Brazil
Minas Gerais – World Bank Partnership
Building on a Strong Foundation and Leading to Next Steps

June 6, 2007

Brazil Country Management Unit
Poverty Reduction and Economic Management Unit
Latin America and the Caribbean Region
ACKNOWLEDGEMENTS

This Partnership document was written in close collaboration with the Minas Gerais authorities and a World Bank team led by Ethan Weisman, Lead Economist for Brazil (LCSPR), Fernando Blanco (LCSPS), José Guilherme Reis (LCSPF), Jeff Rinne and Deborah Wetzel (both LCSPS), Gerald La Forgia (LCSHH), Suhas Paranderkar (LCSHE), Aymeric Meyer (LCSTT), and Carlos Velez (LCSUW). Valuable comments on previous drafts were received from peer reviewers: Bert Hofman (EASPR), Lili Liu (PRMED), David Rosenblatt (LCSPR) and Mark Sundberg (DECVP); as well as from Chris Parei (LCSPM).

CURRENCY EQUIVALENTS

Exchange Rate Effective June 1, 2007
Currency Unit = Brazilian Real
US$1.00 = R$1.92

GOVERNMENT FISCAL YEAR

January 1 – December 31

WEIGHTS AND MEASURES

Metric System

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<thead>
<tr>
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<th>Name</th>
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<td>Ethan Weisman</td>
</tr>
</tbody>
</table>
Table of Contents

Currency Equivalents ..................................................................................................... - 2 -
Government Fiscal Year ................................................................................................. - 2 -
Weights and Measures .................................................................................................... - 2 -
Abbreviations and Acronyms ........................................................................................ - 4 -
Executive Summary ...................................................................................................... - 6 -
1. Background and Context ...................................................................................... - 12 -
   1.1 Poverty and Social Indicators in Minas Gerais .............................................. - 13 -
   1.2 Investment Climate in Minas Gerais .............................................................. - 15 -
   1.3 Brief Recent Economic History of Minas Gerais ........................................... - 18 -
   1.4 The current PAF agreed with the National Treasury (STN) ....................... - 20 -
1.5 A Brief Review of the PMDI 2003-2020 and the PPAG 2004-2007 ............ - 21 -
   a. Development Policy Loan (2006-2007) ....................................................... - 24 -
   b. Other World Bank Activities ........................................................................ - 25 -
2. Plano Mineiro de Desenvolvimento Integrado (PMDI) 2007-2023 ..................... - 25 -
   2.1 Overview ........................................................................................................ - 25 -
   2.2 Sectoral assessments ....................................................................................... - 27 -
       a. Public Sector Management Assessment ....................................................... - 27 -
   b. Education Sector Assessment ....................................................................... - 32 -
   c. Health Sector Assessment ............................................................................. - 35 -
   d. Water Sector Assessment ............................................................................. - 37 -
       e. Transport Sector Assessment .................................................................... - 43 -
   f. Private Sector Development Assessment ...................................................... - 46 -
3. Conclusions and a Way Forward .......................................................................... - 51 -
References ................................................................................................................ - 53 -
<table>
<thead>
<tr>
<th>Abbreviations and Acronyms</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>BDMG</td>
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Minas Gerais - World Bank Partnership: Building on a Strong Foundation and Leading to Next Steps

Executive Summary

1. The purpose of preparing this Minas Gerais – World Bank Partnership document was to provide a vehicle for strengthening this bilateral dialogue to continue Bank support for the Minas development program and to develop the foundations that could support a possible future Bank operation. This vehicle led to a series of contacts and visits where senior officials and technical staff had opportunities to exchange ideas, without linking those interactions directly to a specific Bank product (lending or technical assistance). This allowed a freer form of communication and focused on long-term development issues, policies, and programs under development by the Minas authorities.

2. This document points the direction for next steps and emphasizes the elements and principles of a possible follow-up operation to the Development Policy Loan (DPL) that completed disbursement in April 2007, recognizing that it was premature to discuss the specifics of such an operation during this exercise. For example, a follow-up operation would likely include a strong technical assistance lending component for focus sectors. More focus on programs, projects, and related indicators would be central to such an operation and fit closely with the Minas Gerais development plan. Given the Minas Gerais spotlight on applying their public sector reforms more effectively in the sectors, the core sectoral work in a follow-up operation would cover public sector management and public financial management reforms. One key principle would aim to complete the next generation of public sector management challenges, spreading these advances more deeply in sectoral work, with a view to improving public sector services and enhancing economic growth.

3. These elements and principles would provide the incentives and motivations for the choice of focus sectors under a possible Bank operation with Minas Gerais. The sectors covered in this Partnership document represent areas where the Minas Gerais authorities have concentrated attention and resources, and where the Bank has a comparative advantage to contribute to the authorities’ objectives, policies, and programs. However, because this document was part of an initial exercise in the dialogue process, not all sectors are covered, and even for the sectors that are included, full information has not yet been assessed.

4. Lead actively by the Governor and Deputy Governor, the Minas authorities have clearly identified enhancing the living conditions of citizens in the state as the overall priority. They have set an equally clear objective of making Minas Gerais the best place to live in Brazil and have linked this objective to the concrete and measurable human development indicators. Minas has made progress in recent years to enhance its economic growth and job creation, as well as to improve the quality of public services delivered or supported by the state. As
a result of these efforts, in recent years, Minas has generally grown faster than the national average and has made substantial progress with the human development and other poverty and social indicators.

5. **Nevertheless, the Minas Gerais targets are ambitious and by international standards there is ample room for additional progress.** Not only are real economic growth rates and improvements in poverty indicators modest, but the overall standard of living for average families in Minas Gerais could be significantly improved. The main impediments to such improvements stem from both national and local factors. Chief among the local factors remain further improvements to the business climate and to public sector management, as well as continued robust fiscal policy to stay on a sustainable path.

6. **The Minas Gerais authorities have carefully diagnosed this situation and are well on track to addressing these main issues drawing on their experience and within a context of fiscal requirements agreed with the federal government.** Compared with the situation in the late 1990s and earlier this decade, Minas has made substantial progress. Moreover, based on the experience with the long term strategic development plan (*Plano Mineiro de Desenvolvimento Integrado 2003-2020* or *PMDI 2003-2020*), that emphasized public sector management reforms (the so-called *Choque de Gestão* (Management Shock), the authorities have launched a second generation of the *Choque de Gestão* in their *PMDI 2007-2023*. The key cross-cutting pillars of this strategy are improving the quality of the fiscal adjustment in addition to public sector management reforms. On fiscal policy adjustment, the Minas authorities have worked closely with the federal government to comply with federal requirements outlined in federal debt restructuring operations with the state, the Fiscal Responsibility Law (2000), and associated fiscal adjustment programs agreed with the National Treasury.

7. **The *PMDI 2007-2023* places Minas Gerais in the broader Brazilian context, but takes the benign international context as given.** It contains four disparate scenarios, all based on steady world economic growth of about 3.5-4.5 percent per annum. Along one spectrum the alternatives essentially juxtapose strong economic growth in Brazil based on measures to encourage social inclusion and the rational use of natural resources, on one hand, with more intermittent measures and uneven progress at the national level. Along another axis, the scenarios contrast progress in Minas Gerais with reforms to become more creative, competitive, and inclusive, with the alternative of a conservative, inefficient and exclusive set of policies. The most likely scenario is the more progressive Minas set of policies with slow but steady economic growth in Brazil. This is consistent with the *PMDI 2007-2023* scenario labeled "Overcoming Adversities". However, the context for the *PMDI 2007-2023* does not consider alternative international environments that may be less benign than current circumstances.
8. **Given this context, fiscal policies and public sector reforms in Minas Gerais could be expected to yield continued stronger than national average economic growth and progress in creating jobs.** Fiscal analysis shows that the adjustment pursued since 2003 has been successful in reversing fiscal trends and placing Minas on a sustainable path. Key to the adjustment was current cost containment and improved revenue collection. The improved fiscal outlook has contributed to an improved debt profile, leading to a virtuous cycle. This has also provided room for increase investment by the state and the reduced risk perceived by the private sector is encouraging private investment, further enhancing growth and job creation prospects.

9. **The focus of this Partnership document is mainly on the PMDI 2007-2023 long-term development strategy with an emphasis on broadening reforms across sectors** (rather than concentrating on the central Secretariats, which was the initial focus of the previous PMDI). World Bank staff interacted with the Minas authorities intensively regarding public sector management, education, health, water, transport, and private sector development issues. Each sector assessment aims to identify: the main issues facing the sector; the government’s programs and projects designed to address these issues; potential indicators of relevance for these programs and projects; suggestions for improvements; and areas where further World Bank collaboration could be useful.

10. **In summary, sectoral assessments highlighted the following points:**

11. On **public sector management** there were significant advances during the first *Choque de Gestão*, but these advances were not uniform. These advances represent good international practice compared with OECD experience, and best practice in Brazil. Considerable progress was made in efforts to manage civil servants, to identify key results and to streamline both fiscal and management practices to meet these objectives. Great gains were also made in technical systems to support taxation, expenditure and procurement. Most activities are being carried forward in second generation *Choque de Gestão* with a stronger sectoral focus, improved performance indicators, and better evaluation methods, aiming to spread this new culture of public sector performance across sectors and down to more technical levels within those sectors. The structural project specifically devoted to improved public sector management appropriately focuses on improving performance evaluation and monetary rewards mechanisms, which should have ripple effects across the sectors. However, the link between desired outcomes and specific sectoral programs could benefit from improvements to the process for evaluating individual staff and the system of rewards for performance. On procurement, while Minas is at the forefront of innovation, which has already generated significant fiscal saving, additional Bank technical assistance could support the implementation of a procurement web portal, further studies on strategic sourcing, a review of procurement business processes, e-learning, development of an asset management system, and analytical work on the e-procurement system.
12. On education, the PMDI 2007-2023 appropriately seeks to tackle the twin challenge of improving educational attainment with a simultaneous betterment of educational quality. Looking forward, the Bank would tend to emphasize three recommendations in the education sector of the PMDI: 1) strengthening the detailed planning and processes of discussion to link broad and long-term goals with concrete, detailed, and short-term steps; 2) finding outside support for the Education Secretariat (SEE) to improve management; and 3) that two initiatives (to transform the SEE organizational culture, and strengthening performance evaluation and accreditation of SEE employees) should receive the highest priority.

