistance activities with municipalities. SEDES has signed social</p>	<p>The Social Assistance monitoring system implemented</p>	<ul style="list-style-type: none"> • Increase in the targeted number of rural producers benefiting from technical assistance under the State Program for Productive Inclusion <p>Baseline: zero to a Target: 150,000 producers (by 2014)</p> <ul style="list-style-type: none"> • Increase in the household registrations to the Social Assistance Reference Center CRAS and in the <i>Cadastro Único</i> in the 50 most vulnerable municipalities (with the lowest IGD-M) of 20 percent from 2011 to 2014. 	<ul style="list-style-type: none"> • Increase in small rural producers' participation in institutional markets, namely the National School Feeding Program PNAE across the seven productive chains prioritized under the State Program for Productive Inclusion with the weighted average across municipalities of PNAE sales of rural producers as % of total PNAE sales increasing from a baseline of 5% in 2011 to a target of 20% by December 2014. <p><i>* National School Feeding Program (PNAE), which allows for school meal purchases to be sourced from family agriculture.</i></p> <ul style="list-style-type: none"> • Increase in the coverage rate of the CadÚnico in the 50 municipalities with the lowest IGD-M of 20 percent from 2011 to 2014. <p>Increase in the information available on school attendance</p>

Objectives	Strategy	Tranche I Prior Actions	Tranche II Conditions	Results Indicators	Expected Outcomes in the medium term
	<i>(Cadastro Único), and monitor Bolsa Familia conditionalities</i>	<p>assistance co-financing plans with the 50 municipalities with lowest IGD-M* (Municipal management development index)</p> <p><i>*IGD-M is an index of decentralized management that measures the institutional and program management of the Bolsa Familia and CadÚnico program</i></p>		<ul style="list-style-type: none"> • Increase in the information available on school attendance (monitoring of education conditionality) in the 50 municipalities with the lowest IGD-M <p>Baseline: average of 90% in the selected municipalities in 2011. Target: 5% increase in the 50 municipalities with the lowest IDG-M</p>	<p>in the 50 municipalities with the lowest IGD-M</p> <p>Baseline: average of 90% in the selected municipalities in 2011. Target: 5% increase in the 50 municipalities with the lowest IDG-M</p>
<p>Crime and Violence Prevention</p> <p>Improve the State Government's capacity to respond to violence</p>	Implement Cross sectoral anti-crime policy (<i>Pacto pela vida</i> PPV)	The State of Bahia has established a Sub-committee of crime and violence prevention through Social Development (CSPS) LEI N° 12.357 September 26, 2011, establishing the Social Defense System (SDS) and the <i>Pacto pela Vida</i> (PPV).	The State of Bahia has adopted and implemented: (i) a strategic action plan aimed at improving its institutional capacity to target and implementing social crime and violence prevention programs in Municipalities prioritized by <i>Pacto pela Vida</i>; and (ii) a strategic plan to strengthen its crime and violence data collection, management, and analysis system	<ul style="list-style-type: none"> • Increased number of priority municipalities that receive prevention programs/interventions through initiatives of the Sub-committee of crime and violence prevention through Social Development CSPS <p>Baseline: 4 municipalities in 2011 Target : 20 municipalities by 2014</p>	<ul style="list-style-type: none"> • Improved capacity and coordination within PPV for the implementation of crime prevention interventions through social development • Improved targeting of prevention interventions in all 20 municipalities prioritized by PPV
<p>Gender</p> <p>Promote gender equality as means of increased social inclusion and equitable growth in the State of Bahia</p>	Strengthening of the institutional framework for the design and implementation of policies aimed at promoting gender equality and reducing violence to women	<p>The State of Bahia has established the Secretariat for Women (Secretaria das Políticas para as Mulheres) --Lei 12.212 (May 4, 2011) and included in the PPA law of programs under said Secretariat with a total value of R\$13 million</p> <p>The Secretariat for Women's strategic plan is implemented with an action plan (Plano de</p>	<p>The Secretariat for Women of the State of Bahia has issued a decree to create and implement its gender action plan. and implement an integrated management group (<i>Grupo de Gestão Integrada</i>) to facilitate the mainstreaming of gender issues across multiple sectors, the elaboration of a State Policy on Gender Equity and the effective implementation of the <i>Plano Estadual das Mulheres III</i></p> <p>The State of Bahia is implementing the Federal law for women victims of violence "Lei</p>	<ul style="list-style-type: none"> • The Integrated Management Group for Gender (<i>Grupo de Gestão Integrada</i>) is fully operational as evidenced by an increased number of sectoral partnerships signed and implemented between the Secretariat for Women and other secretariats to mainstream gender issues in State programs. • Expansion of services offered by the reference centers to women victims of violence in <p>Baseline: 1 (Agreement with Secretaria de Agricultura) Target for December 2014: At least 5 sectoral partnerships signed.</p>	<p>Improved mainstreaming of gender issues and execution of a State Policy on Gender Equality across sectors</p> <p>Increased coverage of number and quality of services offered by the reference centers to women victims of violence in the State of Bahia (<i>territorialização</i>)</p>

Objectives	Strategy	Tranche I Prior Actions	Tranche II Conditions	Results Indicators	Expected Outcomes in the medium term
		Ação) fully developed (minutes are approved) to strengthen and improve its functioning and organization.	Maria da Penha” with the publication of a technical guide regulating the functioning and services offered by the reference centers for women victims of violence	the State of Bahia as per the technical guide (<i>territorialização</i>) Baseline: 13 counties in 2011 Target 2014: 27 counties by 2014	
Policy Area 2. Developing Social, Physical, and Institutional Infrastructure for Sustainable Development (Efficiency)					
Disaster Risk Management Reduction of the impact of disasters (landslides, droughts, forest fires, flooding)	Strengthening the Civil Defense System (CDS) for increased efficiency and effectiveness	The State of Bahia has established a coordinating committee consisting of representatives from the its office of Chief of Staff (Casa Civil) and selected secretariats to manage emergency response actions to drought occurring within its territory, as evidenced by Decree No. 13.796, dated March 21, 2012, published in the Official Gazette on March 22, 2012	The State of Bahia has: (i) (A) submitted to its Legislative Assembly, for approval thereby, a draft law, to adopt, or (B) adopted, through the Borrower’s executive branch, as the case may be, a regulatory framework, for re-structuring its coordinating body for disaster risk management, including the establishment of regional units with trained staff and equipment, as evidenced by a letter from the State Government duly received by the Legislative Assembly or a copy of said regulatory framework established through the State’s executive branch, as the case may be; and (ii) (A) completed pilot risk-mappings of two (2) sites located in the metropolitan area of the State of Bahia’s capital, as evidenced by a report issued by the State’s coordinating body referred to in: (i) (A) above, which shall include the maps produced as part of such pilot risk-mapping, (B) Created and implemented a program to support the capacity of volunteer brigades, as evidenced by the necessary measures	<ul style="list-style-type: none"> • The State of Bahia’s Disaster Risk Management Policy is operational as evidenced by: • 5 regional nodes established and trained by December 2014 • Risk- mapping for 2 pilot areas done • 10 self-established voluntary brigades trained by December 2014 	<ul style="list-style-type: none"> • Improved capacity and coordination for prevention, mitigation, preparedness and response to natural disasters

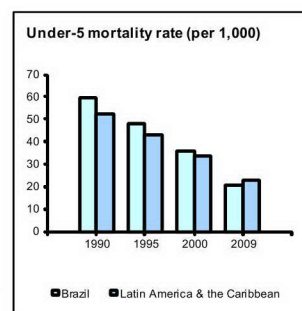
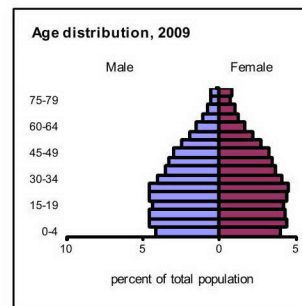
Objectives	Strategy	Tranche I Prior Actions	Tranche II Conditions	Results Indicators	Expected Outcomes in the medium term
			adopted by the State of Bahia		
Transport Improve logistics and the institutional framework for transport to support economic growth	Integrate logistics, transport coordination, planning and networks connectivity	The State of Bahia's Secretariat of Infrastructure has prepared a Draft decree creating the Bahia Advisory Logistics Committee	The State of Bahia has issued the decree creating the Bahia Logistics Advisory Committee and the committee is operational The State of Bahia's DERBA has completed the pilot test of its modernized organizational structure, management by result oriented	<ul style="list-style-type: none"> Bahia Advisory Committee issues 3 resolutions Draft Decree reorganizing DERBA and internal regulation ready 	<ul style="list-style-type: none"> Strengthened institutional capacity in logistics for State transport infrastructure management
Policy Area 3. Strengthening Planning and Management of the Public Sector (Governance)					
Planning and Budgeting Strengthening of Management for results Strengthening of the Multi-annual and cross sectoral approaches to public policy	Reorganize State Planning and Budget preparation system to strengthen results orientation and linkages between budgets and strategy	Diagnostic study on weaknesses in the planning and budgetary system completed and road map for reforms of system developed	The State of Bahia has adopted institutional arrangements or proposed for adoption to the legislative assembly legal arrangements for the development of the annual State Budget to ensure the alignment of the annual budget with the strategic priorities of the State Government and reduce ad hoc modifications to the annual budget during execution	<ul style="list-style-type: none"> Policy planning capacity established in at least six line secretariats Secretaries are directly involved in the annual budget planning process Revised budget and planning process fully documented Reduction of number of intra year modifications to the budget by at least 75 percent (baseline 2010: 7000) 	<ul style="list-style-type: none"> Reduced variability of budget outcomes compared to original budget
Financial and Human Resource Management Coherent, efficient and transparent management of financial and human resources	Introduction of IPSAS for financial management using an integrated and modern budget planning and execution system (FIPLAN)	Detailed roadmap for new business processes, training and introduction of technological requirements (including new financial management system FIPLAN for IPSAS) is developed	The State of Bahia's Finance Secretariat has proposed amendments to State legislation and adopted regulations for the introduction of accrual based International Public Sector Accounting Standards	<ul style="list-style-type: none"> Budget preparation and reporting takes place consistent with IPSASs 	<ul style="list-style-type: none"> Increased efficiency in planning and financial management
	Implement new approach to HR management together with new HR system	Performance management extended to 60 percent of public servants	The State of Bahia has submitted to its Legislative Assembly a draft law or amendment, or has adopted the adequate regulatory framework, for implementing	<ul style="list-style-type: none"> All the personnel from the secretariats of health and of public security (<i>segurança</i>) are fully documented within the new HR system All promotions and transfers 	<ul style="list-style-type: none"> Personnel receives appropriate training and incentives Managers can identify appropriate personnel for tasks, through active use of a

Objectives	Strategy	Tranche I Prior Actions	Tranche II Conditions	Results Indicators	Expected Outcomes in the medium term
			management processes for human resources aimed at allowing workforce planning, career management and extension of merit based promotion performance management systems	for the secretariats of health and public security (<i>segurança</i>) are through a transparent merit based selection	workforce planning system.
Tax Administration Increase State revenue performance	Improve tax administration effectiveness	The State of Bahia has implemented a data sharing agreement with the National Tax Department (<i>Receita Federal</i>) to enhance efficiency in tax revenue collection in the State by gaining access to information on taxpayer's donations, inheritances and assets to facilitate identification of fiscal evasion related to taxes on said donations, inheritances and assets The State of Bahia's Secretariat of Finance has defined the term of reference of an assessment of its tax arrears.	The State of Bahia has cross-checked data based on the access to taxpayer information on donations, inheritances, and assets, and assessed taxpayers with incongruent tax fillings; And as a result of assessment has taken action to collect overdue tax	<ul style="list-style-type: none"> • Tax arrears collection as a percentage of tax revenue Baseline in 2010: 1.02 % Target for December 2014: 1.8% 	Increased tax revenue and tax compliance
PPPs Improve the institutional framework for Private Sector participation through Public Private Partnerships (PPPs)	Implement best practices to take advantage of private sector participation in early project stages (PMI) and efficient contract monitoring	The State of Bahia has issued a decree to regulate the request for private sector participation in early project stages	The State of Bahia has issued a decree that institutes a manual on PPP contract monitoring	<ul style="list-style-type: none"> • At least two private sector participation in early project stage PMI processes are undertaken. • All new contracts signed include a clause requesting that an independent auditor will be contracted to review the contract 	<ul style="list-style-type: none"> • Increased number of projects structured through public private partnership and better contract monitoring.

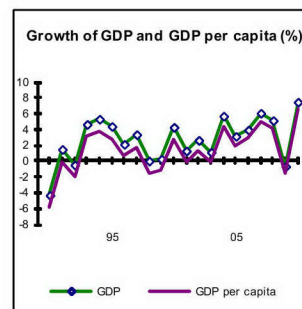
ANNEX 3: COUNTRY AT A GLANCE

Brazil at a glance

Key Development Indicators	Brazil	Latin America & Carib.	Upper middle income
(2010)			
Population, mid-year (millions)	194.9	572	1002
Surface area (thousand sq. km)	8,515	20,394	48,659
Population growth (%)	0.9	1.1	0.9
Urban population (% of total population)	87	79	75
GNI (Atlas method, US\$ billions)	1856.5	4,011	7,515
GNI per capita (Atlas method, US\$)	9,520	7,007	7,502
GNI per capita (PPP, international \$)	10,160	10,286	12,440
GDP growth (%)	7.5	-1.9	-2.6
GDP per capita growth (%)	6.6	-3.0	-3.4
(most recent estimate, 2004–2010)			
Poverty headcount ratio at \$125 a day (PPP, %)	4	8	..
Poverty headcount ratio at \$2.00 a day (PPP, %)	10	17	..
Life expectancy at birth (years)	73	74	72
Infant mortality (per 1000 live births)	17	19	19
Child malnutrition (% of children under 5)	2	4	..
Adult literacy, male (% of ages 15 and older)	90	92	94
Adult literacy, female (% of ages 15 and older)	90	90	91
Gross primary enrollment, male (% of age group)	132	118	111
Gross primary enrollment, female (% of age group)	123	114	110
Access to an improved water source (% of population)	97	93	95
Access to improved sanitation facilities (% of population)	80	79	84



Net Aid Flows	1980	1990	2000	2010 ^a
<i>(US\$ millions)</i>				
Net ODA and official aid	85	151	231	338
<i>Top 3 donors (in 2008):</i>				
Germany	48	31	49	196
Spain	0	0	6	65
France	9	19	24	47
Aid (% of GNI)	0.0	0.0	0.0	0.0
Aid per capita (US\$)	1	1	1	2
Long-Term Economic Trends				
Consumer prices (annual % change)	..	421.2	6.2	5.1
GDP implicit deflator (annual % change)	87.3	2,735.5	6.2	8.3
Exchange rate (annual average, local per US\$)	0.0	0.0	18	18
Terms of trade index (2000 = 100)	78	88	100	113
Population, mid-year (millions)	121.7	149.7	174.4	194.9
GDP (US\$ millions)	235,025	461,952	644,452	2,119,311
<i>(% of GDP)</i>				
Agriculture	11.0	8.1	5.6	5.8
Industry	43.8	38.7	27.7	26.8
Manufacturing	33.5	25.3	17.2	16.7
Services	45.2	53.2	66.7	67.4
Household final consumption expenditure	69.7	59.3	64.3	59.6
General gov't final consumption expenditure	9.2	19.3	19.2	21.1
Gross capital formation	23.3	20.2	18.3	20.2
Exports of goods and services	9.1	8.2	10.0	10.9
Imports of goods and services	11.3	7.0	11.7	11.9
Gross savings	..	18.9	14.0	17.5



1980–90 1990–2000 2000–10
(average annual growth %)

Population, mid-year (millions)	2.1	1.5	1.1
GDP (US\$ millions)	2.7	2.7	3.7
<i>(% of GDP)</i>			
Agriculture	2.8	3.6	3.7
Industry	2.0	2.4	2.8
Manufacturing	..	2.0	2.5
Services	3.5	2.5	3.9
Household final consumption expenditure	1.2	3.7	3.9
General gov't final consumption expenditure	7.3	1.0	3.3
Gross capital formation	3.3	4.2	4.7
Exports of goods and services	7.5	5.9	6.4
Imports of goods and services	0.5	11.6	8.5
Gross savings	..	18.9	14.0

Note: Figures in *italics* are for years other than those specified. 2010 data are preliminary. Group data are for 2009. .. indicates data are not available. a. Aid data are for 2009.

Development Economics, Development Data Group (DECDG).

