ICRR 13172
Report Number : ICRR13172

IEG ICR Review
Independent Evaluation Group

1. Project Data: Date Posted : 10/22/2009

PROJ ID : P080827 Appraisal Actual
Project Name : Brazil First US$M):
Project Costs (US$M): 505.1 516.2
Programmatic Loan
For Sustainable And
Equitable Growth
Country : Brazil Loan/
Loan /Credit (US$M):
US$M): 505.1 516.2
Sector Board : FPD US$M):
Cofinancing (US$M):
Sector (s): General industry and
trade sector (35%)
Banking (25%)
General transportation
sector (25%)
Central government
administration (10%)
Law and justice (5%)

Theme (s): Regulation and
competition policy
(25% - P)
Infrastructure services
for private sector
development (25% - P)
Trade facilitation and
market access (24% -
P)
Legal institutions for a
market economy (13%
- S)
Tax policy and
administration (13% -
S)
L/C Number : L7218
Board Approval Date : 02/19/2004
Partners involved : Closing Date : 12/31/2004 12/31/2004

Evaluator :	Panel Reviewer :	Group Manager :	Group :
Jorge Garcia-Garcia	Rene I. Vandendries	Ismail Arslan	IEGCR

2. Project Objectives and Components:

a. Objectives:

The government of Brazil was committed to a development strategy aimed at raising the growth potential of the Brazilian economy, creating employment, and reducing poverty . Within this strategy, there was a growth agenda, consisting of a broad set of microeconomic and institutional measures aimed at raising Brazil's potential output. The Growth Program comprised (a) logistics; (b) the business environment; (c) financial efficiency and depth; and (d) innovation The DPL program sought to support this agenda, and its main objective was to support sustainable and equitable economic growth. Through its interventions the DPL program sought to: (a) reduce logistic costs, (b) improve the business environment, (c) enhance the efficiency and depth of the financial sector, and (d) increase innovation capacity to transform knowledge into productivity gains . The planned DPL program consisted of three policy loans of which this is the first . In the end only two loans materialized .

b.Were the project objectives/key associated outcome targets revised during implementation?

No

c. Components (or Key Conditions in the case of DPLs, as appropriate):

The loan supported policy and institutional reforms in logistics, the business environment, the financial sector, and innovation. In addition, a satisfactory macroeconomic framework would have to be maintained for the Bank to continue supporting the program. DPL1 had 14 prior actions.

A. Logistics. The loan supported measures to:
1. Improve customs effectiveness
2. Reduce transport costs on the federal roads network
3. Foster multimodal transport

B. Business Environment. The loan supported measures to:
4. Strengthen infrastructure regulation.
5. Enhance the competitiveness environment and strengthen the corporate insolvency framework
6. Simplify entry and business operations

C. Financial sector: efficiency and depth. The loan supported measures to:
7. Increase financial competition
8. Promote sound fundamental legislation and systemic risk control
9. Mobilize long-term resources in the insurance sector
10. Improve efficient access to financial services to the poor and SMEs

D. Innovation. The loan supported measures to:
11. Increase public R&D effectiveness
12. Foster private innovation
13. Create innovation in environmental markets

d. Comments on Project Cost, Financing, Borrower Contribution, and Dates:

The original commitment was $505.1 million, but exchange rate variations made total disbursement $516.2 million. The loan became effective on June 21, 2004.

3. Relevance of Objectives & Design:

The objectives of the loan were relevant for the country's development priorities and consistent with

the Bank strategy in Brazil. At the time, in addition to seeking macroeconomic stability, the government sought to increase the rate of economic growth while reducing poverty . The two DPLs supported measures to help solve problems that reduced Brazil's competitiveness and hampered its ability to grow faster. The Bank and the government selected relevant problems to be solved, and the DPLs used instruments appropriate to deal with them (e.g., better regulations in customs to speed processing of merchandise).