13. On health, the three structural reform programs (i) Health Care Regionalization (RAS), (i) Hospital Strengthening and Quality Improvement (PROHOSP); and (iii) Health at Home (SEC) already underway in the MG health sector are cutting edge within the Brazilian context and have the greatest potential to improve the quality of spending as well as health outcomes. The progress with these programs thus far has led to a number of new steps and directions that could be elaborated further in the Minas Gerais-World Bank Partnership in the health-related sector, especially: development of systematic monitoring, focus on impact evaluation, contract management enforcement, revised institutional arrangements for public foundations dealing with drugs and with blood derivatives, and integration of the FHEMIC state hospitals foundation into the RAS and PROHOSP reforms.

14. On water, the main issues in Minas Gerais include: 1) access to water and sanitation services (WSS) in the poorer northern part of the state; 2) the challenge of implementing the federal WSS law covering the institutional and regulatory framework; 3) WSS efficiency and uniform salaries and prices; 4) implementation of the water resource management (WRM) framework, especially regarding environmental licensing, planning for droughts and floods, and regulation of groundwater; 5) the lack of wastewater treatment; and 6) urban drainage and pollution control. Under the PMDI 2003-2020 a structural project on health contributed to far-reaching legal, institutional, and administrative reforms to strengthen the state water company (COPASA). The PMDI 2007-2023 continues this health project and adds five other water sector related structural projects within three results areas: the regional development in the north, environmental quality, and poverty reduction. A major challenge in the regional development area will be the establishment and operational implementation of a COPASA subsidiary to provide water services. Thus, future collaboration with the World Bank could explore possible financial support to COPASA, as well as technical support to help design and implement the subsidiary. Other possible technical assistance could cover water sector planning, regulation of WSS, public-private partnerships in WSS, support to municipalities on WSS and WRM issues, assistance on flood control, and strengthening information systems and public access to information on WSS and WRM matters.
15. On transport, the main transport sector issues in Minas Gerais are, in substance, common to those encountered in other states and at the federal level: 1) slow progress on the decentralization and delegation discussions between the Federal Government and the states; 2) coping with the consequences of inadequate funding for road infrastructure (and especially investments for rehabilitation) over the 1995-2004 period; and 3) the need to strengthen public sector capacity. Under the first generation Choque de Gestão Minas has achieved results in the transport sector that, on average, go well beyond what other states or the federal government have been able to do. The objective for the second generation Choque de Gestão is to increase the efficiency of priority government programs. Government priorities in the transport sector are adequate and focus on physical infrastructure maintenance and rehabilitation, with selective and localized infrastructure expansion; and a gradual institutional shift toward result-based management, increased involvement of the private sector, and fostering of multimodality. In terms of possible future collaboration with the World Bank in the transport sector, the Partnership could explore possible financial support to the state road rehabilitation and maintenance program, as well as some options for technical support covering institutional strengthening, improved efficiency of expenditures under publicly financed programs in the sector, and development of new models of partnership with private.

16. On private sector development, the Minas Gerais authorities are convinced that improving the investment climate in the state is the best way to establish the conditions for long term growth and continuous job creation. Information on the analytical determinant of economic growth in Minas Gerais are scarce, so using benchmarking, such as results from the World Bank Group’s Doing Business in Brazil provides useful insights. In this context Minas is doing well, ranked overall 3rd out of 13 locations surveyed, but two specific areas stand out for further improvement: paying taxes and enforcing contracts. Eleven of the 57 structural projects included in the PMDI 2007-2023 are related to strengthening private sector development and the assessment focused on those related to innovation and technology, simplification of business processes (Descomplicar), and improving tax efficiency. These projects aim at improving total factor productivity in Minas and enhancing performance in the Doing Business indicators mentioned above. Thus, the Minas Gerais-World Bank Partnership could focus on these areas, as well as on strengthened analysis regarding factor productivity growth processes.

17. Summaries of these assessments also reveal a series of cross-cutting themes, in addition to individual sectoral findings. A natural consequence of the PMDI is the continued cross-cutting emphasis on improved public sector management through the second generation Choque de Gestão. However, one common theme across most of the sectoral assessments was the need to filter the principles and objectives of the second generation Choque de Gestão to levels well below senior management in line Secretariats. The ownership of the PMDI and the structural projects is much weaker the closer one gets to the public service provider, who has the most direct contact with the public service recipient. A great deal more
outreach, training, and capacity building is needed to make the PMDI 2007-2023 successful. Similarly, the challenge of linking indicators with desired outcomes and results is central to the next steps of the PMDI development. In most sectors these linkages seem weak and finding or developing such indicators and making them useful to project managers remains a major challenge. Equally interesting are the linkages across sectors built into the PMDI structural projects. Of particular note, based on the sectoral assessments are the linkages between measures to encourage private sector development and the need to involve the private sector in other sectoral work, especially transportation. Another important linkage recognized in the PMDI was the important role of the transport network to develop and foment regional approaches to health care.

18. In short, the sectoral assessments are at the heart of the Partnership dialogue and could be used as the foundation for future development of the relationship, especially in areas of technical assistance or future Bank operations with Minas Gerais. While it would be premature to discuss the modalities of any future operations, it is worth noting that a follow-up Development Policy Loan (DPL) or an investment loan using a Sector-Wide Approach could be considered. The 2006 DPL to Minas Gerais focused on strengthening fiscal and public sector management, and private sector development. A follow-up operation should expand this focus and accommodate a broader sectoral focus. Regardless of the instrument, the policy and technical dialogue, World Bank provision of technical assistance, international networking, and knowledge sharing events in which Minas would take part should continue. The scale and speed by which these forms of support take place may depend in part on concurrent financial support from the Bank; however, the commitment and channel of communications has been solidified through the process underlying this Partnership document.
1. **Background and Context**

19. **Minas Gerais (Minas) is one of Brazil’s largest and most economically important states.** The state of Minas Gerais has the country’s second largest population (19.5 million people, equivalent to 10.5 percent of Brazil’s population in 2006), about half that of São Paulo (41.0 million). Minas is the fourth largest state in Brazil, covering 586,553 km² or 7 percent of the country. The state’s economy is the third largest in Brazil. In 2004 the Gross Domestic Product (GDP) of Minas Gerais was R$166.5 billion (US$ 60 billion), or 9.4 percent of national GDP, smaller than São Paulo (30.9 percent) and Rio de Janeiro (12.2 percent). Thus, the economy of Minas Gerais is slightly smaller than Peru.

20. **The economic structure of Minas reflects its historical roots in mining,** with strengths in industrial chemicals, iron and steel, agro-industry, and more recently in electronic goods. The state also has a strong agricultural base. In the standard breakdown of state income calculated by the Brazilian Geographical and Statistical Institute (IBGE), Minas has slightly higher concentrations than the national average in both industry and agriculture, but lower in services.

21. **Minas Gerais is sometimes called a microcosm of Brazil.** Its per capita GDP is close to Brazil’s average (ranked 12 out of 27 in 2004). Moreover, Minas contains deep regional disparities paralleling those at the national level. For example, Minas has a poor Northeastern region with similar conditions of extreme poverty, subsistence agriculture, semi-arid climate and intermittent drought experienced in the Brazilian Northeast, the poorest region in the country. At the other extreme, the state contains some of Brazil’s most dynamic industrial areas (for example, the **Mineiro Mineiro** and the metropolitan area of Belo Horizonte, the state’s capital). Minas has 853 municipalities, or over 15 percent of the 5,560 municipalities in Brazil.

1.1 **Political Environment in Minas Gerais**

22. **Successful public policy reforms have lead to a stable political environment.** After years of economic difficulties experienced by Minas Gerais (described below), in 2002 Governor Aécio Neves was elected to a first four-year term. Governor Neves is the grandson of Brazil’s first democratically elected President following the military dictatorship. He is a leading member of the Social Democratic Party (PSDB) and has an immensely strong following in Minas Gerais. Governor Neves was re-elected to a second term (2007-2010) by an overwhelming majority (roughly 80 percent of the vote). His current Deputy Governor, Anastasia, served as Secretary of Planning during Governor Neves’ first administration. Together, they have been the driving force behind the Minas Gerais long-term development plan (*Plano Mineiro de Desenvolvimento*

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1 Population growth in Minas also has been close to the national average.
Integrado 2003-2020 or PMDI 2003-2020) and the so-called Choque de Gestão (Management Shock), to improve public sector management. These efforts have contributed to the Minas Gerais economic recovery. Moreover, the success of these reforms also has been one explanation for the relatively small political opposition in Minas Gerais, as well as a strong outlook for continuity with these policies.

1.2 Poverty and Social Indicators in Minas Gerais

Poverty in Minas also broadly reflects national levels and poverty and social indicators have been improving. Using a national food-based poverty line for household per-capita income of about R$132 (US$56) per month in 2005, Minas has a poverty headcount ratio of about 19 percent of the population (from 25 percent in 2002), implying a poverty headcount of about 3.7 million. Using a 2005 extreme poverty line (about half the poverty line, or R$66 – US$28), Minas has an extreme poverty headcount ratio of about 5 percent (roughly 1 million persons), compared with 8 percent in 2002. As shown in the charts in Figure 1, Minas has third lowest poverty headcount rate among the states, and a relatively high per capita family income.
24. The Human Development Indicator (HDI) of Minas Gerais in 2000 was higher than the Brazilian average and Minas was 9th among the 27 states (with an HDI of 0.773 for Minas, compared with 0.766 for Brazil). However, performance varies widely at the municipal level. Outside the Amazon region, Minas Gerais has the highest dispersion of municipal welfare indicators in Brazil. Setubinha (in the Vale do Mucuri) had the lowest HDI in Minas in 2000 (0.45), reflecting 23 percent illiteracy (ages 18–24) and infant mortality of 61 (one-year definition, per 1000 live births). At the other end of the spectrum Belo Horizonte has an HDI of 0.84 with near complete literacy (ages 18–24) and infant mortality of 27. Similar to the national pattern, 375 municipalities out of 853 Minas Gerais’ municipalities (or 44 percent) are included among the 40 percent of Brazilian municipalities with the highest HDIs, while 222 Minas Gerais’ municipalities (or 26 percent) are included among the 40 percent Brazilian municipalities with the lowest HDIs. In other words, Minas Gerais has a higher proportion of municipalities with high HDIs and a much lower proportion with low HDIs relative to the nation. Moreover, indicators regarding access to water and
sanitation as well as education (child enrolments) are above national averages, and infant mortality rates are low compared with other states, as illustrated by Figure 1.