Balance of Payments and Trade 2000 2010*(US\$ millions)*

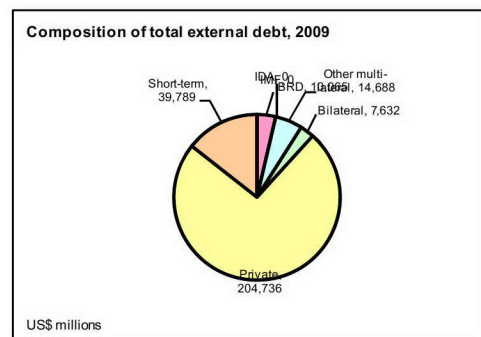
Total merchandise exports (fob)	55,086	201,915
Total merchandise imports (cif)	55,783	181,694
Net trade in goods and services	-7,860	-10,586
Current account balance as a % of GDP	-24,225	-47,365
	-3.8	-2.2
Workers' remittances and compensation of employees (receipts)	1,649	4,234
Reserves, including gold	33,011	288,575

Central Government Finance*(% of GDP)*

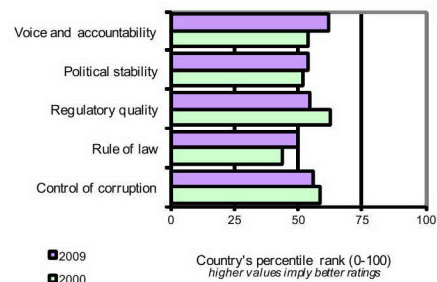
Current revenue (including grants)	16.5	25.0
Tax revenue	14.7	19.2
Current expenditure	18.7	20.4
Overall surplus/deficit	-2.1	-2.2
Highest marginal tax rate (%)		
Individual	28	28
Corporate	37	34

External Debt and Resource Flows*(US\$ millions)*

Total debt outstanding and disbursed	241,550	346,978
Total debt service	64,843	45,806
Debt relief (HIPC, MDR)	-	-
Total debt (% of GDP)	37.5	16.2
Total debt service (% of exports)	93.5	18.8
Foreign direct investment (net inflows)	32,779	25,949
Portfolio equity (net inflows)	3,076	37,071

**Private Sector Development** 2000 2010

Time required to start a business (days)	-	120
Cost to start a business (% of GNI per capita)	-	7.3
Time required to register property (days)	-	42
Ranked as a major constraint to business (% of managers surveyed who agreed)	2000	2010
Tax rates	84.5	..
Access to/cost of financing	84.3	..
Stock market capitalization (% of GDP)	35.1	72.2
Bank capital to asset ratio (%)	12.1	9.1

Governance indicators, 2000 and 2009

Source: Kaufmann-Kraay-Mastruzzi, World Bank

Technology and Infrastructure 2000 2009

Paved roads (% of total)	5.5	..
Fixed line and mobile phone subscribers (per 100 people)	31	111
High technology exports (% of manufactured exports)	18.6	13.9

Environment

Agricultural land (% of land area)	31	31
Forest area (% of land area)	64.5	61.4
Terrestrial protected areas (% of land area)	..	..
Freshwater resources per capita (cu. meters)	30,247	28,498
Freshwater withdrawal (billion cubic meters)	59.3	58.1
CO2 emissions per capita (mt)	1.9	1.9
GDP per unit of energy use (2005 PPP \$ per kg of oil equivalent)	7.3	7.4
Energy use per capita (kg of oil equivalent)	1,086	1,295

World Bank Group portfolio 2000 2009*(US\$ millions)*

IBRD		
Total debt outstanding and disbursed	7,377	10,065
Disbursements	1,692	1,274
Principal repayments	887	1,872
Interest payments	464	359
IDA		
Total debt outstanding and disbursed	-	-
Disbursements	-	-
Total debt service	-	-
IFC (fiscal year)		
Total disbursed and outstanding portfolio of which IFC own account	2,146	3,178
Disbursements for IFC own account	1,157	2,082
Portfolio sales, prepayments and repayments for IFC own account	111	143
MIGA		
Gross exposure	706	248
New guarantees	315	0

Note: Figures in italics are for years other than those specified. 2010 data are preliminary.
.. indicates data are not available. - indicates observation is not applicable.

10/00

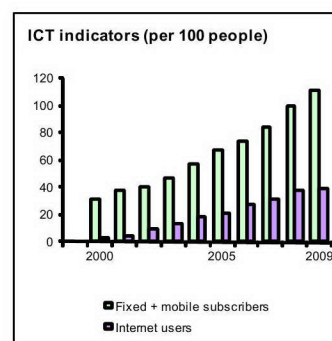
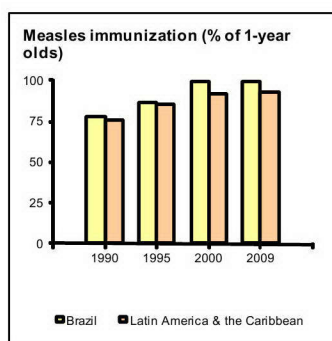
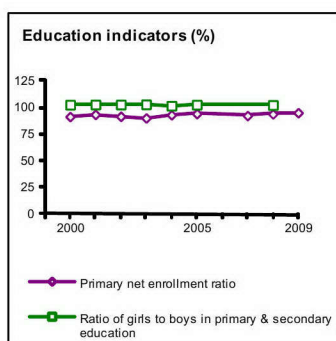
Development Economics, Development Data Group (DECDG).

Millennium Development Goals

Brazil

With selected targets to achieve between 1990 and 2015
(estimate closest to date shown, +/- 2 years)

	Brazil			
	1990	1995	2000	2009
Goal 1: halve the rates for extreme poverty and malnutrition				
Poverty headcount ratio at \$125 a day (PPP, % of population)	15.5	12.0	11.0	3.8
Poverty headcount ratio at national poverty line (% of population)	41.9	35.2	35.2	21.4
Share of income or consumption to the poorest quintile (%)	2.4	2.6	2.7	3.3
Prevalence of malnutrition (% of children under 5)	..	4.5	..	2.2
Goal 2: ensure that children are able to complete primary schooling				
Primary school enrollment (net, %)	..	..	92	95
Primary completion rate (% of relevant age group)	93	90	108	106
Secondary school enrollment (gross, %)	..	..	104	90
Youth literacy rate (% of people ages 15-24)	..	..	94	98
Goal 3: eliminate gender disparity in education and empower women				
Ratio of girls to boys in primary and secondary education (%)	..	..	103	103
Women employed in the nonagricultural sector (% of nonagricultural employment)	35	39	40	42
Proportion of seats held by women in national parliament (%)	5	7	6	9
Goal 4: reduce under-5 mortality by two-thirds				
Under-5 mortality rate (per 1000)	59	48	36	19
Infant mortality rate (per 1000 live births)	50	41	31	17
Measles immunization (proportion of one-year olds immunized, %)	78	87	99	99
Goal 5: reduce maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	120	98	79	58
Births attended by skilled health staff (% of total)	72	88	96	97
Contraceptive prevalence (% of women ages 15-49)	59	77	..	80
Goal 6: halt and begin to reverse the spread of HIV/AIDS and other major diseases				
Prevalence of HIV (% of population ages 15-49)	..	..	..	..
Incidence of tuberculosis (per 100,000 people)	84	71	60	45
Tuberculosis case detection rate (% of all forms)	60	79	74	86
Goal 7: halve the proportion of people without sustainable access to basic needs				
Access to an improved water source (% of population)	88	91	93	97
Access to improved sanitation facilities (% of population)	69	72	75	80
Forest area (% of land area)	68.0	..	64.5	61.4
Terrestrial protected areas (% of land area)	..	..	..	..
CO2 emissions (metric tons per capita)	14	17	19	19
GDP per unit of energy use (constant 2005 PPP \$ per kg of oil equivalent)	7.7	7.8	7.3	7.4
Goal 8: develop a global partnership for development				
Telephone mainlines (per 100 people)	6.3	8.2	17.8	21.4
Mobile phone subscribers (per 100 people)	0.0	0.8	13.3	89.8
Internet users (per 100 people)	0.0	0.1	2.9	39.2
Personal computers (per 100 people)	0.3	1.7	4.9	16.1



Note: Figures in italics are for years other than those specified. .. indicates data are not available.

10/00

Development Economics, Development Data Group (DECDG).

ANNEX 4: FISCAL AND DEBT SUSTAINABILITY ANALYSIS

Introduction

1. **The fiscal situation of the state of Bahia benefited from a favorable economic environment in Brazil and worldwide in the years preceding the global financial crisis.** Fiscal balances were then negatively affected by the global financial crisis in 2008 but Bahia's total revenues recovered fast thereafter.
2. **Bahia has been able to meet fiscal targets established by the Fiscal Responsibility Law (FRL) since 2004.** The existing stock of debt has been decreasing in proportion to its revenues since 2004 and is comfortably within the limit set by the FRL. Bahia has been gradually incorporating sound budget and public finance management practices in order to generate sustainable balanced budgets.
3. **The projected fiscal and debt paths for the state of Bahia are deemed sustainable in the medium-term, even under the worst-case scenarios.** Debt levels are forecast to decline sharply between 2010 and 2016 while annual budget balances will increase. Debt restructuring supported by the World Bank operation in 2012 will reduce debt service in the medium term which is projected to remain well below the limit established by the FRL indicators.

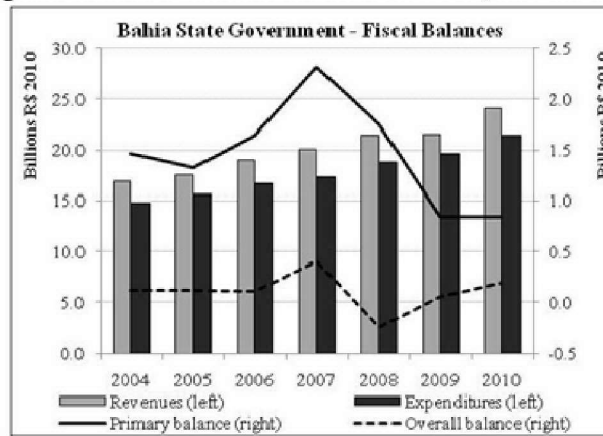
A 4-1 Fiscal analysis of the State of Bahia

Evolution of Fiscal Balances, 2004-2011

4. **Fiscal balances benefited from strong economic growth as well as increased efficiency in revenue collection from 2004 to 2008.** Following the debt renegotiation with the Federal Government and the adoption of the Fiscal Responsibility Law in 2000, the Government's strategy was to rapidly pay down the existing stock of debt. This involved building up the Gross Operating Balance³⁵ with revenues growing faster than expenditures in a context of: (i) GDP growth rate in Bahia higher than the national average which markedly increased the tax base of the State; (ii) the successful implementation of a modernization of tax administration through the PROMOSEFAZ program from 2001 to 2004 which increased the state capacity to collect revenues; and (iii) the favorable effects of the inflation and exchange rate indices on tax collection.
5. **The 2008 global financial crisis led to a reduction of fiscal balances.** During the global financial crisis, Bahia experienced a drop in the primary balance. Overall revenues fell sharply during the period whereas expenditures kept growing. After the financial turmoil, Bahia's primary balance stopped declining but remained at lower level (see figure A4.1).

³⁵ Revenues minus current expenses

Figure A4.1 Evolution of Fiscal Balances, Bahia State

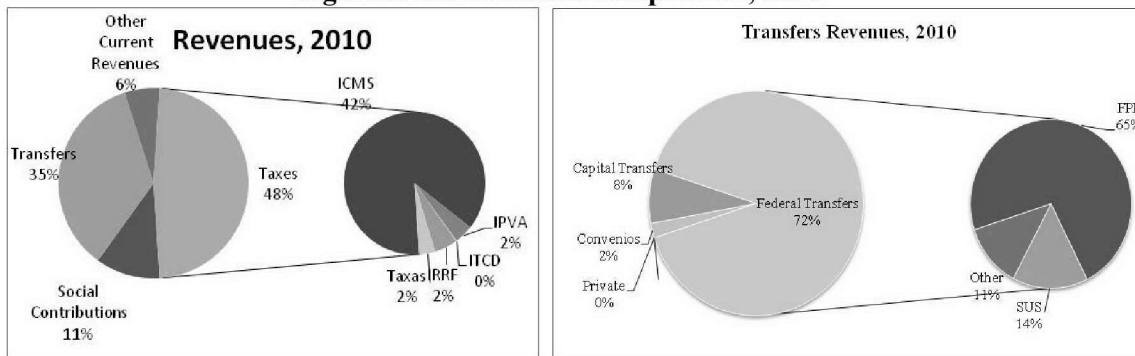


Source: SEFAZ, WB Calculations

Evolution of Fiscal Revenues, 2004-2011

6. Bahia state’s revenues are composed largely of taxes (48 percent in 2010), transfers (35 percent), and social contributions (11 percent). Tax revenues are derived mainly from ICMS (a tax similar to VAT on goods and services), highly correlated with nominal GDP growth (See figure A4.2). Transfer revenues are driven by transfers from the Federal Government (FPE) and financing agreements (*convênios*) in health and education. Roughly half of the inter-Governmental transfers received are derived from FPE, the state’s participation fund based on a sharing rule of federal revenues (Figure A4.2). Transfer revenues dedicated to health service delivery (SUS, Unified Health System) represented 14 percent of overall transfer revenues in 2010.

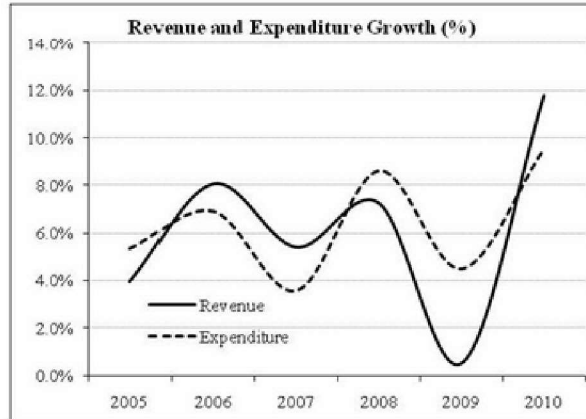
Figure A4.2: Revenues Composition, 2010



Source: SEFAZ, WB Calculations

7. Bahia’s total revenues grew at an average of 6.2 percent in real terms during 2005-2008 due to a good performance in revenue collection. The state’s economy was quite affected by the global financial crisis in 2008 as overall revenues fell sharply after 2008 but recovered rapidly in 2010 (see figure A4.3). Total revenues grew at an average of 6.2 percent in real terms during 2005-2008 due to a good performance in revenue collection. After experiencing almost zero growth in revenue collection in 2009; total revenues grew at 11.8 percent in 2010.

Figure A4.3 Evolution of Fiscal Revenues and Expenditures, Bahia State



Source: SEFAZ, WB Calculations

8. **Tax revenues grew rapidly over the period 2006-2008 and rebounded quickly from the crisis to grow 12 percent in real terms in 2010.** Tax revenues expanded rapidly during the pre-crisis period driven by 8 percent annual GDP growth rate (Figure A4.3 above). With the global crisis, the decline in economic activity and industrial production led to a drop in tax revenues of 0.5 percent in 2009. As GDP fell (-0.6 percent) and industrial value added contracted (-6.7 percent), ICMS declined by -4.5 percent. Tax revenues were however able to recover quickly to reach a 12 percent growth rate in 2010. As a result of the positive performance of the Bahian economy, as well as measures to increase tax efficiency, ICMS grew by 13 percent in 2010.

9. **The InterGovernmental fiscal arrangements of the State of Bahia with its municipalities and with the Federal Government are deemed adequate for the purpose of this DPL.** Transfers expenditures to municipalities are rule-based and represent a fixed amount of 25 percent of ICMS revenues and 50 percent of IPVA revenues. Transfers to municipalities remained stable at around 20 percent of Bahia's Net Current Revenues (Table A4.1). Bahia is a net contributor to FUNDEB: the State of Bahia provided up to R\$2.7 and received the amount of R\$1.9bn in 2010.

10. **Current transfers from the Federal Government have remained stable in terms of Net Current Revenues since 2005, however the share of FPE as a function of tax collection has been volatile.** FPE, the main component of the federal transfers (see Figure A4.3 above), remained stable at around 28 percent of NCR from 2004 to 2010 (Table A4.2). Although, Bahia's dependency on the Federal Government has been rising over time: while FPE transfers represented 34 percent of ICMS tax revenues in 2004, this ratio went up to 41 percent in 2010 and as varied depending on tax collection. Indeed, the state of Bahia was the biggest beneficiary of FPE in Brazil in 2010 (9.4 percent). In the medium-term, the distribution rule of FPE might change. For Bahia a lower share might put pressure on public revenues. Transfers from SUS have increased due to mandated legal increases. Other current revenues have been increasing by 17 percent over the period from 2004 to 2010.

Table A4.1 Transfer Revenue Composition 2004-2010

	Percentage of Net Current Revenues (NCR)						
	2004	2005	2006	2007	2008	2009	2010
Transfers revenues	34.0%	42.7%	43.5%	42.2%	42.8%	44.5%	43.1%
Current transfers	32.1%	42.4%	42.8%	41.4%	42.0%	41.6%	39.7%
FPE	24.8%	27.3%	28.9%	27.6%	29.6%	29.0%	26.4%
Other	7.4%	15.2%	14.0%	13.8%	12.3%	12.7%	13.3%
Capital transfers	1.9%	0.3%	0.7%	0.8%	0.8%	2.8%	3.4%
Transfers expenditures	21.1%	20.4%	20.3%	19.3%	19.5%	19.1%	19.3%
Municipalities	20.9%	20.2%	20.1%	19.1%	19.3%	18.4%	18.6%
Compensação Financ. entre Regimes Previd	0.3%	0.2%	0.2%	0.2%	0.2%	0.7%	0.7%

Source: SEFAZ, WB calculations

11. From January to August 2011, the State of Bahia had a favorable evolution of current revenues. Current revenues reached 10 percent higher than in the same period of 2010, due to significant growth of ICMS receipts from industrial taxpayers (+347.7 percent) and agricultural taxpayers (+85.2 percent). Good revenue performance was driven by an increase in ITCD revenues (+27 percent) and IPVA revenues (+15 percent). ICMS representing 85 percent of tax revenues increased by 7.2 percent in the first eight months of 2011 compared to the same period in 2010. The increase in transfers was mostly from IPI transfers (a Compensation Fund for Exports of Industrialized Products) (+41.6 percent), FPE (+28.4 percent) and royalties (+19.2 percent). However capital revenues decreased by 44.1 percent in the first eight months of 2011 compared to the same period in 2010 driven by a reduction in credit operations (-63.1 percent) and capital transfers (-39.2 percent). As a result of increasing current revenues during the first eight months of 2011, the total budget was 31.1 percent higher compared to the first eight months of 2010 (see table A4.2).

Table A4.2 Bahia State Revenues and Expenditures, January-August 2011

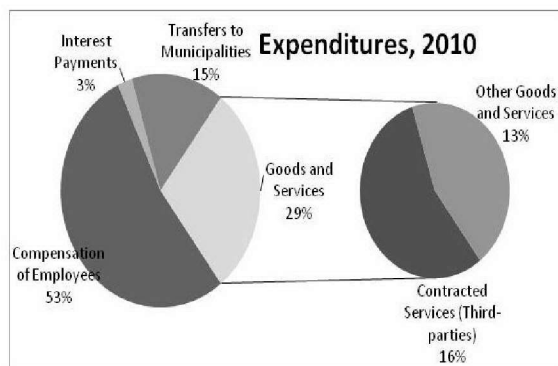
Current R\$ Thousands	Accumulated figures (Jan-August)		Nominal Variation
	2010	2011	
Total Revenues	16,186,024.00	17,421,963.00	7.6%
Current Revenue	15,482,378	17,028,615	10.0%
Taxes	8,462,867	9,190,578	8.6%
Patrimonial	362,083	266,985	-26.3%
Transfers	5,790,593	6,795,810	17.4%
Other current	6,657,428	7,571,052	13.7%
Capital revenues	703,647	393,347	-44.1%
Total Expenditure	15,265,964	16,215,813	6.2%
Current expenditure	13,382,090	14,473,049	8.2%
Personnel and social contributions	7,214,918	7,947,957	10.2%
Other current	5,848,872	6,212,348	6.2%
Interest payments	312,745	317,299	1.5%
Capital expenditure	1,883,874	1,742,763	-7.5%
Investments	1,121,740	856,912	-23.6%
Financial investment	166,571	285,262	71.3%
Debt amortization	595,563	600,590	0.8%
Gross Operating balance	920,060	1,206,150	31.1%
Primary Surplus	1,464,520	1,931,254	31.9%

Source: Secretaria da Fazenda

Evolution of Expenditures, 2004-2011

12. **Bahia's current expenditures are mainly composed of compensation of employees (53 percent), goods and services (29 percent), and constitutionally-mandated transfers to municipalities (15 percent).** As such, most of the expenditures are non-discretionary³⁶, with expenditure on goods and services being the most flexible. In the context of the FRL, Bahia reduced by half its Net Consolidated Debt from 2000 to 2010. As a result, interest payments account for only 3 percent of expenditures in 2010 (Figure A4.4).