4. Achievement of Objectives (Efficacy):

A. Logistics

Improve customs effectiveness. After approving a customs reform strategy (a prior action) the government simplified export procedures, and reformed the clearing systems and the management and information systems of customs.The expected outcome of reducing release times has been achieved. An importer clears customs in 3 days instead of 5, and an exporter clears customs in about half a day instead of two. Efficacy in achieving this objective has been substantial.

Reduce transport costs on the federal road networks. In addition to implementing the law that reorganized the Federal Transport Administration and transferring the remaining non -trunk road of the federal network to state management, the government stepped up its efforts to maintain and rehabilitate roads. As a result, transport costs in roads have fallen and road conditions improved . Now a larger percentage of federal road network is under output-based maintenance contracts (37 percent in 2007, surpassing the 30 percent target set), about 50 percent of the federal road network is considered to be in good condition, and road transport cost decreased by about 11 percent between 2003 and 2007. Efficacy in achieving this objective has been substantial .

Foster multimodal transport . The government restructured railways concessions and advanced in the regulation of the railways sector but did not make operational the Inter -Ministerial Committee for the Integration of Transport Policies. The actions taken helped raise the productivity of railroad operations but the expected 10 percent increase in the share of non-road transportation has not been attained. Efficacy in achieving this objective has been modest.

Efficacy in achieving objective A has been substantial .

B. Business Environment

Strengthen infrastructure regulation. The government established 16 independent regulatory agencies, including the land and water transport regulatory ones (ANTT and ANTQ) and Congress approved in 2004 the Public Partnership Law, which creates the legal environment for joint public-private investments in infrastructure . The government approved five PPP projects, but “the actual implementation of PPP initiatives at the Federal level is taking longer than expected . The actions constitute a step forward. Private investment in energy has surpassed the levels reached in 2000-01 but in telecoms it is still far from the levels in those years . The trends possibly indicate a potential fall in regulatory risk (plus other influences from overall economic policy) but there is no evidence that the regulatory risk in 2009 is lower than in 2004. Efficacy in achieving this objective has been modest..

Enhance the competitiveness environment and strengthen the corporate insolvency framework . Congress approved the Bankruptcy and Insolvency Law and the amendments to the Tax Code in 2005, aligning bankruptcy legislation with international practice . In part as a result of the insolvency and bankruptcy law the time required to deal with bankruptcy fell from 10 to four years and the recovery rates per dollar went from nil to 14.6 cents to the dollar.To complement the law the government needs to enforce a simple and effective antitrust regime . To have an effective antitrust regime the government needs to complement the good efforts of the Administrative Council for Economic Protection (CADE) with a better antitrust law, whose amendments Congress has not approved. CADE, one of three bodies in charge of enforcing the antitrust law, has investigated requests for mergers and acquisitions, sometimes rejecting them, and decides faster on such

requests. Neither the ICR nor subsequent information from the region provides evidence on whether since 2004 Brazil has a more competitive business environment or that the anti -trust authorities are more effective and active in promoting competition by, for example, prosecuting "hard core cartel" cases. Efficacy in achieving this objective has been modest..

Simplify entry and business operations . Congress passed in 2006 a new law for the tax system of small and medium enterprises (SMEs) that combines the six federal taxes with the state and municipal taxes levied on consumption . The ICR notes that the law is expected to lower taxes for SMEs and help reduce informality but does not provide evidence to show this was the case . The Doing Business report for 2009 notes that in Brazil it takes 2,600 hours per year to comply with paying taxes, the same number as in 2006. The loan also supported the simplification of export norms by the Ministry of Development, Industry and Trade and the simplification of procedures to register companies in some cities. There is no information on the extent of simplification of export norms and how much it has reduced the cost of exporting. No progress has been made in simplifying conditions to start a business. According to the Doing Business report, the number of days that it takes to open a business in Brazil in 2009 is 152, the same number as in 2005.This number, though, varies by province. In Minas Gerais, for example, it takes 19 days to open a business while in Sao Paulo it takes 152; because there is not a baseline at the provincial level the review cannot conclude that conditions to start a business improved. Efficacy in achieving this objective has been negligible .