Figure 1

1.3 Investment Climate in Minas Gerais

25. The Investment Climate Survey conducted by the Bank in 2003 reveals that Minas Gerais is representative of Brazil as a whole. Business respondents to the survey ranked the following as the five most serious constraints to operating a business in Minas Gerais: tax rates; the cost of capital; macroeconomic uncertainty; regulatory uncertainty; and corruption. Clearly most of the constraints identified by the business sector in Minas are outcomes of policies at the federal level, over which the state government has little or no control. These
refer to most of the tax burden (Brazilian public sector taxes represented approximately 36 percent of GDP in 2006, using the revised GDP data), the cost of capital (affected by national monetary policy and financial sector regulations), macroeconomic uncertainty, and some regulatory uncertainty. The portion that remains under the state’s control includes measures to re-establish Minas’ fiscal stability, control corruption, and reduce regulatory uncertainty in policies and services that are directly administered by the state itself.

26. **Minas Gerais is the fifth state with the highest time tax— which is an overall measure of the regulatory burden** — with firms’ managers spending around 8.5% of their time in dealing with Government regulations (Figures 2 and 3). However, registration times for new firms are relatively low in Minas Gerais. The time tax measures the proportion of firms’ senior management time in dealing with government regulations such as filing forms, inspections, permits, etc. Firms in the Northeastern states of Paraiba, Bahia and Ceará spend the lowest on dealing with regulations, ranging from 2.4 to about 7 percent of senior managers’ time. The results for Minas seem to be linked to the low levels of investment in IT technologies in the state, at a time when other states were investing. In terms of registration times, Minas performs quite well (fourth out of 12 states) a result that was confirmed by the Doing Business in Brazil report.