Figure A4.4: Bahia State Current Expenditures, 2010



Source: SEFAZ, WB Calculations

13. **The 2010 budget was 12 percent larger than in 2009 due to stronger revenue performance.** The increase in expenditures was mostly in investment and goods and services (in the other current expenditure category in Table A4.3 below). In 2010, expenditures in goods and services grew at a real rate of 23 percent, largely driven by increased investment. Increased consumption of third-party contracted services also resulted in higher expenditures in the other current expenditures category. Social contributions also grew due to a mandated increase of the state's employer's share between 2004 and 2005. Fiscal aggregates for the first semester of 2011 indicate an improvement of the situation that is also driven by lower investment. The higher fiscal space is due to a greater increase in current revenues than in expenditures. The primary surplus expanded by 31.9 percent in the first eight months of 2011 compared to the previous year.

³⁶ Brazilian legislation foresees very few situations where the Government can lay off public servants.

Table A4.3: Evolution of GFS Fiscal Accounts, Bahia State, 2004-2010

Millions 2010 RS	2004	2005	2006	2007	2008	2009	2010
I REVENUE	16,908	17,578	18,995	20,022	21,473	21,581	24,122
Taxes	9,671	9,643	10,533	11,066	12,027	11,481	12,877
Social Contributions	1,440	1,890	2,226	2,367	2,566	2,723	2,929
Transfers	3,221	4,545	4,899	5,239	5,779	6,235	6,734
Other Current Revenues	2,576	1,500	1,337	1,351	1,101	1,142	1,582
	-	-	-	-	-	-	-
II EXPENSE	14,816	15,611	16,693	17,291	18,783	19,630	21,502
Compensation of Employees	7,526	7,942	8,947	9,480	10,363	11,121	11,470
Interest Payments	758	754	727	670	624	556	510
Other Current Expenditures	6,533	6,916	7,019	7,141	7,796	7,953	9,522
III GROSS OPERATING BALANCE (I - II)	2,092	1,966	2,303	2,731	2,690	1,951	2,620
% of NCR	17.3%	15.1%	16.6%	18.5%	17.1%	12.6%	15.1%
IV TRANSACTIONS IN NON-FINANCIAL ASSETS	1,380	1,391	1,380	1,074	1,563	1,667	2,294
Investment in Non-Financial Assets	1,147	1,273	1,279	965	1,345	1,408	2,046
% of NCR	9.5%	9.8%	9.2%	6.6%	8.5%	9.1%	11.8%
Investment in Financial Assets	233	119	101	109	219	260	248
V NET LENDING / BORROWING (III - IV)	712	575	923	1,656	1,127	283	326
% of NCR	5.9%	4.4%	6.6%	11.2%	7.2%	1.8%	1.9%
VI PRIMARY BALANCE (V + Net Interest Payments)	1,470	1,329	1,650	2,326	1,751	840	836
% of NCR	12.2%	10.2%	11.9%	15.8%	11.1%	5.4%	4.8%
VII TRANSACTIONS IN FINANCIAL ASSETS AND LIABILITIES	(596)	(451)	(810)	(1,248)	(1,375)	(223)	(131)
New Loans	419	320	472	188	147	1,046	652
Amortizations, net	(1,068)	(1,080)	(1,299)	(1,439)	(1,536)	(1,274)	(796)
Asset sales	53	309	18	3	14	5	13
VIII GROSS FINANCING NEEDS (Net Debt Service - VI)	356	505	376	(217)	409	990	470
% of NCR	2.9%	3.9%	2.7%	-1.5%	2.6%	6.4%	2.7%
VIII OVERALL BALANCE (VI + VII)	116	125	113	408	(248)	60	195
% of NCR	1.0%	1.0%	0.8%	2.8%	-1.6%	0.4%	1.1%
<i>Memo Items:</i>							
Net Current Revenue (NCR)	12,090	13,020	13,883	14,724	15,729	15,538	17,373
Non-Financial Investment / NCR	9.5%	9.8%	9.2%	6.6%	8.5%	9.1%	11.8%

Sources: SEFAZ, WB Calculations

14. **Investment expenditure has been rising in recent years.** Following a decline in investment as a proportion of revenue between 2004 and 2007, the downward trend was reversed as investment rose from 6.6 percent of revenue in 2007 to 11.8 percent in 2010 (see table A4.3).

Table A4.3: Evolution of GFS Fiscal Accounts, Bahia State, 2004-2010

Millions 2010 RS	2004	2005	2006	2007	2008	2009	2010
I REVENUE	16,908	17,578	18,995	20,022	21,473	21,581	24,122
Taxes	9,671	9,643	10,533	11,066	12,027	11,481	12,877
Social Contributions	1,440	1,890	2,226	2,367	2,566	2,723	2,929
Transfers	3,221	4,545	4,899	5,239	5,779	6,235	6,734
Other Current Revenues	2,576	1,500	1,337	1,351	1,101	1,142	1,582
-	-	-	-	-	-	-	-
II EXPENSE	14,816	15,611	16,693	17,291	18,783	19,630	21,502
Compensation of Employees	7,526	7,942	8,947	9,480	10,363	11,121	11,470
Interest Payments	758	754	727	670	624	556	510
Other Current Expenditures	6,533	6,916	7,019	7,141	7,796	7,953	9,522
III GROSS OPERATING BALANCE (I - II)	2,092	1,966	2,303	2,731	2,690	1,951	2,620
% of NCR	17.3%	15.1%	16.6%	18.5%	17.1%	12.6%	15.1%
IV TRANSACTIONS IN NON-FINANCIAL ASSETS	1,380	1,391	1,380	1,074	1,563	1,667	2,294
Investment in Non-Financial Assets	1,147	1,273	1,279	965	1,345	1,408	2,046
% of NCR	9.5%	9.8%	9.2%	6.6%	8.5%	9.1%	11.8%
Investment in Financial Assets	233	119	101	109	219	260	248
V NET LENDING / BORROWING (III - IV)	712	575	923	1,656	1,127	283	326
% of NCR	5.9%	4.4%	6.6%	11.2%	7.2%	1.8%	1.9%
VI PRIMARY BALANCE (V + Net Interest Payments)	1,470	1,329	1,650	2,326	1,751	840	836
% of NCR	12.2%	10.2%	11.9%	15.8%	11.1%	5.4%	4.8%
VII TRANSACTIONS IN FINANCIAL ASSETS AND LIABILITIES	(596)	(451)	(810)	(1,248)	(1,375)	(223)	(131)
New Loans	419	320	472	188	147	1,046	652
Amortizations, net	(1,068)	(1,080)	(1,299)	(1,439)	(1,536)	(1,274)	(796)
Asset sales	53	309	18	3	14	5	13
VIII GROSS FINANCING NEEDS (Net Debt Service - VI)	356	505	376	(217)	409	990	470
% of NCR	2.9%	3.9%	2.7%	-1.5%	2.6%	6.4%	2.7%
VIII OVERALL BALANCE (VI + VII)	116	125	113	408	(248)	60	195
% of NCR	1.0%	1.0%	0.8%	2.8%	-1.6%	0.4%	1.1%
<i>Memo Items</i>							
Net Current Revenue (NCR)	12,090	13,020	13,883	14,724	15,729	15,538	17,373
Non-Financial Investment / NCR	9.5%	9.8%	9.2%	6.6%	8.5%	9.1%	11.8%

Sources: SEFAZ, WB Calculations

15. **In the first eight months of 2011, total expenditures increased by 6 percent.** The 8 percent increase in current expenditures compared to the same period in 2010 was mainly driven by higher personnel and other current expenditures that increased by 10.2 percent and 6.2 percent respectively. The increase in the personnel expenditures reflect a July 2010 increase in public servants salaries. Investment decreased by 23.6 percent compared to the previous year. As such, the DPL will help the Government maintain its priority expenditures especially in social sectors.

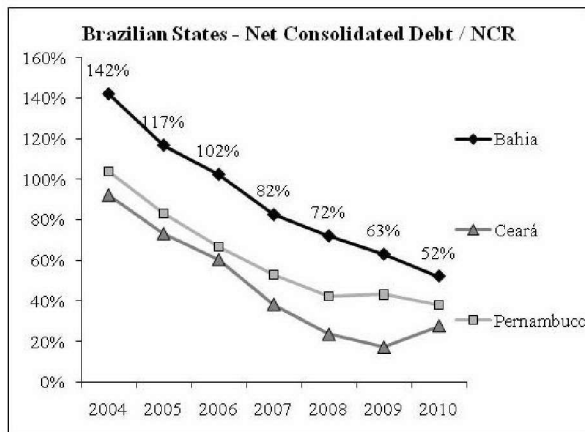
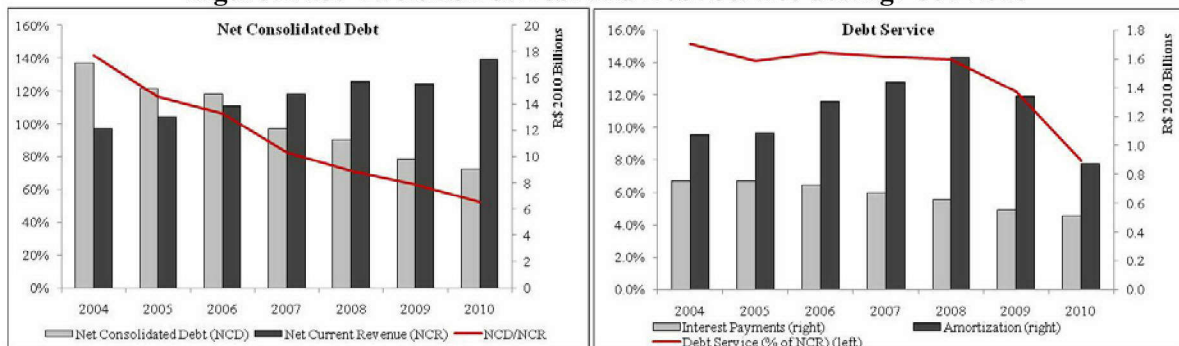
Evolution of Net Consolidated Debt, 2004-2011

16. **Bahia's Net Consolidated Debt has been falling since 2004.** Due to growing fiscal revenues and consistent fiscal adjustments, the net consolidated debt-to-revenue ratio fell steeply from over 140 percent of NCR (See Figure A4.5) in 2004 to 52 percent by 2010, well within the FRL limit of 200 percent (see Figure A4.5 and Table A4.4). Debt relative to current revenues continued to decrease in the first ten months of 2011 compared to 2010. The net consolidated debt-to-revenue ratio stood at 41 percent as of end of October 2011. Debt service³⁷ has been decreasing sharply since 2008 driven by lower interest payments and amortization. Indeed, interest payments have sharply decreased since 2007 while amortization started decreasing in 2009. During the first ten months of 2011, amortization payments and interest payments decreased by 0.9 percent and 1.5 respectively.

³⁷ In 2009, Bahia stopped paying their debt with the federal Government (Lei 9496/97) capped on 13 percent of Net Real Revenue and started paying according to Tabela Price, reducing its commitment to around 8 percent of NRR.

17. **Bahia's contractual debt is largely of short-maturity and is composed mainly of inflation-indexed and dollar-denominated debts.** Bahia's contractual debt totals R\$9.8 billion as of December 31, 2010, a large portion of which is maturing over the next three years. Four-fifths of Bahia's debt stock is owed to the National Treasury and other public institutions, while the remaining 20 percent is owed to multilateral institutions. A large share of its public debt (48 percent) is indexed by inflation; using the wholesale prices indices IGP-DI and IGP-M (see Figure A4.5). As these inflation indices have risen rapidly in the last decades due to their link with the exchange rate, this type of debt has proven to be expensive. Approximately 24 percent of the State's debt is U.S. dollar denominated. TR (*Taxi Referencial*) and UPR (*Unidade Padrao Referencia*) jointly make up approximately 17 percent of the debt. The cheapest debt is that indexed by the TJLP, a subsidized interest rate offered by BNDES.

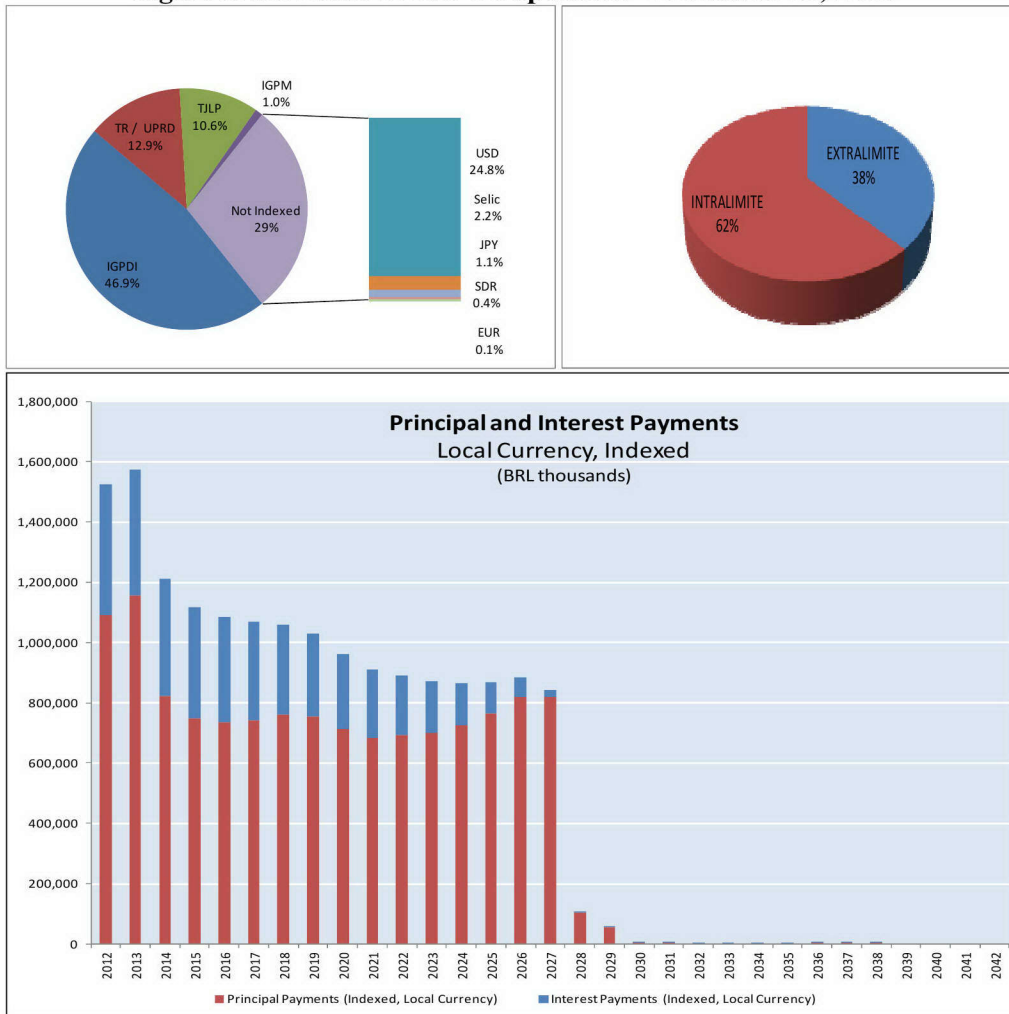
Figure A4.5: Evolution of Debt and Debt Service during 2004-2010



Outstanding Debt as of December 31, 2010		Million RS
Consolidated Debt		10,426
Contractual Debt		9,833
Internal		7,867
External		1,966
Judicial Debt since 05/05/2000 - accrued and unpaid		444
Other Debts		149
Deductions		1,369
Net Consolidated Debt (NCD)		9,057
Net Current Revenue (NCR)		17,373
NCD / NCR		52%

Source: SEFAZ, WB Calculations

Figure A4.6: Bahia's Debt Composition – December 31, 2011



Source: SEFAZ

Evolution of Fiscal Responsibility Indicators, 2004-2010

19. **The State is in solid compliance with the prudential limits set out in the LRF since 2004.** Personnel expenditure has remained stable since 2004 but the Net Consolidated Debt has fallen sharply since 2004 to reach 52 percent in terms of Net Current Revenues in 2010 indicating a sustainable situation on the debt side (see Table A4.3). New loans as a proportion of the net current revenue have not exceeded 7 percent of net current revenues since 2004, well below the legally-imposed limits of 16 percent. The state has also maintained the concession of guarantees under the legally-imposed limits of 22 percent of net current revenue, falling from 3 percent in 2004 to 1 percent in 2010.

Table A4.4 Evolution of Fiscal Responsibility Law during 2004-10

Value in Current Million R\$

Indicators	LEGAL LIMITE %NCR	2004		2005		2006		2007		2008		2009		2010	
		VALUE	% NCR	VALUE	% NCR	VALUE	% NCR	VALUE	% NCR	VALUE	% NCR	VALUE	% NCR	VALUE	% NCR
Personnel expenditures															
Executive	49%	3,747	41%	4,161	40%	4,809	42%	5,378	43%	6,136	43%	6,859	47%	7,501	43%
Legislative	60%	4,366	48%	5,028	49%	5,906	52%	6,601	52%	7,539	53%	8,391	57%	9,128	53%
Net consolidated debt	200%	12,878	142%	12,048	117%	11,616	102%	10,371	82%	10,238	72%	9,235	63%	9,057	52%
Garantees Total	22%	263	3%	180	2%	129	1%	107	1%	105	1%	99	1%	95	1%
Credit Operations Revenues	16%	314	3%	254	2%	386	3%	160	1%	133	1%	988	7%	654	4%
Net Current Revenues (NCR)		9,075		10,329		11,360		12,585		14,238		14,671		17,373	

Source: Sefaz, WB calculations

A 4-2 Fiscal and Debt Sustainability of the State of Bahia

Fiscal Assumptions

20. **The fiscal and debt sustainability analysis is based on:** (i) the current fiscal situation of the State of Bahia, (ii) the outstanding stock of debt; and (iii) the underlying assumptions for the projections of the fiscal balances described in Table A4.5.