Efficacy in achieving objective B has been modest.

C. Financial Sector : Efficiency and Depth

Increase financial competition . The program supported extending the application of the antitrust law to banking, and the prior action consisted of the government submitting to Congress a draft complementary law that made this extension possible . DPL2 did not follow with a prior action that led to approval of such law. Over the period January 2004-January 2008 spreads fell, but rose rapidly since then, reaching a peak in December 2008, suggesting that macroeconomic and confidence factors, rather than competition, caused the change. The Herfindahl-Hirschman index (HHI), which measures the size of firms in relation to the industry and indicates the amount of competition among them, shows that concentration in Brazil’s financial system is low, and, there is no significant risk to competition among the institutions involved (BCB, Stability Report, May 2008). Measured by total assets, the index in December 2007 was close to 0.09 (Central Bank, Financial Stability Report, May 2008, p. 115), about the same that it was in 2004. Measured by the concentration of credit operations the index has fluctuated around 0.098 since 2004, again suggesting low concentration and substantial competition. In summary, the numbers indicate that at least since 2004 concentration has been low, suggesting that there has been competition in the system over this period . This review considers that the objective had little relevance as stated and for that reason efficacy in achieving it has been negligible .

Sound fundamental legislation and systemic risk control . The program supported a constitutional amendment approving new payments systems, the evaluation of residual risk in the payments system, and the preparation of a blueprint for a second phase of reform in payments . According to the ICR the legislation necessary for the control of systemic risk and the resolution of bank failures is still pending. Payments with credit and debit cards have increased their share in total payments from 3.4 percent in 2004 to 4.1 percent in 2007, while payments with checks have declined from 25 percent to 16 percent. These trends arise, among other things, from the overall improvement in economic activity and the better management of economic policy, but also could have been caused by the tax on financial transactions which makes using credit cards more attractive . While the review agrees with the ICR in that reforms in the payment system have led to its modernization, other things happened in the Brazilian economy that could have contributed as much, or more, to the results observed. Neither the program documents for the DPLs nor the ICR tried to isolate the impact of the reforms on risk control or in the efficiency of the system . Efficacy in achieving this objective has been substantial .

Mobilize long-term resources in the insurance sector . The program supported changes in regulation (asset allocation, eligibility, registration, custody, and audit requirements) in the insurance sector and a proposal to reform the reinsurance market. The government eliminated the monopoly of reinsurance held by the state-owned Reinsurance Institute of Brazil (IRB), thereby permitting new entrants into the system. Since then, the private insurance supervisor (SUSEP) has registered 41 reinsurance companies, and in 2008 about 15 percent of the market premiums in reinsurance were underwritten by the private sector compared to zero percent in 2006. Overall, insurance premiums in Brazil have increased from 2.5 percent of GDP in 2002 to about 3.0 percent of GDP in 2008, and part of the increase comes from the growth of private sector providers . Efficacy in achieving this objective has been substantial .

Improve efficient access to financial services to the poor and SMEs . The program supported the establishment of a law to expand financial access to banks and the issuing of regulations that authorized voluntary payroll deductions to civil servants, retirees, and pensioners of the government 's Federal Executive Branch. Payroll deduction loans increased from 6 billion reais (R$6 billion) to R$40.3 billion between January 2004 and August 2008, the number of bank accounts increased from 95 million to 140 million during the period, and overall bank credit increased from 28 percent of GDP in December 2005 to 38 percent in August 2008. These numbers indicate that the financial system has expanded its reach, but cannot confirm whether access to credit for the poor and to SMEs has improved. The ICR notes that the cost of borrowing remains high, limiting access to credit to both families and SMEs, but lacks information on the amount or the proportion of total credit that goes to these groups, specially the poor. While the review acknowledges the advances noted in the financial system of Brazil, the evidence provided in the ICR and subsequent comments and information from the region does not permit to conclude that access to financial services to the poor and SMEs improved. Efficacy in achieving this objective has been substantial .