**Figure 2. Time Tax: Percentage of Senior Management Time Spent on Government Regulations, by State**

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<td>9.0</td>
</tr>
<tr>
<td>Mato Grosso</td>
<td>8.6</td>
</tr>
<tr>
<td>Minas Gerais</td>
<td>8.5</td>
</tr>
<tr>
<td>Goiás</td>
<td>8.3</td>
</tr>
<tr>
<td>Paraíba</td>
<td>8.0</td>
</tr>
<tr>
<td>Rio Grande do Sul</td>
<td>7.9</td>
</tr>
<tr>
<td>Rio de Janeiro</td>
<td>7.8</td>
</tr>
<tr>
<td>São Paulo</td>
<td>7.6</td>
</tr>
<tr>
<td>Ceará</td>
<td>6.9</td>
</tr>
<tr>
<td>Bahia</td>
<td>5.7</td>
</tr>
<tr>
<td>Paraíba</td>
<td>2.4</td>
</tr>
</tbody>
</table>
```

Source: Brazil Investment Climate Survey
27. **On the business climate, Minas Gerais performs well compared to other Brazilian states.** Among the 13 Brazilian state capitals surveyed by the Doing Business in Brazil (2006), Belo Horizonte is placed third in the rank on the ease of doing business in the country (the first two are Brasilia and Manaus (Table 2).² There are two main factors behind this good performance for Belo Horizonte: starting a business and getting credit. In Belo Horizonte it takes 19 days to open a business (a process that requires 10 procedures) and 2 days to establish collateral at a cost of 0.85 percent of the loan value. These were the shortest periods for these indicators among the 13 state capitals surveyed.

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² While the Doing Business methodology is valuable to compare legal and accounting rules, it relies on official and formal documents, rather than actual practice, which may differ markedly.
Table 2: Where is it easiest to do business in Brazil?

<table>
<thead>
<tr>
<th>Rank</th>
<th>City</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Brasilia (Federal District) (easiest)</td>
</tr>
<tr>
<td>2</td>
<td>Manaus (Amazonas)</td>
</tr>
<tr>
<td>3</td>
<td>Belo Horizonte (Minas Gerais)</td>
</tr>
<tr>
<td>4</td>
<td>Porto Velho (Rondônia)</td>
</tr>
<tr>
<td>5</td>
<td>São Luís (Maranhão)</td>
</tr>
<tr>
<td>6</td>
<td>Porto Alegre (Rio Grande do Sul)</td>
</tr>
<tr>
<td>7</td>
<td>Campo Grande (Mato Grosso do Sul)</td>
</tr>
<tr>
<td>8</td>
<td>Rio de Janeiro (Rio de Janeiro)</td>
</tr>
<tr>
<td>9</td>
<td>Florianópolis (Santa Catarina)</td>
</tr>
<tr>
<td>10</td>
<td>Salvador (Bahia)</td>
</tr>
<tr>
<td>11</td>
<td>São Paulo (São Paulo)</td>
</tr>
<tr>
<td>12</td>
<td>Cuiabá (Mato Grosso)</td>
</tr>
<tr>
<td>13</td>
<td>Fortaleza (Ceará) (most difficult)</td>
</tr>
</tbody>
</table>


1.4 Brief Recent Economic History of Minas Gerais

28. Economic growth in Minas Gerais lagged behind the national average for Brazil at a critical point in its economic history. During 1995-1999 Brazil grew at an annual average real rate of 2.6 percent, while Minas grew by 2.9 percent. However, during 1999-2003 national GDP growth was 1.8 percent per annum, whereas Minas GDP grew by only 0.7 percent per year; thus, Minas fell behind the national average during that period.

29. The Minas Gerais state government emerged from the 1990s facing a difficult fiscal situation. The combination of lax fiscal policy adopted by the state, the economic stagnation and the tight monetary policy at the national level used for stabilization purposes during the period 1995-98, led to an unsustainable path for the state’s fiscal accounts. In 1997 and 1998 this culminated in a bail-out operation from the federal government and a subsequent debt renegotiation agreement with the National Treasury (STN). However, these measures were insufficient to cope with the continued poor revenue performance, increasing current expenditure, and sizable debt service owed to the National Treasury (STN).

30. In 1999, Governor Itamar Franco declared a debt moratorium and proposed a default on Minas Gerais debt owed to the federal government, which was soon followed by an economic crisis in Brazil and further fiscal imbalances in Minas. The debt moratorium declaration threatened to unravel the adherence by Minas Gerais and the rest of the Brazilian states to fiscal discipline and to respect the Debt Refinancing Agreements signed in 1997. International markets reacted adversely to the debt moratorium declaration. At the same time international markets experienced a series of shocks. The exchange rate depreciated and the Brazilian economy slowed. Even though Minas Gerais also announced its own fiscal adjustment in 1999, aggravated by the international context the Minas Gerais fiscal adjustment effort was insufficient to curb the increasing trend in its fiscal imbalances.

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3 The 1997 refinancing agreement between the federal government and 25 state governments was conditioned on the adoption of Fiscal Adjustment Programs, coordinated by the National Treasury Secretariat. The program had targets on indebtedness, primary results, personnel expenditures, revenues, investments and privatization programs.

31. At the national level, the Brazilian government reshaped its fiscal relations with the states. Under the 1998 debt renegotiation agreement, states agreed to annually contracted Fiscal Adjustment Programs (PAFs) covering a rolling three-year period signed with the National Treasury Secretariat (STN). In 2000, the government passed the Fiscal Responsibility Law (LRF), setting targets on fiscal variables. For example, under the LRF a target ceiling for state indebtedness (net consolidated debt (DCL) to net current revenue (RCL)) was set at 200 percent by the year 2015. In addition, three other LRF ceiling targets included interest payments and amortization (11.5 percent of RCL), personnel expenditure (60 percent of RCL), and credit operations (16 percent of RCL). To access credit, states would need to be below these ceilings.

32. In 2003, a new Minas Gerais administration launched a strong fiscal adjustment effort to promote a turnaround in the public sector accounts, improve public sector management and revitalize the private sector. Under a program called the Choque de Gestão (Management Shock), the state government defined measures directed to curb the increasing trends in expenditure through tight controls on personnel and operating costs.

33. The results of this adjustment were immediate and impressive during the initial years of the adjustment. Outcomes included: 1) the primary surplus increased from 3 percent of RCL in 2002 to 7.7 percent in 2003; 2) the current fiscal balance increased from -5 percent of RCL 2002 to 3 percent in 2003; and 3) the nominal deficit was reduced from 10 percent of RCL in 2002 to 6 percent in 2003. In 2004, the recovery in economic activity and improved efficiency of tax collection contributed to consolidate the fiscal adjustment. The state government primary surplus rose to 15.8 percent of RCL, current fiscal saving increased to 14.3 percent of RCL, and, for the first time in more than a decade, the state generated a positive nominal balance of 0.7 percent of RCL.

34. The fiscal adjustment and Choque de Gestão implemented by the Minas Gerais government led to full compliance under the PAF agreed with STN and all the requirements established under the LRF. The sound fiscal performance and improved economic conditions have led to a drop in Minas Gerais state indebtedness. The net consolidated debt (DCL) to RCL fell from 278 percent at the end of 2002 to 181 percent in 2006. As a result, the state is below the LRF requirement of 200 percent. Due to this debt reduction, interest payments and amortization fell from 14.6 percent of RCL in 2002 to 11 percent in 2006 (below the 11.5 percent LRF ceiling). Personnel expenditure fell from 66 percent of RCL in 2002 to 50 percent in 2006 (below the 60 percent LRF ceiling). In addition to the LRF requirements, in 2005 Minas achieved all of its fiscal targets under the 2004-06 PAF agreed with STN (see the next section). Therefore, the LRF restrictions, by themselves, are not binding constraints for potential Bank lending operations to Minas Gerais.
1.5 The current PAF agreed with the National Treasury (STN)

35. Under Law 9496 of September 1997, Minas Gerais subscribed in April 1998 to a contract governing the refinancing of its debt with the federal government. In accordance with the contract terms, the value of the operation was R$11.9 billion or 16 percent of state GDP. In exchange for the rescue package, Minas Gerais (like most states) committed to comply with fiscal targets and structural reform programs through rolling three-year Fiscal Adjustment Program (PAFs).

36. The targets established in a PAF are similar to the Fiscal Responsibility Law requirements. Besides the personnel and indebtedness indicators, a PAF comprises targets for the primary surplus, own revenue collection, and investment expenditure. In addition, structural reforms are included and may encompass privatization programs, social security reforms, public sector reforms, etc. The PAFs are reviewed and renewed annually by the National Treasury Secretariat (STN) in conjunction with the state authorities.

37. Minas Gerais has completed the fifth review under the Debt Renegotiation Contract of 1998 and since 2003 has been meeting most of the targets set in the PAFs. The target on investment expenditure to net real revenue has been missed consistently, but has shown a trend toward meeting the target and has obtained a waiver from STN during each review. Table 2 shows the targets for the period 2006-2008 in the current PAF agreed with the STN in May 2006 and the outcomes related to the targets defined in previous PAFs for 2004-06 and 2005-2007. The next review, scheduled for May 2007, showed that Minas met all but one target (on investment) again this year.

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4 From the late 1980s to 1990s, the federal government restructured sub-national debt three times: in 1989, the federal government assumed part of the states’ external debt, which totaled 2 percent of GDP; in 1993, the federal government refinanced the state and municipal debt with federal financial agencies, an amount equivalent to 7.2 percent of GDP; finally, in 1997, the federal government restructured the states’ bonded debt, an operation amounting to 11.5 percent of GDP. Only two states (Tocantins and Amapá) did not have any bonded debt, and hence did not participate in the refinancing agreements.
1.6 Fiscal and Growth Analysis

38. As noted above, Minas Gerais has undertaken a strong fiscal adjustment since 2003, with a view to obtaining fiscal sustainability, reversing the trend in previous years. The fiscal measures that stand out were the control of spending, especially on personnel and operating costs, and actions to improve the efficiency to collect taxes. The early stages of this were accomplished during a period of economic stagnation, when total revenue was declining, putting the main burden on expenditure control. However, with a recovery in the Brazilian economy and in Minas beginning in 2004, the reforms were consolidated and more of the impact occurred through the revenue measures. Revenue increase by about 30 percent in 2004 compared with the previous year. As a result since 2003, personnel costs have been falling as a share of real net current revenue, own revenue has been increasing, investment as a share of real net current revenue has been rising, fiscal balances have shifted from deficits to surpluses, and debt as a share of real net current revenue has declined. In addition, overall economic growth in the Brazilian economy, combined with price stability, strong exports (even in the face of an appreciating Real vis-à-vis the US dollar), has provided a conducive international environment for this recovery. By 2006 the fiscal situation had become more comfortable and the state was able to generate saving, which has allowed the state to increase investment by over 3 times the level attained in 2003. This public investment is contributing to faster economic growth and job creation.
39. The fiscal adjustment has been successful in producing a virtuous circle of improved fiscal and debt conditions, putting Minas Gerais on a sustainable path and encouraging economic growth. As noted above, the fiscal adjustment has led to significant reductions in the state’s net debt position. Consolidated net debt has fallen from 278 percent of net current revenue to 181 percent by the end of 2006. This improved debt situation has contributed further to improve the fiscal situation, by lowering required interest and amortization payments. Also important, the reduced debt and strengthened fiscal position has reduced risk, as perceived by capital markets, and is encouraging private sector investment.

40. To continue down this growth path, fiscal sustainability should continue to be pursued. Projection exercises conducted by Valadares and Blanco (2006) for the period 2007-2014 show a favorable path for most fiscal and financial indicators, suggesting that Minas could significantly reduce its debt further. Nevertheless, sensitivity analysis reveals that the decline in debt would depend mainly on continued efficiency gains in the collection of taxes and rigorous control of current spending. Moreover, the results depend even more on per capita economic growth, in part because tax collection tends to rise with economic growth, but not with population growth; whereas population growth tends to put upward pressure on current spending. To the extent that the government can generate overall fiscal surpluses, it will accumulate net financial assets. In contrast, the use of such financial assets to finance additional primary spending would tend to reduce the fiscal sustainability that has been achieved in the last four years.


41. In 2003 the state government initiated a wide-ranging and comprehensive reform program that is one of the best examples of state-level management in Brazil, and in many ways an international benchmark. The government’s overall objective was to improve the state’s human development index (HDI) in order “to make Minas the best Brazilian state [in which] to live”. This strategy comprised three dimensions to: 1) reorganize and modernize the state’s public administration; 2) promote sustainable social and economic development; and 3) reinvigorate and extend Minas Gerais policies beyond its borders, in Brazil and overseas. These dimensions were articulated in detail in their long-term strategy document, the called the Mineiro Integrated Development Plan (Plano Mineiro de Desenvolvimento Integrado 2003-2020 or PMDI 2003-2020). This PMDI 2003-2020 delineated 10 main objectives which in turn were to be achieved through the implementation of 31 structural projects 5. These strategic options, main