Table A4.5 Assumptions for Fiscal Projections

Variables	Assumptions
Base year figures- 2010	
Revenue	
ICMS	Increase with GDP growth and inflation
Motor Vehicle Tax (IPVA)	Increase with GDP growth and inflation
Others	Increase with GDP growth and inflation
Social Contributions	
	Increase with population growth and inflation.
Transfers	
<i>Current Transfers</i>	
State Participation Fund- FPE	Increase with GDP growth and inflation
Convenios	Increase with GDP growth and inflation
Private transfers	Increase with GDP growth and inflation
<i>Capital Transfers</i>	
	Increase with population growth and inflation
Other Current Revenues	
Non financial assets	Increase with GDP growth and inflation
Interest	Increase with inflation
Miscellaneous	Increase with GDP growth and inflation
Expenditures	
Wages	Increase with GDP growth, personnel growth and inflation
Goods and Services	Increase with GDP growth and inflation
Transfers to municipalities	Increase with GDP growth and inflation
Interest payments	Obtained from Debt Department of SEFAZ
Net Acquisition of Non-Financial Assets	Fiscal space defined as the Gross Operating Balance minus amortization and other investments
Amortizations	Obtained from Debt Department of SEFAZ
IBRD Loan	US\$700 millions disbursed in two tranches

Source: SEFAZ, IBGE, WB Calculations

21. **Under the baseline scenario, the fiscal balances of the State of Bahia will evolve as follows:** revenues and expenditure will broadly grow in line with nominal GDP. In particular on the revenue side, we assume that the social security contribution revenues and capital transfers will grow with the population growth rate and the IPCA inflation. On the expenditure side, we assume that the amount of net acquisitions of non-financial assets will be equal to the fiscal space defined as the Gross Operating Balance net of amortization and other investments, while the interest payments profile is given by the Secretary of Finance of the State of Bahia. The fiscal account classification used is the Government Finance Statistics (GFS) system recommended by the IMF. On the debt side, the outstanding stock of debt is indexed by the projected IGP inflation. The fundamental macroeconomic variables that are affecting the paths of the debt and the fiscal projections such as the inflation rate and the nominal GDP growth rate are detailed below in Table A5.6

Table A4.6 Assumptions for Fundamental Macroeconomic Variables

Year	Real GDP Growth		IGP Inflation		IPCA Inflation		Exchange Rate		Personnel Growth	
	Alternative		Alternative		Alternative		Alternative		Alternative	
	Baseline	(Lower)	Baseline	(Higher)	Baseline	(Higher)	Baseline	(Higher)	Baseline	(Higher)
2010	7.5%		11.3%		5.9%		1.66		2.0%	
2011	3.0%	2.7%	5.7%	9.5%	6.5%	7.8%	1.75	1.93	2.0%	3.0%
2012	3.4%	2.3%	5.2%	9.0%	5.6%	6.9%	1.79	2.03	2.0%	3.0%
2013	4.2%	3.1%	5.0%	8.8%	5.0%	6.3%	1.87	2.09	2.0%	3.0%
2014	4.2%	3.1%	5.0%	8.8%	4.8%	6.1%	1.92	2.16	2.0%	3.0%
2015	4.2%	3.1%	5.0%	8.8%	4.7%	6.0%	1.97	2.25	2.0%	3.0%
2016	4.2%	3.1%	5.0%	8.8%	4.7%	6.0%	2.04	2.33	2.0%	3.0%
2017	4.5%	3.1%	5.0%	8.8%	4.7%	6.0%	2.10	2.43	2.0%	3.0%
2018	4.5%	3.1%	5.0%	8.8%	4.7%	6.0%	2.17	2.52	2.0%	3.0%
2019	4.5%	3.1%	5.0%	8.8%	4.7%	6.0%	2.24	2.62	2.0%	3.0%
2020	4.5%	3.1%	5.0%	8.8%	4.7%	6.0%	2.32	2.73	2.0%	3.0%

Source: BCB, EIU, IBGE, WB Staff Calculations

Fiscal Accounts and Debt Projections

22. **Bahia's medium-term and projected fiscal accounts show sustainable trends and the macroeconomic framework is adequate for the purpose of this DPL.** Tax revenues are expected to grow at a regular pace during in 2011-16. On the expenditures side, total expenditures are projected to keep growing in line with revenues growth. Interest payments are expected to decrease starting 2011 as Bahia is paying down its debt very fast. As a result, the Gross Operating Balance will remain stable at around 15 percent of its Net Current Revenues. Investment is expected to decrease in 2011 due to an increase in debt service. However, investment will recover in 2014 to reach 9.4 percent of Bahia's Net Current Revenues (see Table A4.7). This baseline does not consider the Bank loan.

23. **The main risks to a deterioration of fiscal balances over the medium-term horizon are related to ICMS collection, changes in FPE transfers and growth of personnel as well as goods and services expenditures.** On the revenue side, the state of Bahia's revenues rely heavily on ICMS (a VAT tax on goods and services) which is highly dependent on national growth. A decline in transfers from the Federal Government (FPE) representing a high share of Bahia's revenues might also present a risk to Bahia public finance. More importantly, on the expenditure side, maintaining the wage bill and balancing expenditures in goods and services presents a challenge for the State of Bahia in the coming

years. Indeed, salary increases are the main drivers of Government expenses along with goods and services expenditures and are non-discretionary. This suggests the relevance to control current expenditures and salary adjustments to maintain fiscal balance. See Table A4.7, which displays the projections of the fiscal revenues and expenditures as well as the resulting fiscal balances for the period under consideration.

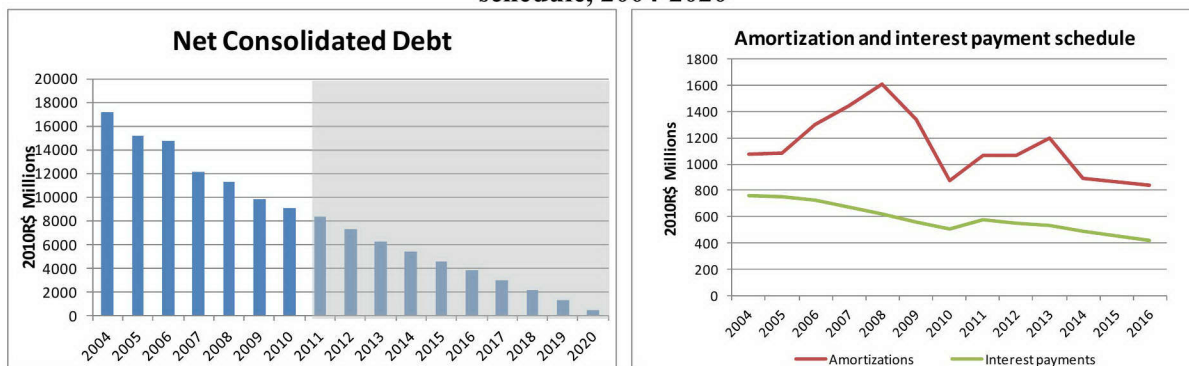
Table A4.7 Fiscal projections, Bahia, 2011-2016

Millions 2010 R\$	Projections						
	2010	2011	2012	2013	2014	2015	2016
I. Total Revenues (I)	24,122.3	24,814.6	25,647.7	26,635.8	27,638.6	28,654.6	29,739.5
Tax Revenues	12,877.0	13,285.8	13,783.2	14,389.5	15,008.2	15,638.5	16,310.9
Social Contributions	2,929.3	2,993.0	3,063.0	3,130.2	3,195.9	3,259.8	3,328.2
Transfers	6,733.7	6,934.9	7,179.2	7,474.5	7,774.9	8,080.1	8,405.9
Current Transfers	6,148.4	6,343.6	6,581.1	6,870.6	7,166.0	7,467.0	7,788.1
Total Capital Transfers	585.2	591.3	598.1	603.9	608.9	613.1	617.8
Other Current Revenues	1,582.4	1,600.9	1,622.3	1,641.6	1,659.6	1,676.2	1,694.6
II. Total Expenditure (II)	21,502.3	22,303.4	23,111.4	24,007.1	24,897.5	25,810.0	26,787.9
Compensation of Employees and Pensions	11,470.4	11,836.8	12,234.8	12,628.4	13,022.2	13,415.4	13,833.8
Interest Payments	510.1	579.5	553.4	532.6	490.4	455.3	421.1
Transfers	3,225.2	3,327.6	3,452.2	3,604.1	3,759.0	3,916.9	4,085.3
Goods and Services	6,296.6	6,559.5	6,870.9	7,242.0	7,625.9	8,022.4	8,447.7
III. Gross Operating Balance (I - II)	2,620.0	2,511.1	2,536.3	2,628.8	2,741.1	2,844.6	2,951.6
% NCR	15.1%	13.9%	13.5%	13.4%	13.4%	13.4%	13.3%
IV. Transactions in Non-Financial Assets	2,046.1	1,447.7	1,469.1	1,428.3	1,851.2	1,974.8	2,111.8
% NCR	11.8%	8.0%	7.8%	7.3%	9.1%	9.3%	9.5%
V. Primary Balance	836.4	1,642.9	1,620.6	1,733.1	1,380.3	1,325.1	1,261.0
% NCR	4.8%	9.1%	8.7%	8.9%	6.8%	6.2%	5.7%
VI. Net Lending / Borrowing (III - IV)	326.3	1,063.4	1,067.2	1,200.5	889.9	869.8	839.9
% NCR	1.9%	5.9%	5.7%	6.1%	4.4%	4.1%	3.8%
<i>Memo item:</i>							
Net Current Revenues (NCR)	17,372.6	18,004.5	18,725.1	19,554.1	20,389.9	21,233.0	22,125.7

24. **Using the Government Finance Statistics (GFS) fiscal classification and the assumptions for the fiscal projections presented in the previous section, the projections of the fiscal accounts of the State of Bahia for 2011-2016 show a sustainable trend.** The fiscal balances, i.e. the primary fiscal balance, the overall balance and the gross operating balance are all expected to record surplus for the projected period. The primary balance is projected to reach 9.1 percent of NCR in 2011 before decreasing in the following years.

25. **The Net Consolidated Debt of the State of Bahia is gradually decreasing over time, remaining largely below the limit set by the Federal Government.** Given the information on the amortization and the interest payments schedule for 2011-2016 (see Figure A4.7), the stock of debt is expected to decrease to reach 17 percent of its Net Current Revenues by 2016 while interest payments are following a downward trend.

Figure A4.7 Evolution of Net Consolidated Debt and amortization and interest payment schedule, 2004-2020

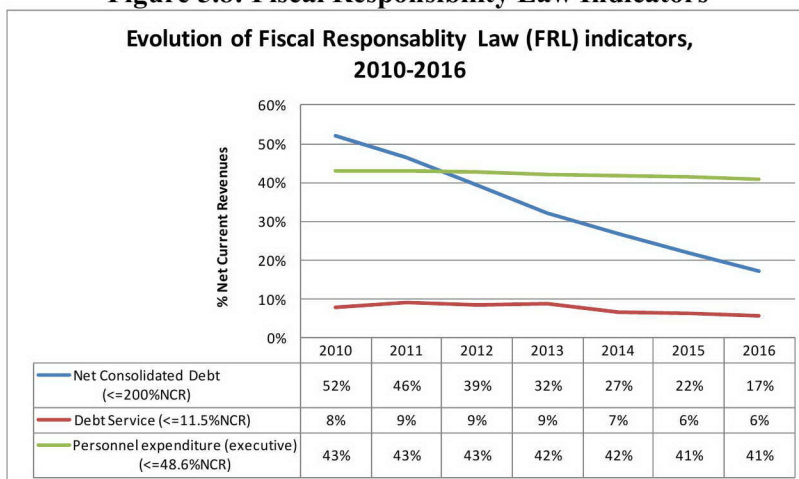


Source: SEFAZ, WB calculations

Fiscal Responsibility Law Indicators Projections

26. **The fiscal and debt sustainability analysis shows a sustainable path for the main Fiscal Responsibility Law indicators for 2011-2016.** Hence, the net consolidated debt per NCR and the debt service as a share of NCR will remain below the limits set by the Federal Government (See Figure A4.8). The Net Consolidated Debt to NCR indicator is expected to decrease by more than 60 percent between 2010 and 2016. Given the amortizations and the interest payments profile, the debt service per NCR follows a downward trend from 2011 onwards.

Figure 5.8: Fiscal Responsibility Law Indicators



Source: SEFAZ, WB calculations

Risk Analysis

27. **The risk analysis assesses the impact of uncertainty surrounding fundamental variables for the state's fiscal outlook.** The main risks that could lead to a deterioration in the state's fiscal balances are related to: (i) fluctuations in macroeconomic variables such as the **exchange** rate, IPCA and IGP inflation, real GDP growth and increased payroll costs; (ii) uncertainty surrounding FPE transfers stemming from federal reform; and (iii) uncertainty surrounding the impact of tax and federal grants reform on revenues. The objective of the analysis is to establish whether any given stochastic shock and simultaneous joint

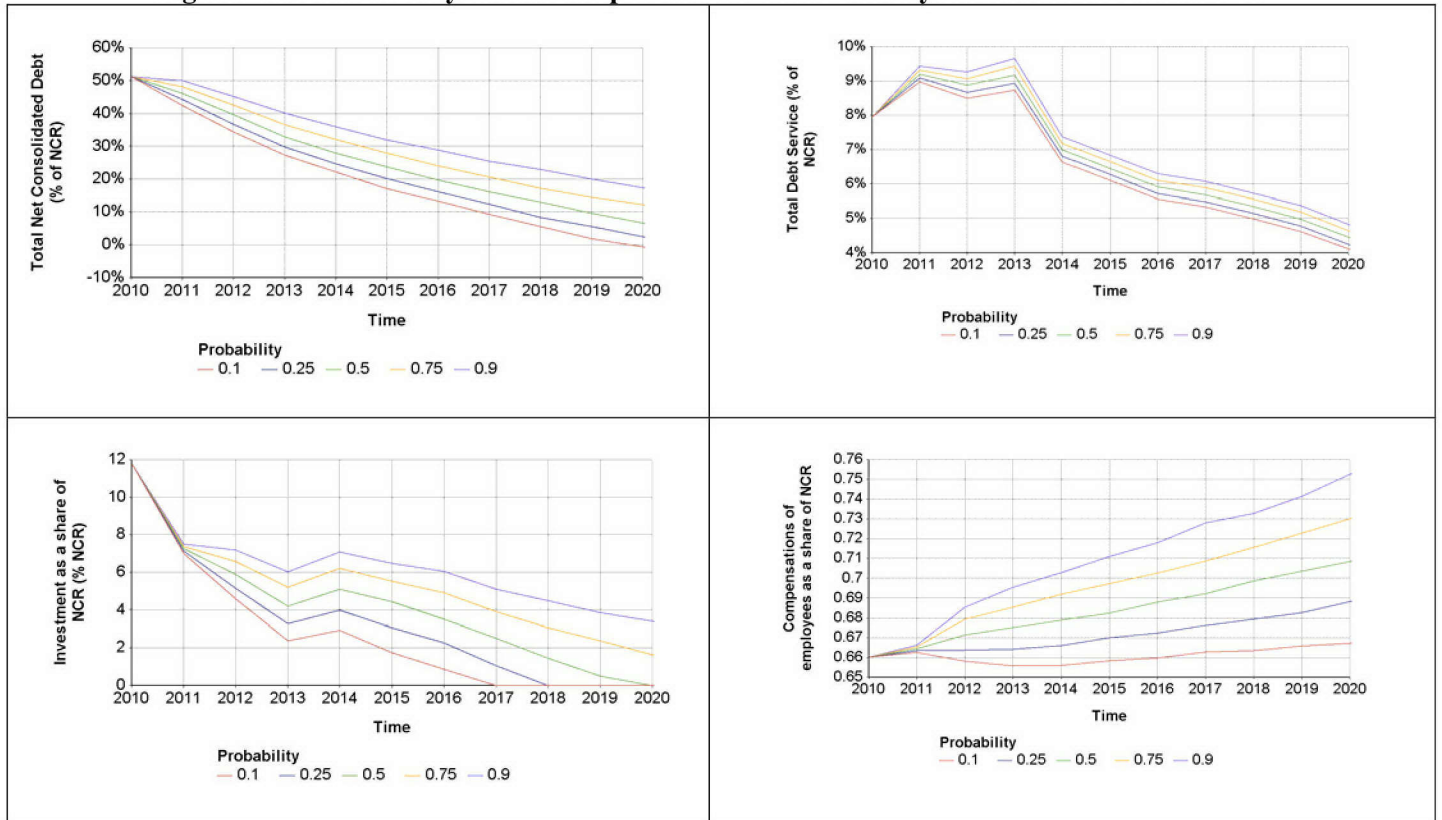
deterministic shocks could have a negative impact on revenues or increase expenditures, and thus compromise fiscal and debt sustainability.

Shocks Resulting from Fluctuations in Macroeconomic Variables

28. **The analysis examines the impact of fluctuations in key macroeconomic variables (the exchange rate, IPCA and IGP inflation, real GDP growth, and personnel growth) on projected fiscal and debt aggregates.** Alternative pessimistic scenarios were modeled for each of the variables, the combined outcome of which produces the joint shock analyzed, painting a highly pessimistic view of the macroeconomic environment. The macroeconomic assumptions underlying the alternative scenarios are found in Table A4.6. The baseline assumptions for the variables are based upon forecasts by the Central Bank of Brazil (BCB), the Economist Intelligence Unit (EIU) and the IMF World Economic Outlook (WEO).

29. **Projected fiscal and debt trends are sustainable in all the scenarios of joint adverse macroeconomic shocks considered.** The pessimistic scenario causes a rise in both **revenues** and expenditures in nominal terms due to the inflation component. Lower growth rates have a large negative impact on current revenues, which increase slower than current expenditures. Higher increases in the workforce are reflected in higher employee compensation expenses, and increases in interest payments due to the deteriorating exchange rate. Nonetheless, despite these adverse effects, both the primary and overall balances remain positive throughout the period, and there is fiscal room for positive state investments. In this scenario, Net Consolidated Debt decreases slowly to reach 21 percent of Net Current Revenues in 2016 compared to 17 percent in the baseline scenario (see figure A4.9).