The review concludes that efficacy in achieving objective C was substantial .

D. Innovation

Increase public R&D effectiveness . The program supported the approval of an innovation law and of a legal framework to subsidize directly the private sector 's R&D. Although little information is available on technology transfers from university to businesses, patenting activity by Brazilian universities increased substantially after 2002. Universities submitted more than 160 patents per year during 2002-2008 compared with less than 50 per year during 1997-2001. Using patenting activity as a proxy for licensing between universities and the private sector, the review concludes that this objective is likely to have been achieved and the outcome indicator met (i.e., number of technology transfer contracts between public universities /research centers and the private sector increased by 20 percent). Efficacy in achieving this objective has been modest.

Foster private innovation. The program supported reforms in the Sectorial Funds, the Green-Yellow Fund, and in tax policy to stimulate private R&D . The ICR does not inform whether the outcome indicators set in the matrix of key actions and indicators were achieved . Subsequent information from the LAC region indicates that after 2004 business expenditure on R&D as percent of GDP has increased, reversing a trend since 2000. Efficacy in achieving this objective has been modest .

Create innovation in environmental markets . The program supported the government's ratification of the Kyoto protocol, making operational the inter-ministerial commission for global climate change, and the publication of the procedures for approval of projects under the clean development mechanism . The expected outcome seems to have been achieved. The sale of carbon credits surpassed the goal of US$100 million set in the indicators matrix; 130 million tons of CO_2 are expected to be reduced during the first commitment period with an estimated benefit for the economy of about US$ 780 million. The ICR does not differentiate between sales and benefits, making it difficult to conclude on the impact of the actions taken. The review considers that efficacy in achieving this objective has been substantial .

The review concludes that efficacy in achieving objective D was modest.

Brazil's macroeconomic performance during 2004-07 was solid. Annual consumer price inflation averaged 5.3 percent, GDP grew at 4.5 percent per year, and the current account had a surplus of 1.2 percent of GDP per year on average. Over the period the government maintained its fiscal deficit below 3 percent of GDP and the public sector's net debt fell from 49 to 45 percent of GDP. The government has also improved the composition of the public debt and lengthened its maturity . The program did not define indicators to evaluate whether the macroeconomic framework was satisfactory but this review concludes that the authorities managed macroeconomic policies well, which explains the good economic results observed during the period.

5. Efficiency (not applicable to DPLs):

a. If available, enter the Economic Rate of Return (ERR) ERR)/Financial Rate of Return (FRR) FRR) at appraisal and the re -estimated value at evaluation : re-

	Rate Available?	Point Value	Coverage/Scope*
Appraisal		%	%
ICR estimate		%	%

* Refers to percent of total project cost for which ERR/FRR was calculated.

6. Outcome:

The loans tried to help solve relevant problems but the actions taken to solve them fell short of what was needed. Relevance of objectives was substantial but efficacy of results was modest.

a. Outcome Rating : Moderately Satisfactory

7. Rationale for Risk to Development Outcome Rating:

The risk of reversal of the implemented reforms is moderate. First, over the last seven years the government has achieved strong growth with low inflation, reflecting favorable external conditions and its adoption and execution of sound macroeconomic policies . Sound policies have contributed to the increased resilience of the Brazilian economy as demonstrated by the limited impact of the global financial turmoil. The success in economic management makes it highly unlikely that Brazil will abandon its present approach. Second, the authorities' emphasis on higher and sustainable growth has been a pillar of its comprehensive policy framework, which has supported steady reform over the period discussed. Third, the government changed little in the areas that the business environment and the financial sector components covered; it is likely that future changes will improve the business environment and the depth and efficiency of the financial sector since these are the options compatible with higher and sustainable growth.

a. Risk to Development Outcome Rating : Moderate

8. Assessment of Bank Performance:

The government worked closely with the Bank to design the two loans and the Ministry of Finance led the microeconomic reform agenda incorporated in the program . The government went

ahead with the second loan despite a change in its priorities, away from microeconomic reform, which delayed by 18 months the effectiveness of the second loan. Loss of interest in carrying out the reforms possibly contributed to the poor outcomes observed in some of the program components. This review rates government performance moderately satisfactory .