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objectives and structural projects became operational in the medium-term through the Minas Gerais multi-year expenditure plan (Plano Plurianual or PPAG). The PMDI 2003-2020 and the PPAG were born from a lengthy diagnostic exercise carried out by the Minas Gerais Development Bank (BDMG) toward the end of 2002 (the end of the previous administration’s tenure). That study – “Minas Gerais in the 21st Century” – provided an in-depth analysis of the predicament the state found itself in 2002 and the path by which it had arrived there.

42. To support the successful implementation of the structural projects more direct management of those projects was put in place as part of the Choque de Gestão (Management Shock). The government also developed a results-based management model. As a result of these managerial improvements, rates of execution of the structural projects were considerable.

1.8 Recent World Bank Relations with Minas Gerais


43. A World Bank development policy loan (DPL) operation called the “Minas Gerais Partnership for Development” supported the three main pillars of the first PMDI 2003-2020 that aimed to improve fiscal management, public sector management, and private sector development. Each pillar was used as a cross-cutting opportunity for impact on the entire program of government policy and spending. At the first level, the DPL operation reinforced the LRF and Brazil’s system of fiscal federalism checks and balances. Second, within the state itself, the fiscal adjustment combined with improved economic performance lead to reduced poverty both through higher incomes and through increased spending available for education, health, and basic local infrastructure. Third, the improvements in the quality of public management in Minas focused on bringing better service delivery to the poor. Efforts such as results-based management and

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6 The Inter-American Development Bank (IADB) is the other international financial institution supporting Minas Gerais development process. It has a portfolio covering projects on state road transportation and regional development (Vale de Jequitinhonha and PlanorOeste) amounting about US$ 300 million.

performance-based human resource management have been instrumental in this area. In part due to these reforms, and as noted above, Minas Gerais’ economic growth performance improved to be slightly above the national growth rate during 2004-06.

b. Other World Bank Activities

44. In addition to the DPL, the World Bank Group has supported several programs and projects to further development of municipalities, rural development, and procurement in the state of Minas Gerais, including through the Cities Alliance and through umbrella programs affecting specific municipalities such as Belo Horizonte and Uberaba. The Bank has also supported the municipality of Betim an industrial city in the metropolitan region of Belo Horizonte through an investment lending project to increase the coverage of sanitation services provided by the local government and urban upgrade workouts. On rural development, the rural poverty reduction project (PCPR) focuses on the northern part of the state through community driven development projects and to strengthen municipal councils. Over 300 community projects have been approved and training has been provided to 188 municipal councils. Another important area where the World Bank has been supportive is related to procurement. Technical support for automating and streamlining procurement processes, developing price benchmarks, and other procurement activities will continue in the near future with the May 2007 signing of an International Development Fund grant. In contrast, in recent years, the International Financial Corporation (IFC), the World Bank Group’s private sector arm, has not been active in projects in Minas Gerais.

2. Plano Mineiro de Desenvolvimento Integrado (PMDI) 2007-2023

2.1 Overview

45. The PMDI 2007-2023 is the second of two long-term development strategies developed by the Government of Minas Gerais. The PMDI 2007-2023 comprises six major strategies and eleven results areas ("Áreas de Resultados"), each with public sector management improvements (as part of the second phase of the Choque de Gestão), defined strategic objectives, final targets, and sets of indicators to follow up progress. All results areas are to benefit from improved public sector management and fiscal stability, which are the two overarching objectives of the PMDI. The PMDI is supported by 57 structural projects (Projetos Estruturantes"), which are really the priority programs of the government, and it identifies other associated projects. The structural projects are to be implemented using results-based indicators. The PMDI was approved by the State Assembly (SA) in April 2007. While the 2007 budget has been already approved, the 2008 budget that will be consistent with the PMDI will be sent to the State Assembly by 30 September 2007 for consideration.
46. The Minas Gerais authorities have created an Indicators Unit (*Area de Indicadores*) within the Secretary of Planning. Besides developing indicators and improving the quality of the indicators, the unit aims to help the government to: better understand the indicators and through them the impacts of the state projects; monitor progress with the indicators by comparing stated objectives with actual results; facilitate policy making; do more systematic research with available information and data; and highlight the importance of this information within the government.

47. Nevertheless, the indicators in the *PMDI 2007-2023* could be improved. These indicators essentially target three different types: outcomes (final), trends (intermediate) and products (specific and project related). They could be improved using ‘technical sheets’ for each indicator that comprise: definitions, protocols for calculation, baseline data, targets, results, matrix of responsibilities, sources, and comments or observations – including proposed fields of research. A complementary task regarding the proposed indicators (targets and results), is to review the set of selected figures vis-à-vis absolute and relative benchmarks (at the state, country and regional level).

48. As part of the preparation of this document, World Bank staff with sectoral expertise worked with the Minas Gerais authorities to assess the PMDI 2007-2023, with a view to strengthening the implementation of this long-term strategy. Visits were able to cover issues concerning public sector management,
education, health, water, transportation, and private sector development. These preliminary interactions have built a strong dialogue for future engagement. The principle findings and recommendations are summarized in the following paragraphs.

2.2 Sectoral assessments

a. Public Sector Management Assessment

49. Beginning in 2003 with Governor Neves' first term, under the Choque de Gestão Minas Gerais eliminated its fiscal deficit, consolidated administrative structures, and reduced the number of non-career posts. The new management approach was exemplified through the organization of the highest-priority programs into structural projects (PEs), which were managed in novel ways. The planning, monitoring, and evaluation of these select projects was intensive. Project leaders were obligated to meet contracted performance outputs. Periodic meetings were held to hold project leaders accountable, and projects were closely monitored by the Governor. Monthly status reports included financial reports. Every three months a synopsis for each PE was consolidated in a Painel de Controle, with one page summary per project.

50. This focus on results mirrors similar tendencies toward performance management that have occurred in other OECD countries. Minas' efforts included a variety of performance measures from relatively simple ones related to business process measures, to those focused on specific results. Their efforts did not go so far as to focus on measures focused on ratios such as costs/output or productivity measures such as outputs per input, but they reflect a fairly complex set of measures in line with OECD practice. As with most OECD experiences of performance orientation, Minas has not established direct budgetary incentives tied to the achievements of goals. In addition, the process of developing performance assessment of staff to create proper incentives for achieving the desired results needs to be deepened. Finally, the first Choque de Gestão also faced the difficulties of connecting the more top down initiatives of the central secretariats, with the implementation of plans and programs of the line secretariats, a problem often found in OECD countries.

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8 While the Bank team intended to include an assessment of urban issues, and possibly energy, resource constraints and scheduling limitations prevented their inclusion in this Partnership document at this time. For example, a strong interest was stated by the Minas Gerais authorities to receive Bank assistance in the area of renewable energy, particularly in support of the ongoing 6-year program with the private sector (about 2,000 MW based on 52 plantations of about 30,000 hectares and 40 MWH each, generating about 250,000 new employments).

9 See Manning, Nick and Jurgen Blum. (forthcoming). Recent Public Sector Management Developments in OECD Countries. OECD. p. 36.

10 A more detailed evaluation of the first Choque de Gestão, based on case studies of some of the structural projects should be prepared as a follow-up to this Partnership document.
51. In 2007, at the start of the Governor's second term, the administration has
ebegun work on a second generation *Choque de Gestão*. Its content reflects both
the successes and perceived shortcomings of the first generation (GERAES). The
government has carried out a review of the experience from 2003-2006 of the
GERAES. The PE concept, including monitoring and evaluation techniques, was
generally positive (GEMG, 2006). However, there were important critiques,
including the fact that the authorities were evaluating and tracking products,
indicators, and management processes, but not results and outcomes. These
critiques applied to both PEs and the 24 Results Agreements (RAs) that were
signed with line Secretariats. The impacts of the PEs and RAs were not
evaluated. Under the 24 RAs R$112 million was paid in prêmios (described
below), but the money may not have been well spent because the indicators were
not well linked to goals. As a result of this review, the focus of the second
generation *Choque de Gestão* aims to address this set of critiques, as described in
the following paragraphs.

52. **Results Agreements**: RAs that used to be with signed with Secretaries will now
be with agreed more broadly across sectors. The Sectoral Projects are being
developed in more detail in April 2007. Sectoral Results Agreements are
scheduled to be completed by May 15, 2007. Thus far, the process has been top-
down from the central Secretariats (mainly Planning), but in the next phases there
is to be more engagement by lower levels within the relevant sectoral Secretariats.

53. **Performance Indicators**: Under the second generation *Choque de Gestão* the key
indicators are to be the final outcome indicators, and they will be “unpacked”
*(desdobrado)* to groups in the relevant departments within the Secretariats, to
better engage staff in the achievement of these outcomes, not only upper
management. The group goals, it is expected, will be defined at the level of the
administrative unit (that usually involve 20-100 employees). These relevant
parties are to explore indicators that can be measured at least annually for
purposes of the evaluation. However, it is often difficult to identify “final
outcome” indicators that can be measured annually and simultaneously can be
expected to show variation within that time frame.

54. **Evaluation**: Once identified the final outcome indicators it is proposed that they
will be evaluated as shown in the following table. The final scores will determine
how much of the available resources will go to particular departments.
Table 4: Evaluation system

<table>
<thead>
<tr>
<th>Evaluation components</th>
<th>Weight</th>
</tr>
</thead>
<tbody>
<tr>
<td>Final Results</td>
<td>30%</td>
</tr>
<tr>
<td>Structural Projects (PES)</td>
<td></td>
</tr>
<tr>
<td>Management Shock Agenda</td>
<td>60%</td>
</tr>
<tr>
<td>(cross-cutting reform items, e.g., procurement)</td>
<td></td>
</tr>
<tr>
<td>Indicators on rationalization of expenditure (e.g., reducing travel costs, lower expenditure on office supplies)</td>
<td>10%</td>
</tr>
</tbody>
</table>

i. The Specific Choque de Gestão Structural Project

55. There are two levels of “management shock” in Minas: 1) the government-wide Choque de Gestão; and 2) the specific Choque de Gestão PE that supported (horizontally) the goals of implementing the wider management reform in Secretariats and departments. Both types of Choque de Gestão link to each other.

56. While not all the PES were perceived as successful during the first generation Choque de Gestão, the specific Choque de Gestão PE was among the PES singled out as effective. The specific Choque de Gestão PE covered both classical and more modern management reforms were undertaken. Some of the classical management reforms were: rationalization of career plans (reducing career categories to 129, from 893); simplification of the compensation system; strengthening merit selection; and introduction of performance evaluation. More modern elements covered “natural progression” in the pay matrix (every two years based on satisfactory performance); promotion linked to additional education and training; and pay for performance.

57. The PMDI 2007-2023 includes a second generation specific Choque de Gestão PE that will focus on improved performance evaluation and monetary incentives.

58. On performance evaluation the system contains four final “grades: excellent, good, regular, and unsatisfactory. During the second evaluation phase (2005-2006), more than 99% of employees received an evaluation of “excellent” or “good.” Only 0.34% received “regular” and 0.04% (44 people) received