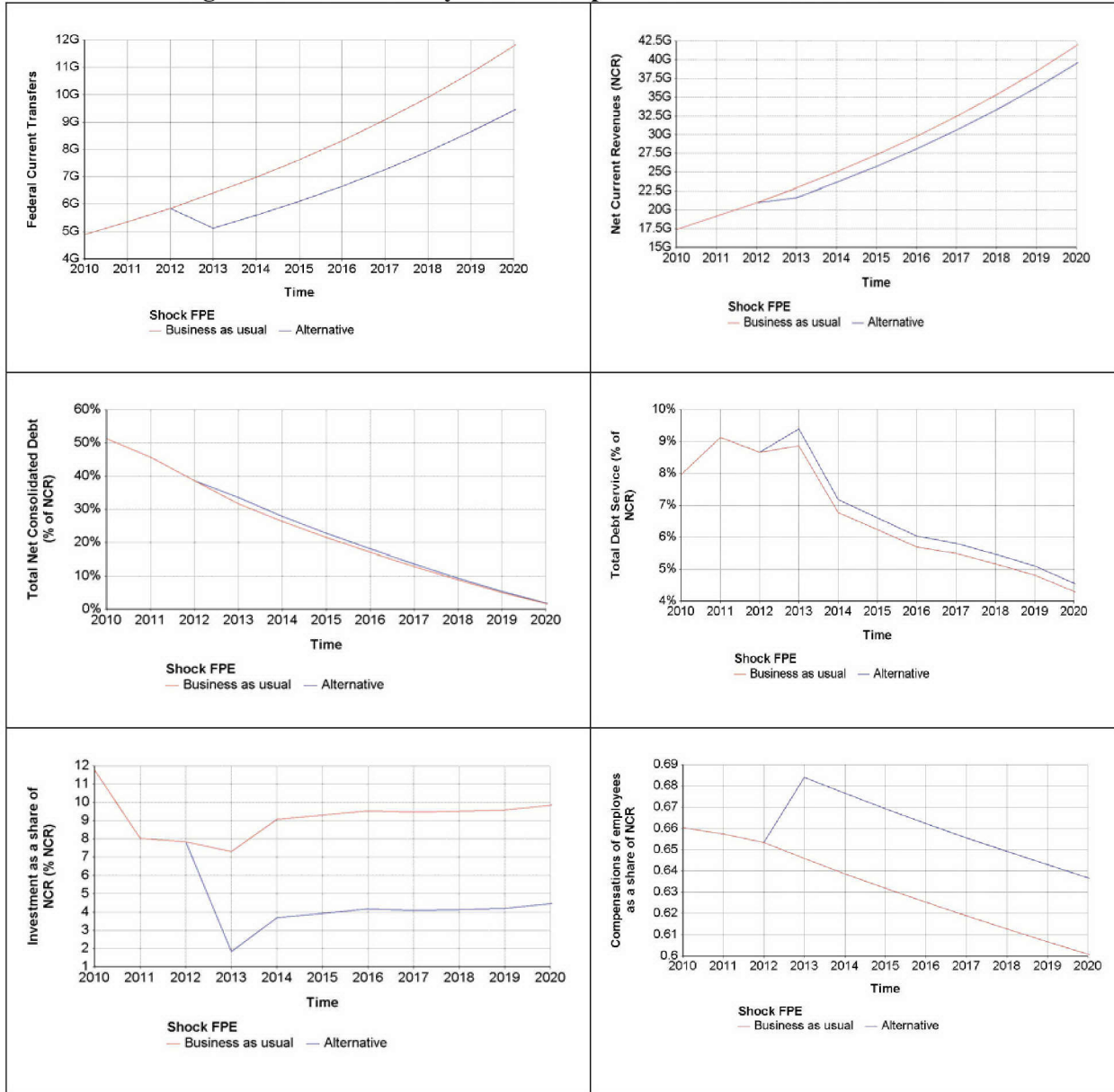
Figure A4.9: Risk Analysis of the impact of fluctuations in key macroeconomic variables



Uncertain FPE

30. **This analysis models the risks associated with uncertain FPE transfers to the state.** Bahia is heavily dependent on FPE transfers as they represented 43 percent of their Net Current Revenues in 2010 (see Figure A4.10). Yet, a large uncertainty surrounds the future of this revenue source given possible changes to the sharing rule applied in the determination of state specific transfer amounts. An alternative scenario is analyzed which assumes a 20 percent reduction in the sharing rule percentage from the baseline level, applied in 2013. This alternative scenario causes a permanent decline in Net Current Revenues. The lower transfers to Bahia are reflected in slightly higher debt level, higher employee compensation expenses and a decline in investment. Nonetheless, despite these adverse effects, both the primary and overall balances remain positive throughout the period.

Figure A4.10 Risk Analysis of the impact of uncertain FPE revenues



Source: WB Staff Estimates

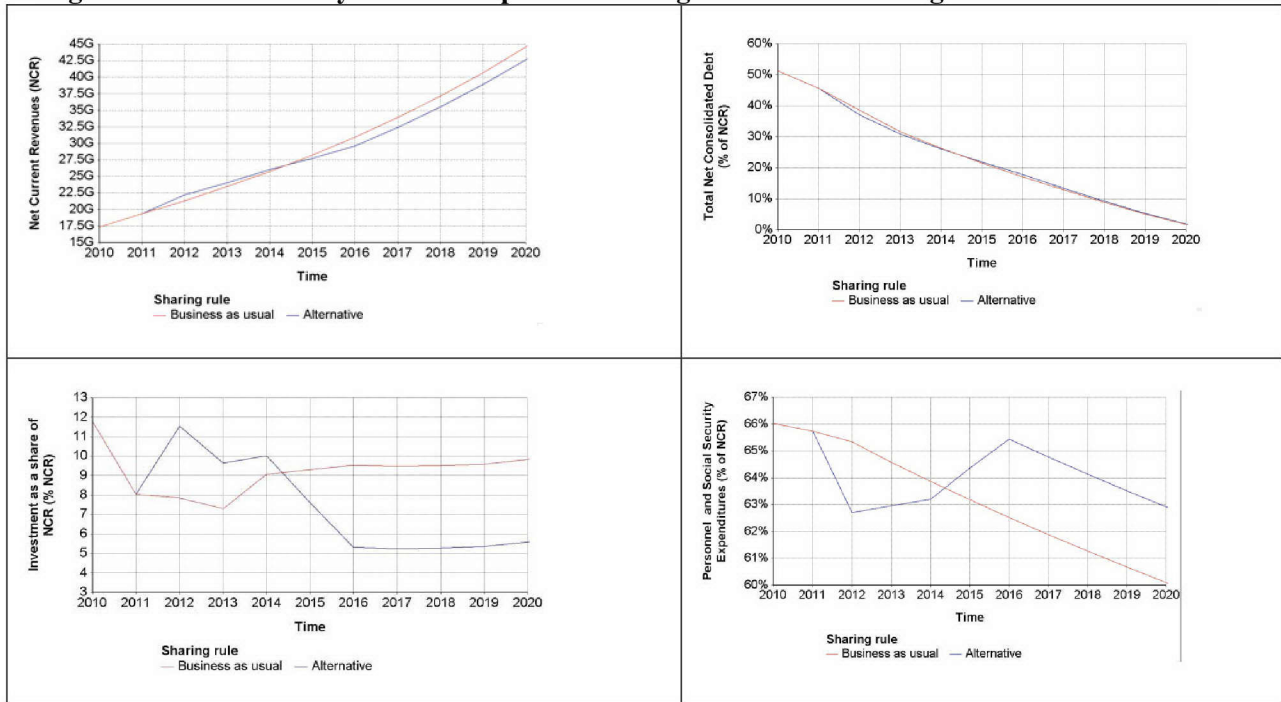
Impact of tax and federal grants reform on revenues

31. This analysis models the risks associated with changes to the allocation formula for FPE transfers, royalties, and tax reform on state revenues. ICMS revenue represented 64 percent of Bahia’s current revenue in 2010. Yet, a large uncertainty surrounds the future of this revenue source arising from the tax reform process currently under discussion. Adoption of the destination principle for taxation of interstate trade— a key issue of the tax reform discussions— would impose losses on Bahia’s ICMS collections. Bahia’s current revenues are also likely to be affected by proposed changes to the FPE sharing rule applied in the determination of state specific transfer amounts. In contrast, royalties’ reform, the most advanced of the reforms, is expected to result in a distribution design advantage over the current situation. Changes to the allocation formula of royalties, as presented in the bill of

royalties³⁸ provide for an increasing distribution of royalties to all states, offsetting potential revenue losses from FPE and tax reform. In addition, implementation of the changes will be gradual, minimizing the total net effects on revenue collection. It is worth noting that royalties revenues are planned to be transferred a year before potential changes in the FPE which would compensating revenues creating a kink on revenues and investment in 2012.

32. **Projected figures indicate sustainable fiscal and debt trajectories over 2010-20, assuming changes in the revenue sharing rules and tax reforms are implemented.** Implementation of tax reforms has a significant impact on Net Current Revenues (see Figure A4.11). However, fiscal space for investment remains positive. The trajectory for the ratio of Net Consolidated Debt remains negatively sloped closed to the baseline scenario.

Figure A4.11 Risk Analysis of the impact of a change in revenue sharing rules and tax reform



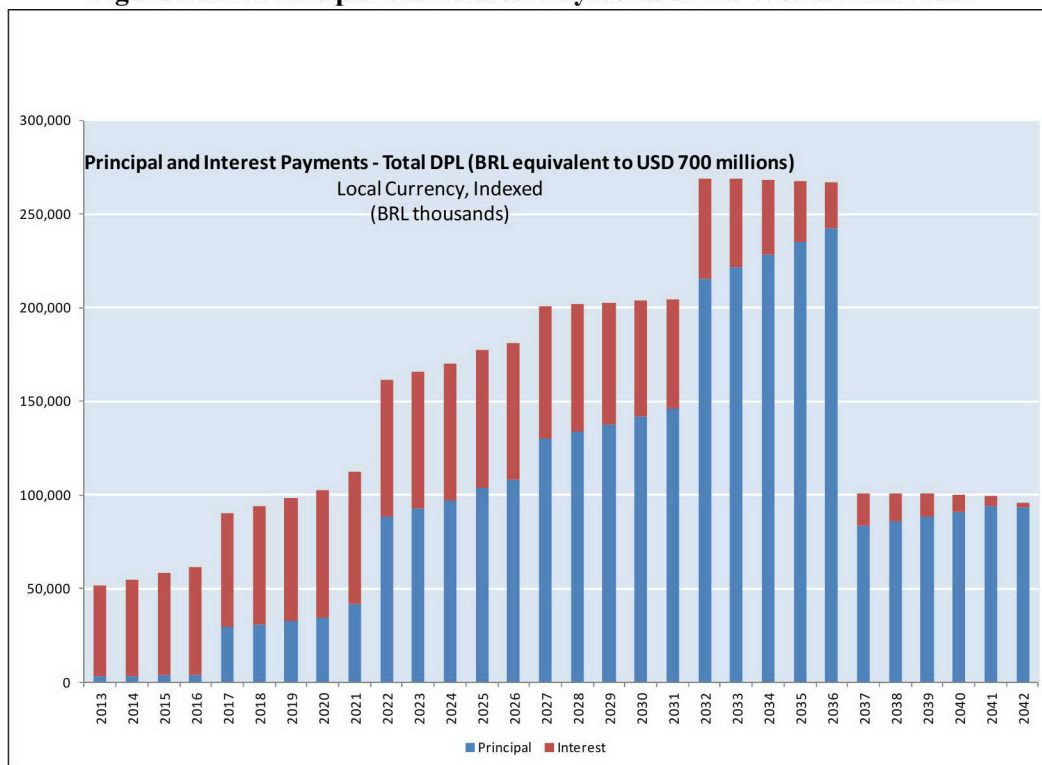
Source: WB Staff Estimates

Fiscal Impact of the World Bank Operation, 2010-2014

33. **We simulated the impact of the two-tranche Development Policy Loan (DPL) of US\$700 million to the state of Bahia.** Customized principal payments of the World Bank Loan will gradually increase over time (see Figure A4.12 for Principal and Interest Payments).

³⁸ A revision to the distribution criteria of royalties is well advanced, having passed the Senate in October 2011.

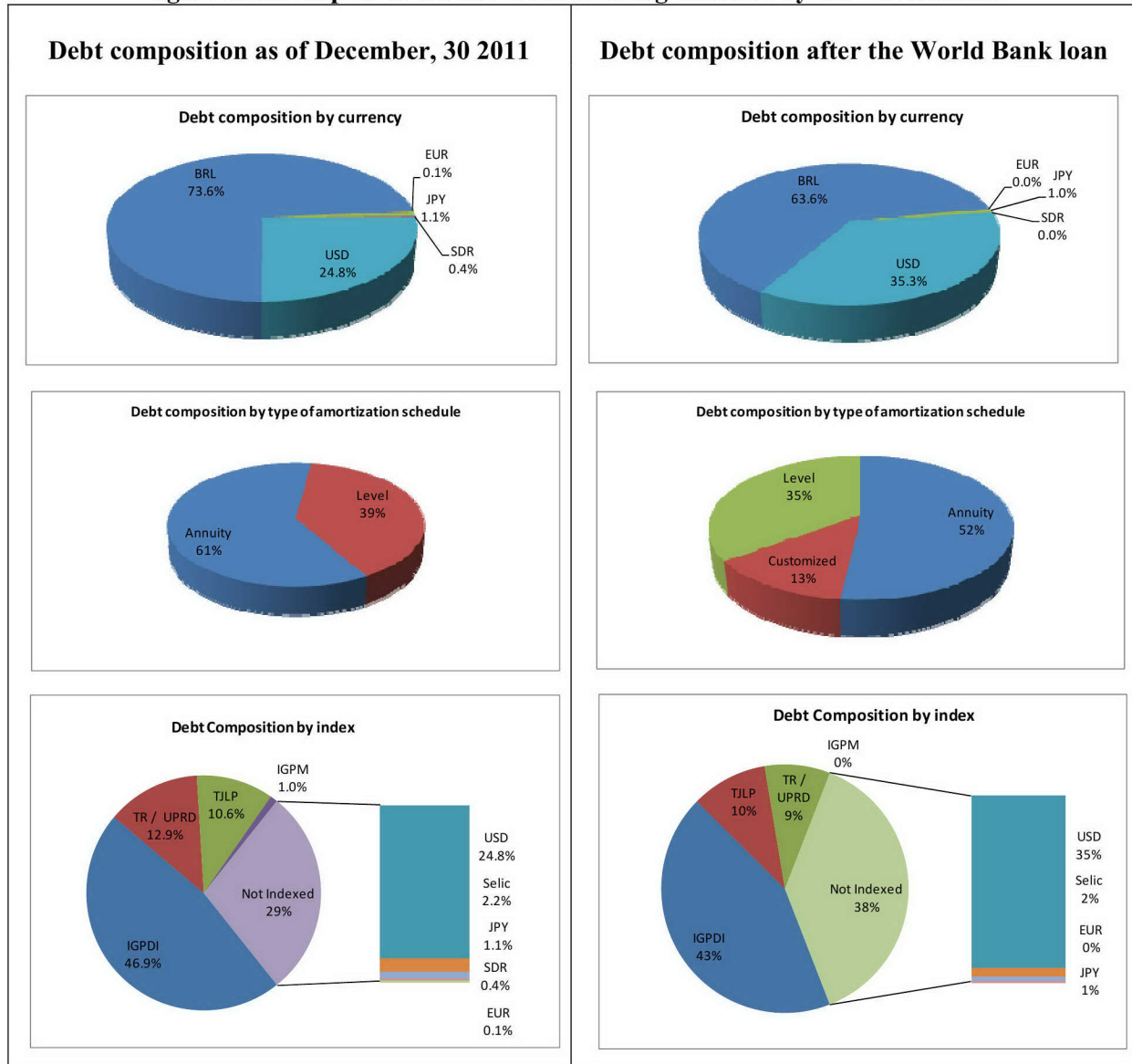
Figure A4.12 Principal and Interest Payments of the World Bank Loan



Source: SEFAZ, WB

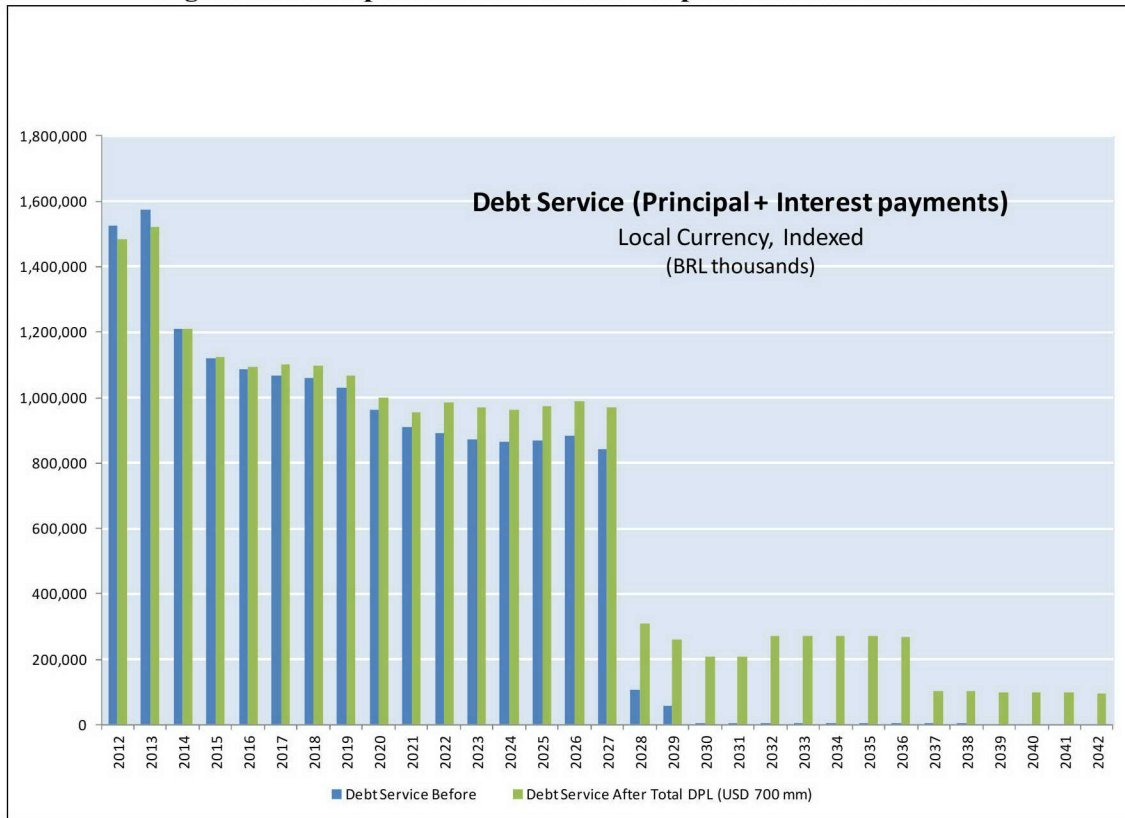
34. In a scenario in which the State uses part of the loan proceeds to refinance two previous debts for a total amount of US\$300 millions the profile and composition of Bahia's total debt would change significantly (see Figures A4.13, A4.14 and A4.15). The refinancing of two short term expensive debts which are indexed by highly volatile wholesale price indices, IGP-DI and IGP-M would reduce the share of Bahia's debt indexed by inflation from 47 percent to 43 percent. The World Bank loan in the amount of US\$700 millions would lead to a higher share of Bahia's debt in US dollars, estimated from 25 percent to 35 percent. However, total net consolidated debt would fall to below 20 percent of net current revenue (NCR) by 2016. In this scenario, debt service would be reduced as a percentage of NCR— and also in absolute terms in the short term – thus freeing up additional fiscal space for investment. The planned use of the rest of the loan proceeds, for an amount of US\$400 million, to further boost investment would help ensure the full implementation of Bahia's strategic programs: in the scenario with the WB operation, the ratio of investment to NCR would increase by about three percentage points in 2012 and 2013 (see Figure A4.15).