Several ministries and government agencies were involved in designing and implementing the program, but not all of them succeeded in producing the results expected from it . Notable in results were the Federal Revenue Secretariat that led the reforms in customs . This review rates implementing agency performance moderately satisfactory .

at -Entry :Moderately Satisfactory

a. Ensuring Quality -at-

b. Quality of Supervision :Not Applicable

c. Overall Bank Performance :Moderately Satisfactory

9. Assessment of Borrower Performance:

The government worked closely with the Bank to design the two loans and the Ministry of Finance led the microeconomic reform agenda incorporated in the program . The government went ahead with the second loan despite a change in its priorities, away from microeconomic reform, which delayed by 18 months the effectiveness of the second loan. Loss of interest in carrying out the reforms possibly contributed to the poor outcomes observed in some of the program components . This review rates government performance moderately satisfactory .

Several ministries and government agencies were involved in designing and implementing the program, but not all of them succeeded in producing the results expected from it . Notable in results were the Federal Revenue Secretariat that led the reforms in customs . This review rates implementing agency performance moderately satisfactory .

a. Government Performance :Moderately Satisfactory

b. Implementing Agency Performance :Moderately Satisfactory

c. Overall Borrower Performance :Moderately Satisfactory

10. M&E Design, Implementation, & Utilization:

The program documents used intermediate and process indicators to monitor and evaluate impact but there was little effort to explore the economic implications of some of the actions taken, such as measuring the reductions in logistics costs, the clearest case where costs were mentioned . Overlooking the direct economic impact of the reforms and neglecting to point out and measure their economic benefit constitutes a flaw in the design of M&E. Because the economic results were not thought out, there was no effort to evaluate the economic impact of this operation, and use that information to influence future program design. Overall, the quality of M&E was modest.

a. M&E Quality Rating : Modest

11. Other Issues (Safeguards, Fiduciary, Unintended Positive and Negative Impacts):

12.

12. Ratings :	ICR	IEG Review	Reason for Disagreement /Comments
Outcome :	Moderately Satisfactory	Moderately Satisfactory	See section 4 above
Risk to Development Outcome :	Moderate	Moderate	
Bank Performance :	Satisfactory	Moderately Satisfactory	See section 8 above
Borrower Performance :	Satisfactory	Moderately Satisfactory	See section 9 above
Quality of ICR :	Satisfactory		

NOTES:

NOTES

- When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
- The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate .

13. Lessons:

When the government owns the reform process and drives the reform agenda a policy loan is more likely to succeed because it incorporates practical and political constraints in its design and timing . Government ownership is likely to increase if good technical analysis supports the design of the loan, but does not guarantee the success of the operation.

Selecting good outcome indicators constitutes an integral part of project design . It facilitates evaluating the loan's impact, it helps to check the logic behind the theory of change supporting the loan, and it permits to identify if the actions proposed can deliver the objectives set for the loan .

14. Assessment Recommended? Yes No

15. Comments on Quality of ICR:

The ICR summarizes well the project's design, implementation, and achievements. It discusses outcomes better for the logistics and business environment components than for the financial and innovation components. It does not discuss the macroeconomic framework. The discussion on results in the financial and innovation components provides little information on what was achieved and the information selected to portray achievements is not necessarily useful or relevant . Subsequently, the LAC Region provided the missing information or complemented the information in the ICR, which permitted to obtain a better grasp on what the project achieved.

The lesson that deep institutional reforms require sector specific operations rather than DPLs does not emerge clearly from the discussion, If sector specific operations are judged to be better, the ICR should have explained better why that is so in Brazil, whose government has the capacity to carry out reforms if the political will exists .

The ICR presents different ratings for Bank performance for DPL2 in the ratings summary table (satisfactory) and in the text (moderately satisfactory).

a.Quality of ICR Rating : Satisfactory