“unsatisfactory.” Only four processes are underway to remove employees. 70% (good) is the minimum required to be eligible for a pay reward. Under the PMDI 2007-2023, Minas officials are working to structure two evaluations: 1) individual competencies (a traditional employee evaluation); and 2) evaluation of whether group goals were met. (These group goals would be included in the written Employee Work Plan.) The weight of these two separate evaluations in the final employee score is not yet decided.

Table 5: “Second Generation” Employee Evaluation Scheme

<table>
<thead>
<tr>
<th>Evaluations</th>
<th>Targets/Expectations</th>
<th>Weight</th>
<th>Result</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competencies</td>
<td>Established annually in Employee Work Plan with manager</td>
<td>X%</td>
<td>Overall ‘Individual’ Performance Evaluation</td>
<td>The “competencies” evaluation alone will determine “progression” steps</td>
</tr>
<tr>
<td>Group results</td>
<td>Specified in sectoral RA</td>
<td>Y%</td>
<td>Overall evaluation determines eligibility for monetary rewards (and possibly promotion)</td>
<td></td>
</tr>
</tbody>
</table>

59. On monetary rewards, during the first phase of the Choque de Gestão, the way for an institution to be eligible for a performance reward was to collect more than expected income or to economize on expenditures. This scheme clearly provided advantages to certain institutions (e.g., those with revenue-generating capacity) over others. During 2004-2006, 10,891 employees from eight different institutions received a Prêmio por Produtividade. Under the PMDI 2007-2023 the monetary rewards system will aim to be more equitable, because all institutions will be eligible – provided the government runs a surplus. But if at least at 70% of the goal is not met, then there is no payment of a financial award.

ii. Procurement

60. Minas is at the forefront of innovation on procurement in Brazil, designed to support other public sector management reforms. Procurement reform represents a key element to provide state services efficiently, while generating fiscal saving. Strengthened procurement processes and successful application of information technology led to the implementation of sound electronic procurement, that in turn has resulted in significant fiscal saving (an estimated 23 percent saving in 2006), including a monthly saving of US$500,000 per month on
pharmaceuticals alone. These improvements not only lead to saving, but also reinforce objectives of strengthening quality and timeliness of purchases (and payments) as well as transparency of public purchases. Collaboration with the World Bank has covered procurement planning (especially the development of a procurement platform and indicators for monitoring and evaluating progress), and acceptance by the Bank of Minas Gerais procurement practices in Bank financed operations. In the future, collaboration is likely to focus more on efficient procurement processes, stock control, price benchmarking, and contract management that are high priorities with the state modernization agenda. Additional Bank technical assistance could support the implementation of a procurement web portal, further studies on strategic sourcing, a review of procurement business processes, e-learning, development of an asset management system, and analytical work on the e-procurement system. A grant was recently signed with the Bank to provide additional technical assistance particularly in procurement areas of civil works management and further modernization of processes and information management.

Some Observations and Unresolved Issues

61. There certainly were advances during the first Choque de Gestão but these advances were not uniform; nevertheless, most activities are being carried forward in second generation. There are about 30 “new” PEs, but most are activities that were already present in the former PEs and now have been broken out as stand-alone PEs for the second generation.

62. The government-wide Choque de Gestão is a top-down exercise whose logic begins with outcome indicators being set for 2011. These are to be broken into annual (or more frequent) indicators that can be assigned to administrative units. However, a challenge still remains because some outcome indicators might only be available, say, every 3 years. Moreover, higher frequency indicators may not show much movement in the short term of one year. In addition, as with all results-based programs and projects, indicators need to be designed carefully to confront the challenge of attribution, (linking actions with outcomes and results). Minas Gerais officials are well aware of these challenges. The key will largely depend upon whether appropriate indicators can be found during the “unpacking” process to develop in more detail the PEs. For the Sectoral Results Agreements (which involve commitments by more than one Secretariat to a common outcome) it is anticipated that the cross-cutting results in the RAs will have separate weighting for those Secretariats and their units that are primarily responsible and for those who are contributors. The methodology for this has not been fully worked out. SEPLAG officials have concluded since the end of the second cycle of individual employee evaluations that an important reason why the evaluations do not differentiate better between employees is that there is too much bureaucracy in the process; too much paperwork. However, it is not clear how this issue will be alleviated if there are to be two evaluations in the place of one.
b. Education Sector Assessment

63. The Secretariat of Education (SEE) is by far the biggest employer in the State Government, with about 225,000 employees, with 160,000 teachers and 60,000 administrative support staff at the level of the school; approximately 4,500 staff working in one of 46 Regional Superintendents (SREs) located throughout the State; and 800 staff working in the central Belo Horizonte office of the SEE. The State Government manages about 4,000 schools at the Ensino Fundamental (EF: Grades 1 through 8) and Ensino Médio (EM: Grades 9 through 12) levels. Schools managed by the State government account for roughly half of the enrollment in Educação Básica (EB: Pre-School and Grades 1 through 12). Under the Brazilian Constitution, the Pre-school (Educação Infantil) level is the responsibility of municipalities; EF is shared between the State and Municipalities and EM is the responsibility of the State Government. Given the important links between one education level and the other, as well as the co-existence of State and Municipal schools providing service to the same population, the aspect of cooperation between State and Municipalities requires dedicated policy attention. In principle, this cooperation takes place through both general and specific contracts (convênios) for cooperation. An evaluation of the working of the convênios merits a closer and more detailed analysis, as the State Government can scarcely reach a long way with regards to the goals for the education sector without working together with municipal governments.

64. The PMDI 2007-2023 appropriately seeks to tackle the twin challenge of improving educational attainment with a simultaneous betterment of educational quality. The eight PMDI structural projects related to education are a subset of SEE priority intervention” projects. To improve the quality of education and linked to a broader government-wide effort to improve the system of public service performance evaluation, the PMDI 2007-2023 incorporates a program of accreditation of SEE employees, teachers, and principals, including written exams and school community elections for principals. Moreover, a key initiative being implemented under this PMDI is the restructuring of the SEE to seek a better alignment between the PMDI goals and the functions and competencies of different departments within the SEE. Two elements of the restructuring deserve mention – the establishment of the Sub-Secretariat of Information and Educational Technology, and the conception of a matrix structure that links the multiple and variegated projects to the functional hierarchy of the SEE. The newly formed Sub-Secretariat would be an organizational locus to spearhead a transformation in the organizational culture in terms of monitoring and evaluation as an integral part of policy framing and implementation. The SEE is still in the process of establishing the exact roles and responsibilities of the functionaries of the Sub-Secretariat for information, and hiring talent from the outside. Success in the efforts regarding the generation and utilization of information is a critical element that would determine the probability of accomplishment of the PMDI goals.
65. **A noteworthy innovation concerns the formation of a matrix for implementation of the plethora of projects**, as shown in the table below. The idea is that each school belonging to the State system of schools would belong to one of seven “networks” formed by schools that share a common characteristic – shown in *columns* of the matrix below. The *rows* of the matrix would be formed by each of the projects, in the table below only the ‘structural’ projects are shown, though there are some 30 odd projects overall. Each structural project would be under the responsibility of a ‘Project Manager’ who would be someone from within the line units of the SEE, rather than be a part of a separate project management unit; the ‘Project Manager’ might continue to have other line responsibilities, depending on the particularities of each project. A particular school may be benefiting directly or indirectly from any combination of the projects – there would be a figure of a ‘Network Champion’, a person who would be functionally located in the newly created Sub-Secretariat of Information, who would be responsible for providing monitoring and follow-up regarding the implementation of all the projects that would be benefiting the schools in that particular network.
### Table 6: Implementation matrix of education projects

<table>
<thead>
<tr>
<th>PMDI &quot;Structural&quot; Education Projects</th>
<th>School Networks (Mutually Exclusive from one another)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1) Inclusive Education Schools</td>
</tr>
<tr>
<td>Number of Schools</td>
<td>1000</td>
</tr>
</tbody>
</table>

| 1. Literacy in Early Grades (?)     |   | | | | | | |
| 2. Expansion in Access to Secondary Education |   | | | | | | |
| 3. Vocational Education             |   | | | | | | |
| 4. Integration with the Community   |   | | | | | | |
| 5. Accelerated Learning             |   | | | | | | |
| 6. Umbrella Project of Teacher Professional Development |   | | | | | | |
| 7. Evaluation of Quality of Learning and Schools |   | | | | | | |
| 8. Umbrella Project of Infrastructure, Internet Connectivity and Occupational Certification of Frontline Workers |   | | | | | | |

Source: Power-Point presentation “Matriz de Projetos SEE-2007”, dated 6th March, 2007. The list of structural projects is at variance with the list in the PPT due to information from interviews carried out with SEE authorities in the week of April 16—specifically, the project called Escola Viva/Comunidade Ativa, which provides for schools to be open on weekends is being combined with a project extended the school day for a group of students (Opção de Tempo Integral). It is not clear whether Literacy in Early Grades, mentioned in the interviews as a structural project, and included in earlier lists of structural projects remains one. It is not confirmed whether the Accelerated Learning Program refers to the project to be targeted in specific underdeveloped regions of the State or would be implemented in the whole State. Also, though some projects purportedly include municipal schools, it is not clear how these schools would be counted in the proposed matrix.

66. **This innovative arrangement is likely to place very high demands on the organizational, administrative and leadership abilities of various people throughout the structure of the SEE, and there is plausibly a great amount of diversity in the existing distribution of these abilities.** The proposed structure seems to be conceptually interesting, but whether it is an important step towards the accomplishment of the PMDI goals depends a lot on the details of implementation of the projects and the arrangement in place to generate and sustain ownership through the SEE, together with the information systems in place to provide information in adequate format for decision making. While officials from the SEPLAG work together regularly with respective project teams, at least for the structural projects, successful implementation of the projects and
mid-course adaptation with regard to project implementation and the larger PMDI goals would require greater technical assistance from human resources with adequate background and experience in implementation. A good place to begin this exercise would be to define exactly the meaning of the term ‘project’, which in the current list incorporates a wide variety of activities, goals, inputs and products.

67. **Looking forward, the Bank would tend to emphasize three recommendations in the education sector of the PMDI:**

1) strengthening the detailed planning and process of discussions to link broad and long-term goals with concrete, detailed, and short-term steps; 2) finding outside support for the SEE to improve management, such outside management expertise should simultaneously understanding the circumstances confronting education in Minas Gerais; and 3) that the two initiatives under the PMDI (the Sub-Secretariat for Information and Education Technology to transform the SEE organizational culture, and strengthening performance evaluation and accreditation of SEE employees) should receive the highest priorities among all the proposed actions.

c. Health Sector Assessment

68. **The State’s health sector faces a number of systemic challenges that are similar to many states in Brazil:**

(i) oversupply of hospitals, particularly of underutilized small facilities; (ii) low primary care coverage resulting in unnecessary use of expensive hospital emergency rooms; (iii) low quality and inefficient hospital services, and (iv) little coordination or integration among health providers are resulting in poor quality of care, inefficiencies, and increased financial burden on patients. Each of these problems has implications on resource allocation and management, quality of spending and ultimately, health outcomes.

69. **Between 2003 and 2005 the SES launched three large “flagship” programs to address the above issues:**