Figure A4.13 Impact of the debt restructuring intended by the Government



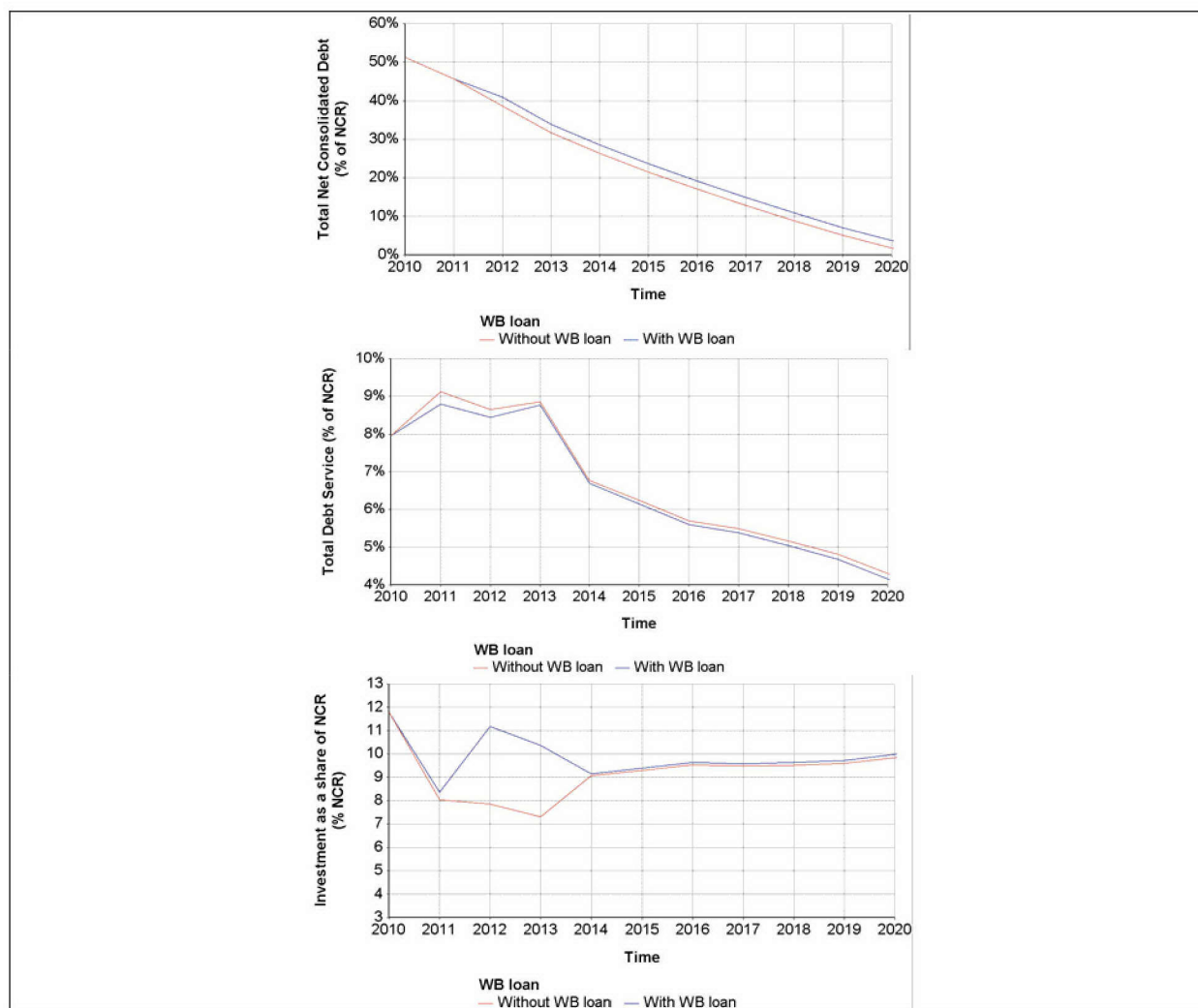
Source: SEFAZ, WB calculations

Figure A4.14 Impact of the World Bank operation on debt service



Source: SEFAZ, WB calculations

Figure A4.15 Analysis of the impact of the World Bank Operation



Source: WB Staff Estimates

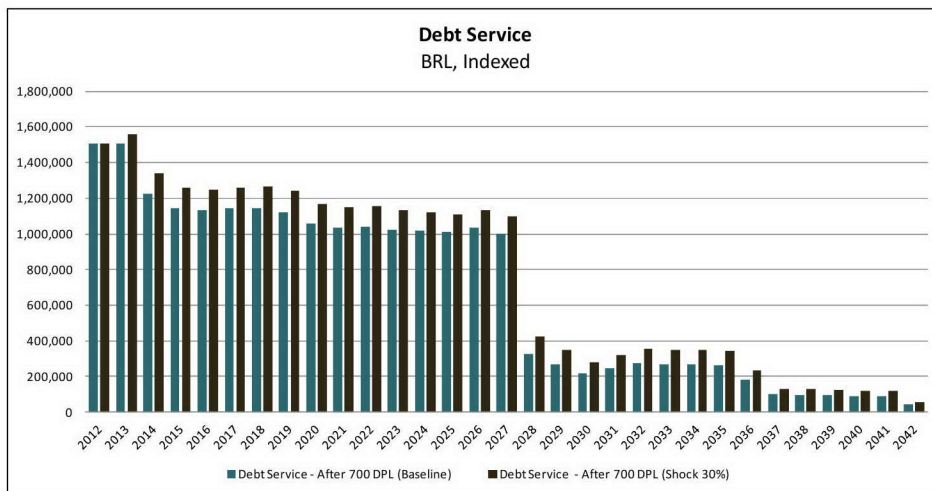
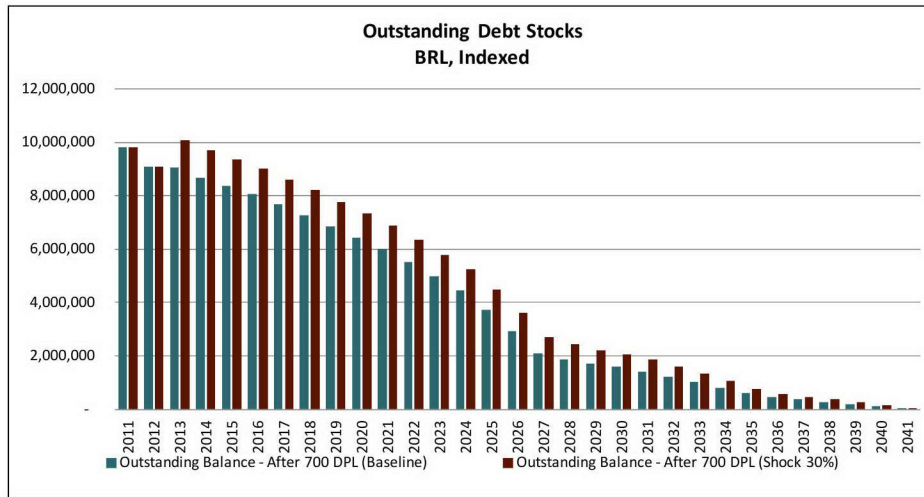
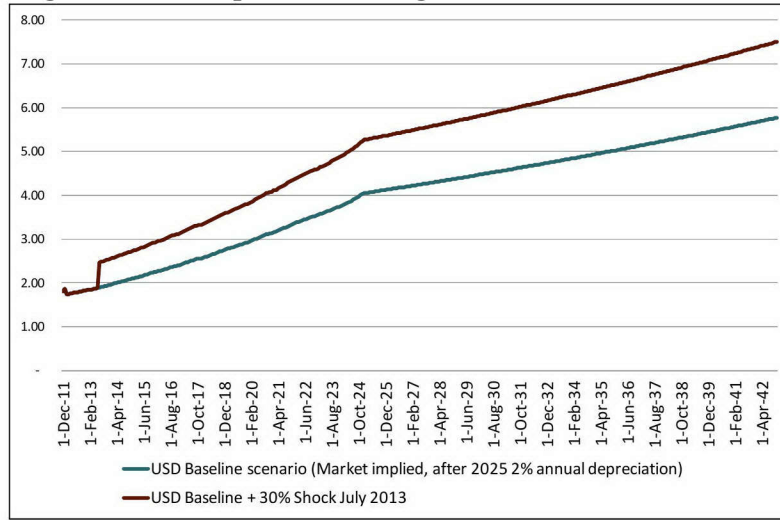
Impact of exchange rate shocks in the context of the increased external debt share

35. **The World Bank loan in the amount of US\$700 millions would reduce the share of Bahia’s debt denominated in BRL from 73 to 63 percent at the expense of an increase in the foreign currency debt from 27 to 37 percent.** US dollars loans will increase their share from 25 percent to 35 percent. As a result, the World Bank operation will increase the exposure to foreign currency risk. This risk is mitigated by the gradual amortizing structure of the IBRD loan and the fact that wholesale prices in Brazil are significantly correlated to the exchange rate.

36. **This analysis models the risks associated with an exchange rate shock increasing Bahia’s portfolio’s foreign currency exposure.** Under this analysis, the baseline scenario relies on market projections until 2025 and then applies a 2 percent annual depreciation thereafter while a pessimistic scenario depicts a 30 percent depreciation of the real against the dollar in July 2013. Under a negative exchange rate shock in 2013, Bahia’s debt will increase from an estimated would R\$9 billion to R\$10 billion (see figure below). As a result the debt

service will increase by an additional R\$52 million in 2013, R\$112 million in 2014 and R\$114 million in 2015 in the event of a significant depreciation of the BRL.

Figure A4.16: Impact of exchange rate stocks on Bahia's debt



Source: Sefaz, World Bank estimates

ANNEX 5: POVERTY AND SOCIAL IMPACT ANALYSIS (PSIA)

1. **The World Bank team carried out a poverty and social impact analysis (PSIA) to assess the expected impacts of the policies supported by this DPL operation.** The PSIA focused on a desk review of secondary data and primary research that was based on interviews and focus groups consultations with stakeholders and experts.³⁹ It assesses the potential distributive effects of the policies supported by this operation on different socioeconomic groups, focusing on the more vulnerable social groups. The overall conclusion of the PSIA is that the policies supported by this operation address some of the underlying causes and effects of the socioeconomic inequalities that have historically hampered the sustainable development of the state of Bahia.

Original Conditions

2. **Poverty and extreme poverty have been sharply reduced in Bahia.** In 2004, poor people counted for 27.0 percent of the state population and extremely poor people represented 15.8 percent. In 2009, these ratios declined to 17.1 percent and 9.6 percent, respectively. In the same period, *per capita* income has increased 46 percent in the state and the gap between state and country in terms of this indicator has been reduced from 43 percent to 35 percent.⁴⁰ Socioeconomic conditions and urban and rural infrastructure have improved throughout the 2000s and poverty has sharply declined over the past decade (from 60 percent of the population in 2003 to about 39 percent in 2009). The economy has been able to generate an increasing number of formal jobs; the coverage of health care services and the enrollment rate in elementary school have increased. The state of Bahia is the largest economy in the Northeast of Brazil, accounting for about 4.9 percent of the national gross domestic product (GDP). The State made substantial progress with respect to urban and rural infrastructure; and, the Human Development Index-HDI rose from 0.688 to 0.767 between 2000 and 2007.

3. **However, Bahia continues to be characterized by overwhelming socioeconomic inequalities.** The GDP *per capita* is just about half the national average, the extremely poor people still comprise about 14 percent of the state population, and the jobs being created are mostly low wage jobs. The average *per capita* income equals just 65 percent of the national average and the state is ranked the seventh worse among all states in this indicator. The state's extreme poverty ratio doubles the national average (10.2 percent vis-à-vis 5.2 percent).⁴¹ Poor and extremely poor households have, in the average, more inhabitants and more children (see

³⁹ Secondary data included census data, studies, research reports, and reports on previous consultations with different social groups (women organizations, poor family farmers, *quilombola* communities and Indigenous Peoples) recently carried on by the State Government. The later include recent state plans and policies for indigenous peoples, *quilombola* communities, women and youth, which have been discussed and defined in participatory ways. Consultations with stakeholders included state and municipal authorities, scholars and experts.

⁴⁰ Jorge Abrahão de Castro, *Dimensão e Mensuração da Pobreza na Bahia*, http://www.ipea.gov.br/agencia/images/stories/PDFs/110701_pobrezabahiaabrahao.pdf.

⁴¹ Data from the Population Census of 2010 show that the extremely poor (per capita income below one quarter of the minimum wage) still strikes about 21.1 percent (Census, 2010) of the households, a percentage twice the national average (10.4 percent) and poor households taken as those with per capita income below half the minimum wage (poverty line) amounted to 44.9 percent of the total, well above the Brazilian average (27.6 percent).

Table A5.1, below). By age, extreme poverty reaches more children and youth than elderly people. While 16.1 percent of the children (ages 0 to 14 years old) and 10.1 percent of the youth (ages 15 to 24 years old) are extremely poor, just 0.4 percent of the people 65 years old and more are in this situation. The income sources of extremely poor people are heavily dependent upon Governmental cash transfers (which constitute 41.4 percent of their income). As sources of family income, work and retirement pension correspond to only 50.2 percent and 1.8 percent of their earnings, respectively. However, only 66 percent of them were benefited by the “*Bolsa Família*” program. Inequality in household *per capita* income has not changed in the last years and remains high (Gini Index = 0.56).⁴²

Table A5.1: Poverty and Extremely Poverty Profile – Bahia State, 2009 – Selected Indicators

State of Bahia	Number of inhabitants per household	Percentage of families with 4 children or more	Percentage of Families without children	Percentage of people with informal jobs, unoccupied and inactive	Percentage of rural producers and workers	Percentage of formally employed, entrepreneurs and employers
Extremely poor	4.3	16%	24%	60%	34%	6%
Poor	4.5	10%	18%	59%	23%	18%
Vulnerable people	3.7	1%	40%	51%	11%	38%
Not poor	2.4	0%	77%	33%	5%	62%

Source: Abrahão de Castro, *Dimensão e Mensuração da Pobreza na Bahia*, op. cit.

4. **Poverty strongly affects the rural population and the State of Bahia is home to up to 20 percent of the rural poverty in Brazil.** The rural-urban composition shows that rural workers still comprise 31.6 percent of Bahia’s labor force, a figure almost twice as high as the Brazilian average (16.5 percent). Poor and extremely poor people are overrepresented in the municipalities in the largely rural semi-arid zone, which lag behind in terms of economic activities and development, job creation, and contribution to growth. The extreme poverty ratio is 17.1 percent in rural areas and 6.4 percent for urban areas. It reaches 13.0 percent in small municipalities compared with 4.4 percent for large ones.⁴³

5. **Rural poverty affects family agriculture and stems from multiple factors.** Bahia houses 13.1 percent of the rural people in the country. Family agriculture comprises landless rural workers, small sharecroppers and renters, small landowners, indigenous peoples, *quilombola* and other traditional communities. There are 665,831 family farms in the state and they represent 87 percent of the state’s farms; but they hold just 34 percent of the agrarian land, averaging nearly 15 hectares per landholding.⁴⁴ They are overrepresented among the rural poor and extremely poor people. Their poverty is due to chronic water scarcity and lack of access to basic infrastructure, and precarious quality of public services offered in rural areas; high illiteracy levels and poor schooling; precarious land tenure rights and high concentration of land; scarce technical assistance, lack of access to rural financing and technology, and reliance on traditional livelihoods based on subsistence agriculture among other factors that lead to low productivity.

⁴² Abrahão de Castro, *Dimensão e Mensuração da Pobreza na Bahia*, op. cit.

⁴³ Abrahão de Castro, *Dimensão e Mensuração da Pobreza na Bahia*, op.cit..

⁴⁴ Instituto Brasileiro de Geografia e Estatística, Censo Agropecuário 2006: Agricultura Familiar – Primeiros Resultados – Brasil, Grandes Regiões e Unidades da Federação. Rio de Janeiro: IBGE, 2009.

6. **Indigenous peoples and *quilombola* communities are among the most vulnerable social groups.** Indigenous peoples comprise 15 different ethnic groups and nearly 30 thousand people in the state of Bahia. They live in 26 regularized or claimed indigenous lands. The regularized lands comprise about 137,000 hectares.⁴⁵ As occurs with other poor rural population, the livelihood of these indigenous groups is based mostly on subsistence agriculture and extractive activities; their lands are small in face of demographic growth and they lack access to technical assistance; their productivity is low and they often face situations of food insecurity. Indigenous peoples have access to special health and education services, but they lack access to basic infrastructure and face water shortages. Previous consultations held with indigenous peoples in the state of Bahia show that their main concerns refer to land claims, water shortage, ethno-development and socio-environmental sustainability, strengthening of representative organizations and access to basic public services of quality (education, health, water supply, sanitation, access roads).⁴⁶

7. **Poverty and extreme poverty are still harsher in rural *quilombola* communities (descendants of escaped slaves).** According to Governmental statistics, Bahia holds 229 *quilombola* communities; NGOs estimate that there are from 300 to 500 *quilombola* communities in the state.⁴⁷ Just five of these communities in Bahia have their lands regularized. Land claims filed by other 105 communities are still being processed. They are mostly rural, remote and isolated. They are among the poorest and their livelihood is based on subsistence agriculture with very low productive yields. Consequently, poverty levels and food insecurity are high among them and basic public services are poorly provided to them. Recent data show that weight/age and height/age deficiencies are high among *quilombola* children (8.1 percent and 11.6 percent respectively), 91 percent of *quilombola* children live in households with monthly incomes of less than US\$200, and 58 percent of them live in households with monthly incomes of less than US\$100. Previous consultations with remote *quilombola* communities in the Bahia state have revealed that, from their perspectives, the key barriers that block them from access to public services and improving their living standards are related with lack of or weak local community organizations, lack of access to empowering information, lack of appropriate and participatory technical assistance, and lack of experience with the preparation of community initiatives for external financing. Preliminary results of participatory appraisals carried on *quilombola* communities reveal their huge reliance on traditional and low technology productive activities and poor access to basic infrastructure and public services.⁴⁸

8. **Poverty in Bahia also presents significant inter-regional differences.** As depicted in Figures A5.1 and A5.2 below, the absolute and relative number of poor people varies widely according state regions and municipalities. Regional differences are clearly expressed

⁴⁵ Information on these 26 indigenous lands is available at the Instituto SocioAmbiental website (<http://pib.socioambiental.org/caracterizacao.php?uf=29>).

⁴⁶ Sources: Coordenação de Políticas para os Povos Indígenas, *Plano de Trabalho Operativo – Povos Indígenas da Bahia*. Salvador: Bahia/Secretaria da Justiça, Cidadania e Direitos Humanos, 2009; [www.sjcdh.ba.gov.br/.../Plano de trabalho operativo para povos indigenas na bahia.pdf](http://www.sjcdh.ba.gov.br/.../Plano_de_trabalho_operativo_para_povos_indigenas_na_bahia.pdf); CAR/ SEDIR, *Plano de Participação dos Povos Indígenas – Projeto Integrado do Estado da Bahia – Produzir III*. Salvador: SEDIR/Bahia, Dezembro de 2008; <http://www.car.ba.gov.br/publicacoes.asp?id=30>.

⁴⁷ Information provided by the Comissão Pró-Índio de São Paula (http://www.cpsp.org.br/comunidades/html/i_brasil_ba.html).

⁴⁸ Bahia state's Technical Unit of the Leveling the Field for Quilombola Communities, funded by the Japanese Fund for Social Development/The World Bank.

by the inequality ratio find in different indicators between the worst and the best regions. Thus, inequality ratios are: 3.6 for the extreme poverty indicator and 2.0 for the poverty indicator; 2.0 for the infant mortality rate and 3.9 for the death rate for external causes; 6.5 for the adult illiteracy rate, 2.0 for average school passing rates and 2.6 for school dropout rates. The same regional variation is found on the percentages of households linked to local water and sewage networks and to garbage collection systems. The inequality ratio between the regions with the worst and the best indicator reached 0.64 for water supply, 0.45 for garbage collection and 0.05 for general wastewater collection systems.

Figure A5.1: Bahia – 2009 – Number of Extremely Poor People

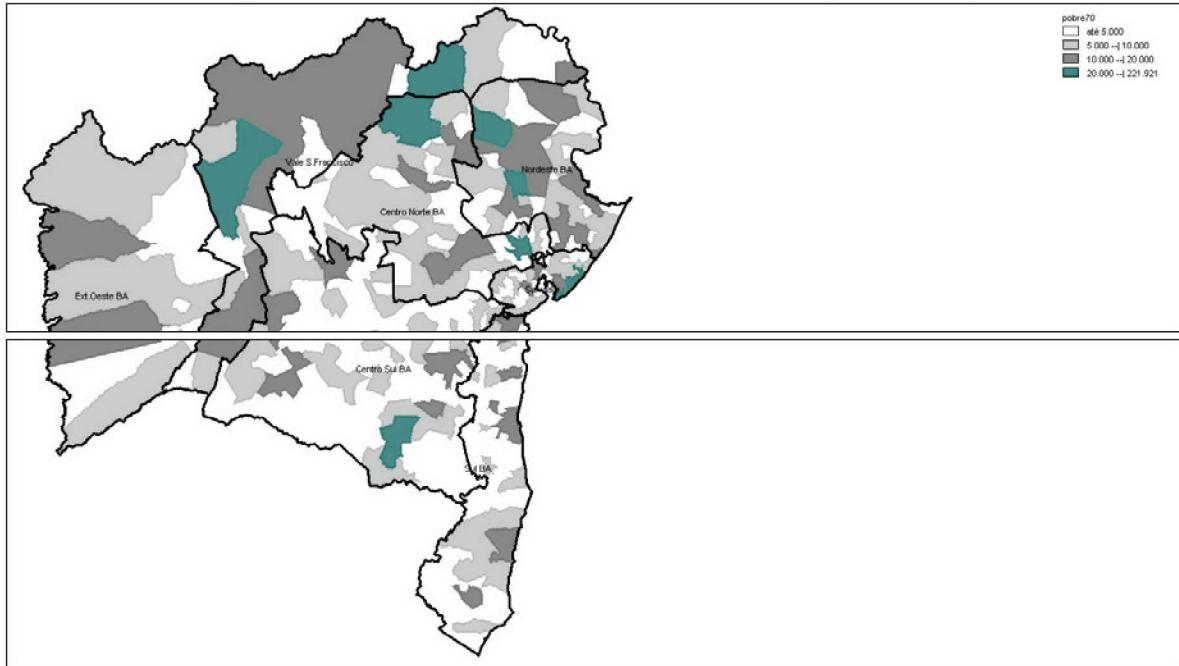
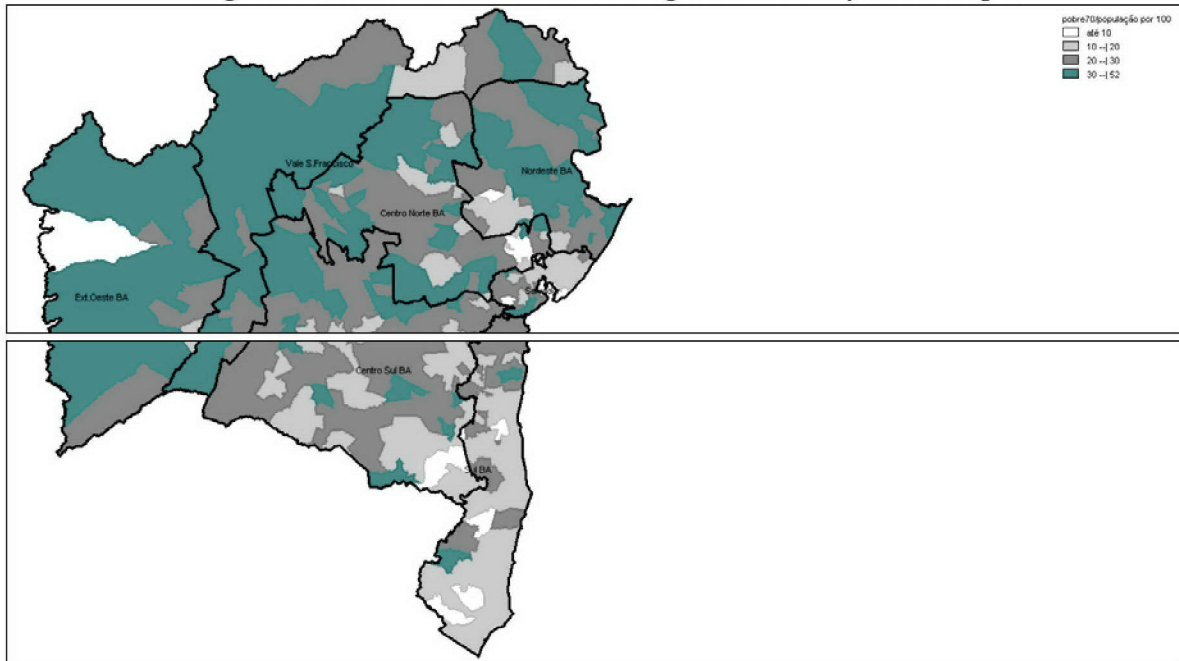


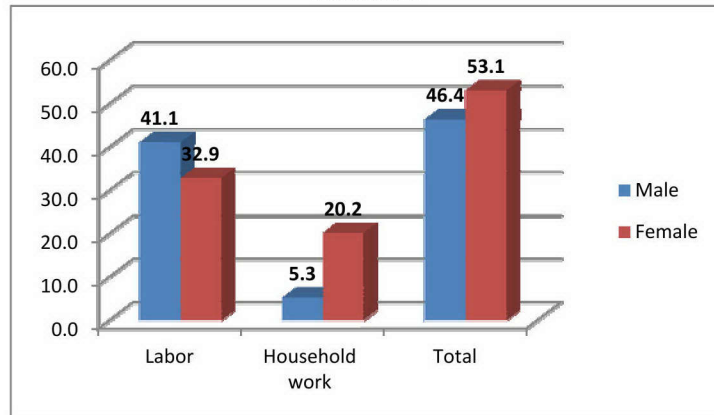
Figure A5.2: Bahia – 2009 – Percentage of Extremely Poor People



Source: Abrahão de Castro, *Dimensão e Mensuração da Pobreza na Bahia*, op. cit.

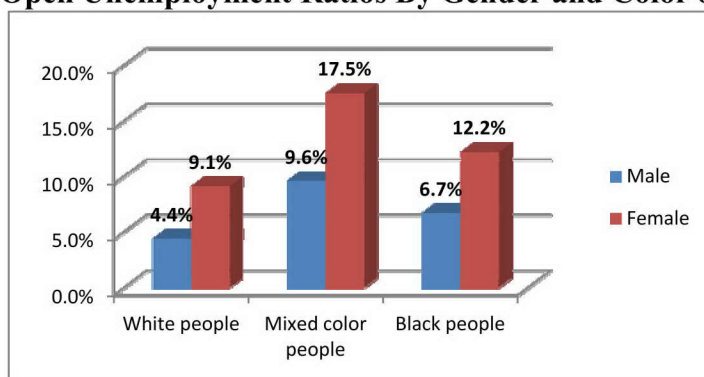
9. **Poverty has also gender and race dimensions.** Gender inequality has many dimensions and one of them is related to labor market outcomes. In the state, unemployment is falling and labor earnings are rising. However, these improvements reach differently male and female workers. The rate of occupation of women and men are, respectively, equal to 51.4 percent and 73.1 percent; whereas the female and male open unemployment ratios equal to 12.5 percent and 6.8 percent. Traditional gender rules that ascribe the household workload to women contribute to reduce female opportunities to access the labor market as well as to render their workload more intensive than men's. Women spent just 62 percent of their weekly workloads in labor activities, whereas 89 percent of men's do. Weekly women spent 20 percent less time in the labor market than men, but the female household workload is nearly four times longer than male's and the female total workload is 15 percent longer than the male workload. Consequently, labor earnings for men are 58 percent higher than women's, revealing the persistence of sharp gender inequalities and the brutal challenges faced by the 32 percent of households headed by women in Bahia.

Figure A5.3: Weekly Workload by Gender – Bahia – Hours per week in labor and household activities



10. There are also wide differences in labor earnings by race. While whites received nominal income 53.5 percent higher than the State's average, non-white had lower labor earnings than Bahia's average. The labor earnings ratio between whites and afro-descendants is 1.80 and between whites and mixed (pardos) 1.81. As depicted in Figure A5.4, below, race and gender factors combine and unemployment hits harder the male and female afro-descendent population.

Figure A5.4: Open Unemployment Ratios By Gender and Color of Skin – Bahia



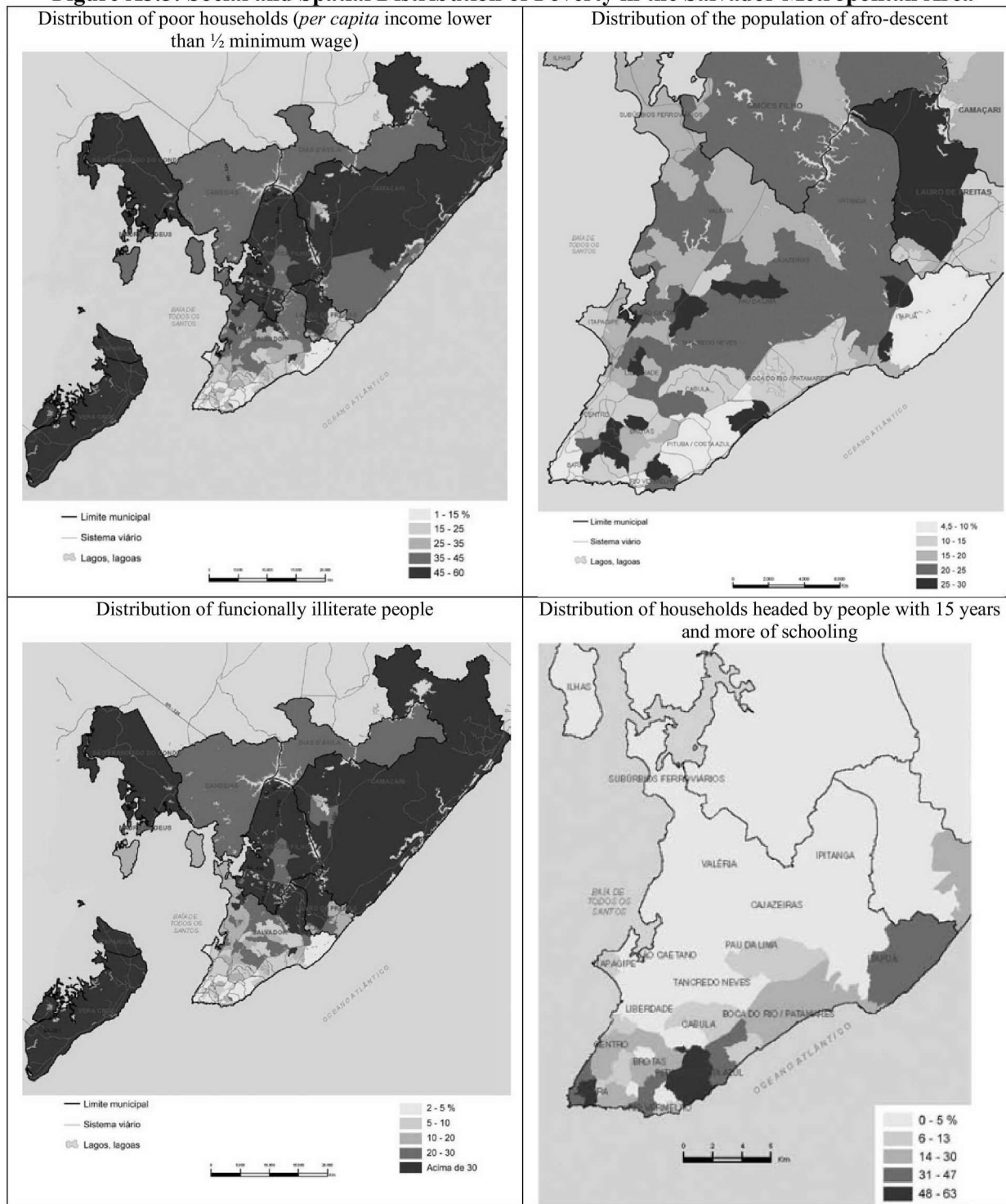
Source: Governo do Estado da Bahia, Secretaria de Promoção da Igualdade e Conselho Estadual de Defesa dos Direitos da Mulher, II Plano Estadual de Políticas para as Mulheres. Salvador: SEPROMI, 2009.

11. **Poverty and extreme poverty hit hardly the non-white population.** Afro-descendants and indigenous peoples comprise 84 percent of the states extremely poor people and 79 percent of the poor people; conversely, they are just 71 percent of the non-poor.⁴⁹ In the Metropolitan Region of Salvador, poverty has a clear social and space distribution and is strongly related with race and education as graphically depicted on Figure A5.5. Poor, less educated, and afro-descendent people are strongly concentrated in the areas know as “Miolo” (“The Middle”) and “*Subúrbio Ferroviário*” (“The Railway’s Suburban areas”), which are the most deprived of basic infrastructure and public services and in which is also concentrated the huge housing deficit of Bahia.⁵⁰

⁴⁹ Abrahão de Castro, *Dimensão e Mensuração da Pobreza na Bahia*, op.cit.

⁵⁰ The housing deficit is considered below (paragraph 16).

Figure A5.5: Social and Spatial Distribution of Poverty in the Salvador Metropolitan Area

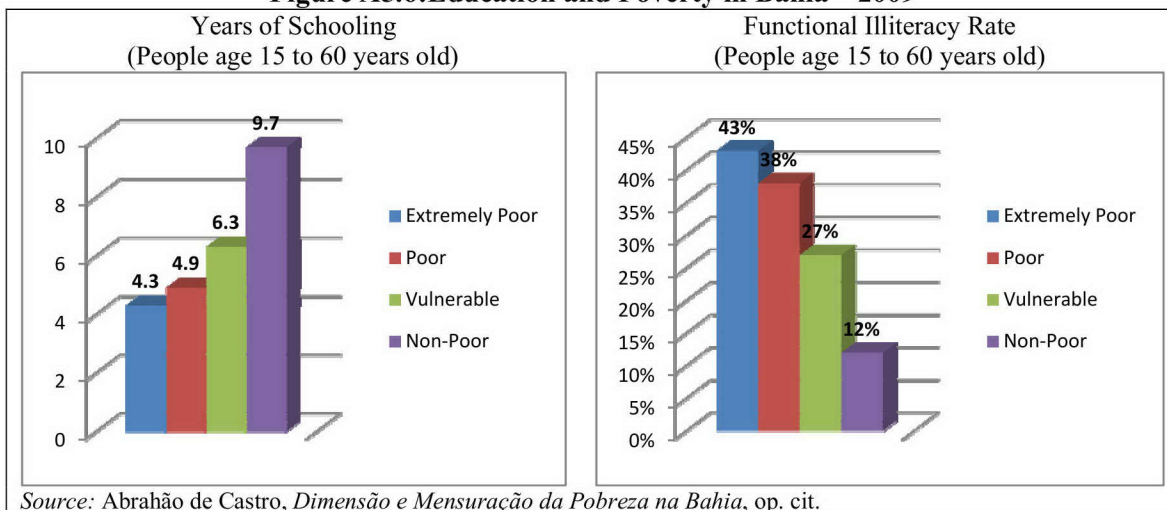


Source: Inaiá Maria Moreira de Carvalho and Gilberto Corsa Pereira (org.), Como Anda Salvador. Rio de Janeiro: Letra Capital/Observatório de Metrôpoles, 2009.