(i) Health Care Regionalization (RAS), (i) Hospital Strengthening and Quality Improvement (PROHOSP); and (iii) Health at Home (SEC). The content of these programs was complementary, and together they sought to rationalize and coordinate supply, raise coverage and quality of care, and improve the efficiency of service organization and delivery.

70. In 2005, under the **RAS**, the SES began to rationalize the organization, demand and supply of health services based on a regional network model. The program established 13 macro-regions and 73 micro-regions, covering all of the state’s 853 municipalities. The idea is that each micro- and macro-region would be self-sufficient in secondary and tertiary care respectively.

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11 PROHOSP was originally part of RAS.
12 It is important to note that the macro- and micro-regions were designed based on criteria that drew on in-depth analyses examining the spatial (including road network) supply and demand characteristics of hospital care in each area.
71. PROHOSP aims to improve the quality and efficiency of hospital services while making managers accountable for results. Consonant with the above-described regionalization initiative, PROHOSP directs state investment financing to only a subset of 130 “pole” or referral hospitals in the macro- and micro-regions. The idea is to reduce the supply of smaller facilities while increasing the case resolution capacity of larger hospitals. The state plans to convert an undetermined number of smaller hospitals to ambulatory or emergency care centers. Eventually, all financing for admissions in about 400+ non-pole facilities will be discontinued. As such, these facilities will essentially cease to be hospitals, and many are likely to shut down.

72. The SEC program seeks to improve the quality and coverage of primary care state-wide. Its long-term aim is to resolve 90% of the demand for health care at the primary level. The cornerstone of SEC involves an innovative financial system to strengthen primary care delivery, especially in the poorest municipalities.13

73. The three structural reform programs (RAS, PROHOSP, and SEC) already underway in the MG health sector are cutting edge within the Brazilian context. They address three critical areas -- network formation, hospital reform and primary care extension, -- which are major challenges throughout SUS. It is difficult to imagine improving the performance of SUS-financed health care from fiscal or health standpoints without systematic change in each of these areas. In short, the three priority programs selected by SES have the greatest potential to improve the quality of spending as well as health outcomes.

74. On the other hand, while the indicators applied to each of the three structural programs by SES tend to have a strong health orientation, many may be inappropriate for the broader Choque de Gestão initiative. This is unfortunate because the core interventions of each of these programs contribute robustly to the broader public sector agenda of raising the quality of spending through rationalizing investments, reducing waste, improving resource management, and linking financing to results. In short, the SES needs to develop an alternative set of intermediate indicators that directly impact on resource management and finance while indirectly impacting health outcomes. The following is a preliminary list of measurable indicators that would result in cost savings or containment:

- Reduction of hospital admissions for conditions susceptible for primary health care (already an SES indicator);
- Reduction of unnecessary hospital admissions;
- Reduction of unnecessary emergency treatments at hospitals;
- Reduction of unnecessary referrals to higher levels of care;
- Increase in proportion of health system contacts at the primary level;
- Reduction of hospital lengths of stay;

13 In Brazil, primary care is a municipal responsibility.
- Reduction in unnecessary diagnostic exams;
- Increase in productivity of surgical theaters;
- Reduction of cases requiring multiple inter-facility transfers;
- Reduction in hospital infections rates, medical errors and adverse events.

75. To some extent, the progress thus far has led to a number of new steps and directions that could be elaborated further in the Minas Gerais-World Bank Partnership in the health-related sector, especially: development of systematic monitoring, focus on impact evaluation, contract management enforcement, revised institutional arrangements for public foundations dealing with drugs and with blood derivatives, and integration of the FHEMIC state hospitals foundation into the RAS and PROHOSP reforms. More specifically, for the RAS, new steps and directions cover: improved coordination across health service providers through a strengthened command structure by the macro-region administrative units with real decision-making authority; pooled financing arrangements across municipalities and hospitals within macro-regions; resource allocation mechanisms that distribute pooled financing to each macro-region; further development of clinical pathways; and improved integrated information systems across the network to better manage care delivery. For PROHOSP, new steps and directions could include: improving organizational and governance arrangements for public and publicly-funded non-profit hospitals; payment mechanisms reforms to improve incentives through the way hospitals are paid; strengthened and standardized cost accounting systems; and more wide-spread licensing and accreditation of hospitals. For the SEC program these new steps and directions include: efforts to improve the quality of primary care services; mandates on grant transfers to municipalities to support family health and to provide performance incentives; and health promotion and chronic disease management.

d. Water Supply and Sanitation (WSS) and Water Resources Management (WRM) Sectoral Assessments

Sector Issues

76. Access to Water and Quality of Services. The provision of Water Supply and Sanitation (WSS) services in Minas Gerais, in general, is of very good quality for those systems operated by COPASA (the State Water Company), private concessionaires, and municipal companies or autarquias of the most affluent municipalities. However, in the rest of the State, particularly in the smallest and poorest municipalities, access to these services is limited and their provision severely affected by problems of intermittency, rationing, and low quality of service. This inequality is especially severe in the valleys of Jequitinhonha, Mucuri, São Mateus and the northern part of the state, an area of Minas Gerais where the quality of life resembles the poorer states in the Northeast. This situation affects the poor disproportionately and, as a consequence, health
indicators associated with water-related diseases are still high when compared to the rest of the state and to national averages.

77. **Policy Definition and Regulation.** Independent tariff regulation and the supervision of service quality are largely inexistent in Minas and suffer from significant policy interference. The recently approved federal WSS law brings a long overdue institutional and regulatory framework to the sector, but presents many challenges for its nation-wide implementation including in Minas.

78. **Sector Efficiency and Pricing.** COPASA and some municipal companies operating in the more affluent municipalities are relatively efficient, but there is still room for major improvements. In the case of COPASA, the existence of uniform salary and tariff structures across the state is particularly troublesome giving the socio-economic differences that exist in the geographical area covered by the company. In the smallest and poorest municipalities, room for improvement is considerable since most of them do not even cover their operating and administrative costs, and therefore lack the capacity to provide adequate services. There is an interesting case of a direct consumption subsidy to the poor in the Municipality of Varginha provided to the poorest COPASA clients.

79. **Water Resources Management.** Despite the development in recent years of a sophisticated institutional and regulatory framework for water resources management in the state, the implementation of the framework and its main instruments remains weak. Although only one water supply system operated by COPASA lacks water abstraction licenses, many systems operated by municipalities function without such licenses. The situation is worse in the case of effluent discharge since many sanitation systems function without the requisite environmental licenses and urgently need to regularize their situation to comply with the law and targets set by the State Environmental Agency. A sustainable and equitable use of water resources for current and future generations requires better information and more transparency in investment and other decision-making processes. As in the rest of the South and Southeast regions, urban and rural floods are more frequent and require river basin planning and management approaches to manage excess flows, droughts, and to develop infrastructure. Moreover, unregulated utilization of groundwater resources is leading to overexploitation and contamination. The expansion and intensification of the agriculture frontier in Minas imposes additional pressures on this vital resource.

80. **Water Pollution: a lack of wastewater treatment.** COPASA supplies water systems in 611 (585 are operational) of the 853 municipalities in the state (71.6% of the total) and sewerage systems in 183 (95 are operational) municipalities (21.4%). Through the operation of these concessions, COPASA provides potable water to a population of about 11.6 million (60% of the state’s total population) and sanitation services to a population of about 6.0 million (30% of the state’s total population). The volume of sewage treated by COPASA is only 37% of the collected volume. These numbers underline the significant gap that exists in the
provision of sanitation services vis-à-vis potable water; a feature common to most Brazilian companies and systems that only recently has began to be seriously addressed by some companies, including COPASA. Years of discharging untreated wastewater from municipal and industrial users, as well as from agribusiness, has turned the degradation of water quality into a major environmental, social, economic and development issue in the South and the Southeast regions, including Minas Gerais.

81. **Urban Drainage and Pollution Control.** As in the rest of the country, explosive urban growth has increased exponentially the complexity of water management, particularly in the large metropolitan areas. Urban drainage, pollution control, and the protection of water sources fall within multiple jurisdictions with limited coordination capacity and financial resources to develop and implement investments or to operate and maintain existing infrastructure. There is an interesting approach in the case of Belo Horizonte, where COPASA contributes a percentage of its revenue from the city to a municipal fund to invest in WSS in the protection of sensitive environmental areas.

*Plano Mineiro de Desenvolvimento Integrado (PMDI)*

82. **Understanding that water is a key element in the promotion of sustainable growth and a more equitable and inclusive society, the PMDI 2003-2020 included “More Health for Everybody” (Saneamento Básico: Mais Saúde para Todos) as one of its structural projects; and the results achieved in the WSS sector, on average, go well beyond what other states have been able to do.** Of particular note were the series of far-reaching legal, institutional, and administrative reforms taken to strengthen COPASA. These included issuing shares on the Stock Exchange; negotiation to incorporate the municipality of Belo Horizonte as a shareholder; actions to regularize concessions throughout the state; bilateral negotiations with selected municipalities (e.g. Betim) to advance sector investments; changes in statutes to allow the company to operate outside the state (for example, COPASA provides technical assistance in Angola); and internal incentives to increase efficiency and competitiveness (for example, a performance-based bonus system).

83. **The PMDI 2007-2023 has kept the Saneamento Básico WSS initiative as one of the 57 structural projects and added five new projects linked to improving the provision of WSS services and the management of water resources to its list of priorities.** Table 7 shows the four results areas and the six structural projects related to the WSS and WRM sectors. Besides activities designed to continue to improve the state’s quality of life through the provision of universal and improved WSS services (*i.e.*, the healthy living result area), the objectives of the second generation *Choque de Gestão* include:

a) **The social and economic development of the poorest region of the state (the North of Minas, Jequitinhonha, Mucuri and Rio Doce) through the structural project**
**Vida no Vale.** This project attacks poverty and inequality in the north of the state, using WSS as an engine of change. The *Vida no Vale* project aims to encourage regional development through an integrated package of actions covering health, education, employment creation and training of local labor, private sector participation, and environmental management objectives.

b) The improvement of the state’s environmental quality through strengthening WRM and consolidating water basin management, reducing water pollution, increasing treatment of solid wastes, and acting on other key related environmental issues.

c) The reduction of poverty through an integrated program (including WSS, housing, education, urban upgrading and security) in a given geographical area (*Ribeirão das Neves*). The *Projeto Travessia* is another innovative and challenging project that attempts to transform a poor area and form a generation of young leaders.

<table>
<thead>
<tr>
<th>Results Areas</th>
<th>Structural Projects Related to WSS &amp; WRM Sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Healthy Living</td>
<td>• Saneamento Básico: Mais Saúde para Todos</td>
</tr>
<tr>
<td>Development of the North of Minas, Jequitinhonha, Mucuri and Río Doce</td>
<td>• <em>Vida no Vale</em></td>
</tr>
<tr>
<td>Environmental Quality</td>
<td>• Revitalização do Rio das Velhas</td>
</tr>
<tr>
<td></td>
<td>• Tratamento de Resíduos Sólidos</td>
</tr>
<tr>
<td></td>
<td>• Consolidação da Gestão de Bacias Hidrográficas</td>
</tr>
<tr>
<td>Poverty Reduction and Productive Inclusion</td>