12. **Finally, poverty is closely and significantly correlated with education.** Preliminary diagnostics have shown that low literacy skills are the main cause of poor learning outcomes and performance across all levels of education in public schools. They have also positively and significantly correlated schooling and educational levels to occupation, income, and better

living standards. Figure A5.6 below, shows the correlation between years of schooling and poverty levels as well as the overrepresentation of functionally illiterate people among the poorest strata of the state's population.

Figure A5.6: Education and Poverty in Bahia – 2009



Key Challenges

13. **The Government of Bahia needs to strengthen its governance to meet these challenges and there is also a need to foster efficiency for developing social, physical and institutional infrastructure, where these can contribute to greater equity.** Improved planning and budgeting increased State revenue and an upgraded management of financial and human resources are necessary measures to achieve sustainable development and inclusive growth. Planning and budgeting have not been aligned to the strategic priorities of the Government. Tax administration in the State of Bahia is characterized by highly volatile revenues and relatively low capacity. Finally it is recognized that effective administration and service delivery requires effective management of human resources.

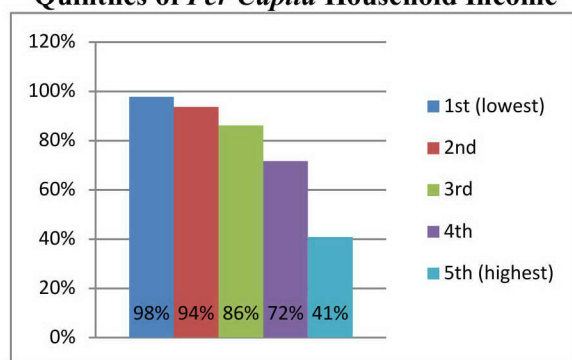
14. **The state of Bahia also performs poorly at the health sector and penalizes mostly the poor who have no other alternative for health services.** Infant and maternal mortality ratios remain above national averages. In 2010, the state Infant Mortality Rate (IMR) equaled 17.8 deaths per thousand born alive; whereas the country IMR was 13.9/1000. The state Maternal Mortality Rate (MMR) increased in the past decade⁵¹ and nearly one third of deaths of women are associated with pregnancy, delivery and postpartum assistance. Abortion is one of the most important causes of such deaths. Maternal mortality strikes mostly poor women and poor afro-descendent young women are an especially vulnerable group. Studies focused on the Metropolitan Region of Salvador have shown that the portion of the population making use of the private health services is low and lower income families – specially those living at subnormal settlements and those single headed by women – rely mostly on the public health system.⁵²

⁵¹ In 2000, the MMR in Bahia was 50.9/1000. In 2010, the MMR was 61.3/1000.

⁵² Haroldo Torres et al., *Serviços Básicos de Educação e Saúde em Salvador: cobertura, acesso e avaliação da população pobre*, in **Bahia Análise & Dados**, v. 17, n. 1, Salvador: Superintendência de Estudos Econômicos e Sociais da Bahia, 2007, p. 721-737.

15. **Educational outcomes at the state of Bahia are also worrisome and low quality education at public schools disproportionately penalizes the poor and vulnerable groups, who mostly need and attend to them.** Illiteracy still reaches 17 percent of the population age 15 years and more. Illiteracy is mostly a rural phenomenon: in this age group, illiteracy is found among 11.6 percent of the urban population and 30.3 percent of the rural people. High proportions of youngsters remain out of school. Although flunk, dropout and age-distortion rates in basic schools have fallen between 2007 and 2010, they remain above than national averages.⁵³ Schooling continues to be hampered by low quality of teaching, high drop-out and age-grade distortion ratios, and the learning outcomes remain poor across all levels of education. Thus, Bahia ranked last in the country at the last three editions of IDEB for 4th graders. As depicted in Figure A5.7 (below), census data (2010) for the state of Bahia shows that the basic school system has reached almost universal coverage. Statewide, municipal and state child care centers and elementary schools enroll 82.1 percent of the children. Furthermore, the enrollment rate in public school institutions increases as the per capita household income declines. Finally, 59 percent of all children enrolled at public institutions belong to families in the two lower quintiles of *per capita* income.

Figure A5.7: Percentage of Children in Public Child Care Centers and Elementary Schools by Quintiles of Per Capita Household Income



16. **Urban and rural infrastructures have improved, but there are still huge deficits on housing (concentrated at the Metropolitan Region of the capital city) and sanitation at most backward rural municipalities.** Throughout the last decade the state improved its basic infrastructure. However, Bahia continues to have a huge qualitative deficit in infrastructure, which is represented by the lack of household access to water (20 percent off the general supply system), sewage (55.0 percent with no connection to the general network) and garbage collection (23.8 percent have no collection at all). Bahia also has a deficit of over 500,000 housing units of which 70 percent is located the in urban areas and disproportionately concentrated in the Metropolitan Region of Salvador (RMS). Bahia’s deficit is equivalent to 8 percent of the total deficit for Brazil and approximately 96 percent of it corresponds to families with incomes of less than three minimum salaries. This housing deficit has also race and gender dimensions. People from afro-descent and households headed by single women are overrepresented among the population living in informal precarious settlements. Bahia’s poor population is the most exposed to and affected by small but frequent natural hazards.

⁵³ The State ratios equal 15.7 percent for disapproval, 6.6 percent for dropouts, and 38.1 percent for age-distortion, whereas the national averages are 10.3 percent, 3.1 percent, and 23.6 percent, respectively.

Urban areas suffer from localized landslides and flooding from excessive rainfall. Rural areas in the semi-arid region are affected by cyclical droughts and forest fires.⁵⁴

Main Expected Impacts

17. **The specific policy reforms supported by this loan address the socioeconomic inequalities previously analyzed and may contribute to answer key challenges faced by the state of Bahia to reduce its characteristic poverty and overcome social inequality.** They are expected to have significant and positive poverty alleviation and social inclusion impacts in Bahia. Poor, extremely poor and most vulnerable social groups may have the most positive gains from reforms in the delivery of public services and infrastructure. The potential pro-poor effects of DPL supported policy reforms will be firstly felt as a result of improvements in the access and quality of education and health services, the policies designed to promote social and productive inclusion, to control crime and violence, and to mainstream gender and to fight gender based violence.

18. **Pro-poor effects of changes in education are expected from the fact that the “*Todos pela Educação*” Program is a partnership program designed to improve the quality of literacy among first and second grade students enrolled in municipal public schools.** The program is intended to overcome the enormous difficulties faced by municipalities, especially the poorer ones, to provide fundamental education of good quality. The program addresses the issue of low literacy skills, which is the main cause of poor learning outcomes and performance across all levels of education in public schools. Poor children may benefit the most from the improvement of literacy classrooms (first and second grade). Children from first and second quintiles of the *per capita* income rankings and most vulnerable social groups need and attend most public schools; they will be the prime beneficiaries of the program as it also targets on the poorest of the state’s municipalities. These children will directly benefit from improvements in literacy skills among students of public schools because they will increase their probability of advancing to higher educational levels, which are much lower for poor children coming from the public school system. Schooling is strongly correlated with better job opportunities and income levels; hence, it is expected that, by improving the probability of poor students from public schools reaching higher educational levels, they will indirectly gain from improved access to better labor opportunities and will have more chance to earn better incomes. Therefore, in the long run, the “*Todos pela Educação*” is expected to improve the chances of poor children to escape poverty.⁵⁵

19. **Policy reforms promoted in the health sector also have most positive impacts for the most deprived social groups.** The PSIA has demonstrated the potential pro-poor effects of improvements in the access and quality of public health services. PSIA has found that: (a)

⁵⁴ Disasters reported by the municipalities during the last 20 years, shows an average of over 140 disasters per year for the State of Bahia. Irregular garbage collection and precarious sewage systems aggravate the effects of heavy rainfall and related landslides in urban areas where housing and urban infrastructure are deficient.

⁵⁵ Although expressing their full support to this policy, stakeholders interviewed during PSIA preparation have highlighted – among the various constraints that hinders education quality – a large number of poorly qualified teachers, inadequate teaching methods, lack of teaching materials, and poor interGovernmental coordination (federal, state and municipal). They mostly fear that weak interGovernmental coordination involving municipalities may hamper the policy’s sustainability. Civil society participation and adequate monitoring systems are being enforced to mitigate such risk.

infant mortality and maternal mortality ratios (17.8 per thousand live births and 61.3 per hundred thousand live births, respectively) remain above national averages (13.9 and 55.3, respectively); and (b) the lack of medical assistance is the main reason female mortality in Bahia and reflects the poor coverage of health services and the low access to simple and low-cost preventive procedures by poor women.⁵⁶ Hence maternal mortality strikes mostly poor, young and afro-descendent women, who most rely on public health services. Improving the quality, expanding the coverage of primary public health care in priority areas, and strengthening the state maternal and child care network, these policy reforms are essential to reduce maternal mortality (especially related to abortion) and have a clear pro-poor impact since the most vulnerable women will benefit the most from the proposed actions. By reducing maternal mortality, they also lead to a drop in the infant mortality rate, especially early neonatal mortality that hits hardly the children from the most vulnerable groups.⁵⁷

20. Poor family farmers in lagging semi-arid regions and urban workers engaged in precarious informal labor markets will gain the most positive from social and productive inclusion policy changes. In lagging semi-arid regions, poor family farmers – among whom *quilombola* population and indigenous peoples are mostly found – may benefit most from policy reforms related with productive inclusion, which will contribute to increase their productivity and their access to technology, technical assistance, and market. The expected outcome from these policy reforms are increased income and welfare for poor rural population. Furthermore, as productive and social inclusion policies might make more cash available at the local market of poor and backward municipalities, the economy of these lagging regions may also benefit through increases in tax collection and larger investment ability.⁵⁸ In urban areas, productive inclusion policies focus in the informal sector where many urban poor seek to earn a living. They may also contribute to address and overcome gender inequalities in the access to formal labor market that hamper women economic empowerment. Finally, extremely poor families and, particularly, the female headed households are also expected to benefit from social inclusion policies that aim to reach out to them, to improve their access to social services, social safety networks, and conditional cash transfers programs. Therefore, these policies have the potential to promote equitable growth and reduce poverty.⁵⁹

21. The “Pacto pela Vida” (PPV) program for controlling crime and violence focuses on reducing lethal violence which particularly affects poor, young and afro-descendent

⁵⁶ Bahia, SEPROMI/CDDM, *II Plano Estadual de Políticas para as Mulheres*, op. cit.

⁵⁷ Bahia, SEPROMI/CDDM, *II Plano Estadual de Políticas para as Mulheres*, op. cit. This state plan was built with the broad participation of women from different regions of Bahia through a set of municipal, regional and state conferences held in 2007. The stakeholders interviewed expressed some concern with horizontal coordination within the State Government and joint actions with municipal Governments, which are required by this policy reform and which might fail especially if it rests on the creation of interGovernmental committees, an experience that was unsuccessful in the past.

⁵⁸ The Government of Bahia has also demonstrated interest in improving logistics and the institutional framework for transport to support economic growth by integrating logistics, transport coordination, planning and networks connectivity. An adequate transport and logistics framework will develop further the agriculture/livestock and industry sectors, fueling the State economic growth. By increasing the efficiency and the competitiveness of the state economy, these policies will foster economic growth, broadening opportunities for the poor.

⁵⁹ Stakeholders interviewed have expressed some concerns in regard with possible weaknesses of public (especially municipalities) and private partners to deal successfully with the financial and technical requirements of the program.

population. Today, Bahia ranks as the third worst state in the Northeast and the 5th in Brazil for homicides. Young people (15 to 24 years old) is the cohort most affected by the spike in violence, which is mainly associated with the increase in crack-cocaine consumption and trafficking in Bahia in the past three years. Violence associated with crack cocaine affects youths and blacks disproportionately, especially those from poorer backgrounds. Thus, poor families in low income settlements at the metropolitan region as well as in other municipalities, particularly the youth of afro-descent, are expected to gain the most from policies designed to respond to violence and to reduce drug addiction.⁶⁰

22. **The policy reforms of the state Government of Bahia have strengthened its institutional framework aimed at promoting gender equality.** This aim will be mostly achieved by reducing the barriers to women's access to better labor market outcomes – more job opportunities and better labor incomes. The state has created a Women's Secretariat ("*Secretaria das Políticas para as Mulheres*"), which is able to advance gender mainstreaming in the public sector, while expanding its areas of focus to other key pressing gender issues in Bahia – namely: violence against females, gender education, and health. The contents of these policies have a major pro-poor tendency because they seek to reduce gender inequality and to increase opportunities to women by means of social protection and improved citizenship. As such, these policies are expected to increase economic, social and cultural opportunities for women, while narrowing gender wage and occupational gaps and promoting women's citizenship and strengthening their self-esteem. Finally these policies will help protect women who are victims of domestic or street violence and raise women's awareness of their rights and thus opening up new opportunities.⁶¹

23. **DPL supported policy reforms are designed to develop social, physical and institutional infrastructure for Disaster Risk Management (DRM).** Low-income families living in informal settlements and in urban areas at risk may benefit most from policies that address vulnerability to natural hazards. The poorer population should benefit the most from disaster risk management policies since it has been historically the social group that lives in the most vulnerable areas of the State. The realization of losses due to extreme events has been shown to be associated with socioeconomic conditions. Poorer populations are more exposed to extreme weather events, asset loss and the interruption in the provision of public services, especially education and health. Disaster and risk management policies are also expected to contribute to reducing the economic and human costs associated with droughts in the semi-arid zone of the State. This reduces the vulnerability of the rural poor to adverse climate events and to forest fires related losses. Therefore, these policies tend to protect the poorer population.⁶²

24. **The Strengthening of Public Sector Management by means of improved planned and budgeting systems, financial and resource management and public-private**

⁶⁰ Stakeholders interviewed have expressed their concerns with the coordinating process required by a multi-sector program and with the capacity of key entities and actors to collect appropriate information to feed the necessary actions.

⁶¹ Bahia, SEPROMI/CDDM, **II Plano Estadual de Políticas para as Mulheres**, op. cit. Low institutional capacity of the recently created State Secretariat of Women Affairs is a major concern among the stakeholders consulted.

⁶² Stakeholders manifested their concern about the capability of the "Coordenadoria de Defesa Civil" (CORDEC) to undertake the key task of promoting cooperation among municipal Governments because it is under-staffed and lacks most of the necessary cartography.

partnerships are essential for the State of Bahia to achieve equitable growth, social inclusion and increased economic efficiency. Thus, these policies will contribute to reduce poverty and inequality. First and as annual budgets are unrealistic and unconnected to the strategic Government priorities, by adopting new policies of *planning and budgeting* as well as by improving *costing and resource allocation*, the State Government will benefit from: (a) reduced transaction costs within the public sector, (b) lower costs of public services, and (c) free resources to be spent according to its strategic priorities. Hence, it is expected that the State Government may reach increased efficiency in the allocation of public funds, more effective provision of public services and better targeting of programs and projects that may benefit the poor and reduce inequality. Furthermore, the better provision of public services at lower costs might have positive distributional effects and increase social well-being.

25. **Secondly, society benefits if it gets a better provision of public services and if public resource allocation becomes more efficient as a result of the improved tax procedures.** Despite recent increase in revenues, there is also considerable space for enhancing efficiency and effectiveness of the state's *tax administration system*. Changes in tax collection procedures would reach painlessly this objective. As proposed, the strengthening of the tax administration capacities of the State may increase compliance and is based on the modernization and automation of processes and mechanisms that do not imply an increase of tax burden on the poor. Redistributive and pro-poor effects are expected from increased compliance insofar as the richer segments of the population finance improved public services and the higher revenues are spent according to existing priorities. This helps to strength governance without hurting the poor or sharpening existing inequalities. For society at large new tax procedures creates an environment less favorable to tax evasion.

26. **Society supports any policy in state's human resources management whenever it experiences improvements in the quality of public expenditure and in the provision of key public services.** The policies proposed to improve *human resources management* may raise the quality of public expenditure and public services and are expected to contribute to increased well-being. For society at large the benefits arises from the fact that increases in the productivity of the State's civil service leads to improvements in the delivery of strategic public services, thus increasing well-being.

27. **Finally, the proposed public-private partnerships (PPPs) might free public money to be invested in other critical social areas.** Joint investments between the private and public sectors not only make feasible undertakings in social and economic infrastructure that benefits the poor but also free public money that can be invested to meet other critical social demands. These investments will improve social and economic infrastructure and increase the well-being of the population. They will be focused on a wide range of infrastructure investments in roads, ports, logistics corridors, urban mass transit, and additional sectors (a hospital, the "World Cup Arena", a submarine outfall, a regional network of health labs and rehabilitation centers for detainees). These investments will improve the range and quality of public and private goods and services leading to increased well-being of the population. Hence, the content of the proposed PPP investments will contribute to reduce poverty and inequality by diversifying and upgrading the social and economic infrastructure that provides transportation, mobility, health services, sewage disposal and entertainment. Additionally, the construction phase of these undertakings will generate low skilled jobs, increasing the wage

income of those workers located in the lower bracket of the income distribution profile. Thus, PPPs projects have a pro-poor impact and a positive distributional effect.

28. **Therefore, the overall conclusion of the PSIA is overwhelmingly positive.** All the policies considered have clear benefits for the poor, particularly in the medium to long term. Although a few challenges have been pointed out by the stakeholders interviewed, the consultations have indicated no significant opposition to any of the policies being pursued.