<td>• <em>Projeto Travessia: Atuação Integrada em Espaços Definidos de Concentração de Pobreza</em></td>
</tr>
</tbody>
</table>

84. Implementing projects such as the *Vida no Vale* will be a challenge, at least during the first year, because of the changes that their execution will entail, particularly regarding the technical/managerial capacity and adaptability of the executing entities. Both projects have clearly defined objectives and are designed to make a clear contribution to the government’s development agenda; however, they do not yet have clearly defined implementation strategies, nor a consolidated set of instruments to achieve the objectives.

85. In this regard, the establishment and implementation of a COPASA subsidiary, which is necessary for the implementation of the *Vida no Vale* project, still depends on how the subsidiary will be formed, administered, regulated and controlled. The final model and implementation of the new company will determine its degree of autonomy, and its agility to respond to WSS challenges. For example, will the subsidiary provide services to all localities.
within the region or will it be limited to localities with less than 5,000 people? Its area of influence, and the way it will grow in the future will determine who will have access to WSS and over what timeline. Specifically, when and by whom will localities with less than 200 people be attended? Costs and affordability will be determined by its investment, tariff and subsidy policies, technological and managerial innovations and practices, and the way it will involve the private sector. Some additional issues relate to how the COPASA subsidiary will face labor legislation in Brazil. Will the subsidiary be treated like any state company and have to pay the same salary and other benefits of COPASA’s direct employees? How will subsidies to the poor in the Vida no Vale be seen by the poor in other COPASA concession areas? If COPASA can provide cheaper services to Vida no Vale why could it not provide the same low cost in other areas? How will Vida no Vale be seen by the market and how it deal with COPASA’s long-term strategy? The outcomes could consolidate current practices in the Brazilian WSS sector and launch the sector on a new path. The Bank could assist the state government in the evaluation of these risks and the analysis of alternatives, such as negative concessions (PPPs), COPASA sub-concessions or management contracts.

Indicators

86. In the water sector, the PMDI 2007-2023 contains relevant aspects in three results areas: Regional Development in the North of Minas, Jequitinhonha, Mucuri and Rio Doce; the Healthy Living; and Environmental Quality. In particular for the Regional Development area, the structural projects seem to need more elaboration to explain how selected projects are supposed to reach estimated results (particularly important in cases where big achievements are expected in short periods of time). For example, the projected increase of 20% in the coverage level of water supply in a single year would need to be detailed in a series of concrete and short-term steps. A key indicator, reduction in the morbidity rate, is missing. In the Healthy Living area, the set of final results includes septic tanks as an important factor, although not specified in the list of detailed indicators. However, increasing the percentage of households with access to sewerage or septic tanks is not enough, since appropriate maintenance (particularly of the septic tanks) is crucial to the sustainability of successful outcomes. In the results area of Environmental Quality, it would be useful to review the experience and lessons learned from PROSAM (the Minas Gerais Water Quality and Pollution Control Project executed with World Bank financing in the 1990s), particularly regarding water quality indicators. Increasing access to adequate disposal of solid waste has been identified as a priority challenge facing Minas Gerais. However, another equally important indicator, increasing the volume of treated wastewater, has been omitted. The information provided on the volume of treated wastewater seems too low and may need to be reviewed.

87. Public Information. As suggested for the transport sector (described below), the WSS and WRM sectors could substantially benefit from a continuous flow of
information to the public. The government could define entity-level performance indicators, particularly regarding access to and quality of service. This would likely require the definition of a mission statement for each water sector entity in the state. COPASA and its subsidiary could take the lead, providing an example of transparency and outreach to private operators and municipal companies in the state. This flow of information would inform forthcoming regulation. COPASA is now listed in the Bovespa Novo Mercado stock exchange, which includes minimal requirements regarding corporate governance, transparency, and accountability. This financial-corporate governance experience could be used as a model for improving COPASA’s operational and social dimensions.

Future Collaboration with and Assistance from the World Bank

88. In terms of possible future collaboration with the World Bank in the water (WSS and WRM) sector, the Partnership could explore possible financial support or partial guarantees to COPASA, as well as some of the following options for technical support.

Possible technical support:

- Conducting a public expenditure review and impact evaluation study of the state’s WSS sector, with particular emphasis on the projects and the municipalities included in the PMDI 2007-2023.
- Water sector planning. Approval of the federal water law has created a need to work on the preparation of municipal, regional (multi-municipal) and state WSS plans, especially regarding the study and definition of approaches to targeting and subsidizing the poor.
- Regulation of WSS services. Approval of the federal water law has created an urgent need for strengthened WSS regulation, through state, regional, or municipal entities. The Bank could support the establishment of a state agency and the delegation of responsibilities by municipalities to this agency.
- Evaluation of the risks and the analysis of alternatives regarding the COPASA subsidiary, such as negative concessions (PPPs), COPASA sub-concessions or management contracts. Specifically, supporting a management contract between the state government and COPASA’s subsidiary, with COPASA and the Secretariat of Planning as contractual parties, with appropriate indicators and targets. This Management Contract could last until a regulatory agency is established and operating.
- Developing a fund for holding and redistributing COPASA dividends.
- Developing new models for public-private partnerships in the WSS sector, to identify and structure such partnerships, and conduct pre-feasibility and feasibility studies.
- Developing new models of results-based financing in the WSS sector.
- Support municipalities on WSS and WRM issues, especially access to PAC funding, corporate governance of water entities. Aggregation also could be an
issue in some areas of the State (such as Zona da Mata, Triângulo Mineiro) to obtain economies of scale, increase efficiency, and encourage competition.

- Support to the state government in flood control, including studies of associated economic and social costs.
- Strengthening state information systems for WSS and WRM.
- Rural Sanitation.

e. Transport Sector Assessment

89. Road infrastructure in Minas Gerais, the central location of the state in Brazil, as well as the state more recent focus on logistics, have allowed Minas to become a multimodal transport hub of national importance. Over 15% of all freight in the country moves within or through the state. The transport matrix on the freight side is more balanced than in most states, with only about 50% of goods transported by roads (compared to around 65% at the federal level, and over 90% in a number of states). Half of rail freight can be considered captive (iron ore and semi-finished iron products). On the passenger side, the road network provides for over 95% of all trips, in line with what is observed elsewhere in the country.

90. Relatively to most other states, Minas has a well developed transport infrastructure network, including 9,500 km of federal paved roads, 15,000 km of state paved roads, 10,000 km of state unpaved roads, 5,000 km of railway lines, 700 km of waterways, and 3 major airports. Most of this infrastructure is located in the more developed part of the state (the southern part, basically from Belo Horizonte south to the state border), on which 70% of all road and rail traffic takes place.

91. On the other hand, the situation in the infrastructure sector also increases the dependency of the state on the federal government in the resolution of transport infrastructure issues. Federal paved roads, the railway lines, the waterways and the major airports are under federal jurisdiction. Even in the road sector, where there is a substantial part of the network under state jurisdiction, around 70% of all road traffic takes place on federal roads.

92. Over the next 5 years or so, the existing transport infrastructure is expected to require limited capacity expansion, but relatively significant upgrading to allow for higher quality of road transport services in the poorer and agricultural frontier areas (both in terms of better access to/from markets and services, as well as lower transport costs). In terms of transport infrastructure maintenance and rehabilitation, the needs are most pressing in the road sector, where present efforts will need to be maintained and possibly reinforced (see below).
93. The main transport sector issues in Minas Gerais are, in substance, common to those encountered in other states and at the federal level. These issues include: 1) slow progress on the decentralization and delegation discussions between the Federal Government and the states; 2) coping with the consequences of inadequate funding for road infrastructure (and especially investments for rehabilitation) over the 1995-2004 period; and 3) the need to strengthen public sector capacity.

94. Under the first generation Choque de Gestão Minas has achieved results in the transport sector that, on average, go well beyond what other states or the federal government have been able to do. Teams working on priority programs have been given incentives to perform adequately. For example, they have received recognition within the government, have more secure availability of funding, and have direct access to the highest authorities to resolve obstacles to program execution (e.g. delays in obtaining environmental licenses for civil works. Plans are being executed; for example, the ProAcesso program met 85% of its target in 2006. Bidding processes (for engineering projects and simpler works) are undertaken under 4 months. Environmental licensing has been substantially streamlined. Bills are paid in 30 days. Moreover, the private sector works as a partner (rather than a simple service provider) with the public sector. The first generation Choque de Gestão in transport tested the effectiveness of government programs, by focusing on initially selected priorities and modifying their structure or priority level as necessary. However, by focusing on effectiveness, these results in the transport sector were relatively easier to achieve. They were possible without having to undertake far-reaching reforms in terms of modifications to the existing legal, organizational, or administrative framework.

95. The objective for the second generation Choque de Gestão is to increase the efficiency of priority government programs. The program aims to ensure: (i) the assimilation of result-based management principles by sector entities in charge of government programs, and the inclusion of such principles in the sector entities’ systems, processes, and operational procedures, through the definition and implementation of an Agenda Setorial de Choque de Gestão; and (ii) the rethinking of programs’ design and implementation processes to increase their efficiency. Implementing the second generation Choque de Gestão will be a challenge, at least during an initial period of 2-3 years. This is because changes are likely to: (i) put to the test the sector entities’ technical abilities and adaptation capacity, given the breadth of the changes to be implemented (see the agenda provided in annex 1 to the transport appendix); and (ii) require external support at the policy, regulatory, normative, technical and operational levels. Moreover, efforts will be required to improve the attractiveness to the private sector of transport infrastructure investment, including through a variety of public-private arrangements including Public-Private Partnerships (also see the private sector development assessment).

96. Government priorities in the transport sector are adequate and focus on:
Physical: infrastructure maintenance and rehabilitation, with selective and localized infrastructure expansion; and.
Institutional: a gradual shift toward result-based management, increased involvement of the private sector, and fostering of multimodality.

97. Priority investment programs have clearly defined objectives, as well as a clear contribution to the government's development agenda; however, they do not yet have clearly defined implementation strategies, or a relatively consolidated set of instruments to achieve the objectives. Two examples are worth highlighting. Under the Região Metropolitana de Belo Horizonte project, the Linha Verde project appears to be a stand-alone project, (and not the first project in a succession of projects) aiming to improve traffic flows in the metropolitan area. The ProMG Pleno project uses result-based maintenance and rehabilitation contracts (based on the World Bank model for Brazil). This project is at the pilot stage (operating in 2 out of 20 areas of the state) and does not yet have a set of result-oriented procedures and technical standards.

98. Physical investment program indicators are adequate, usually measuring physical and financial progress of specific activities under the program. However, process indicators could be added for activities under the program. Basic information on the government's investment programs is presented in annex 2 in the transport appendix.

99. Indicators on the institutional side are few and, in some cases, not sufficiently specific. As part of the detailing of the Agenda Setorial de Choque de Gestão, the government could: (i) define and follow administrative processes, such as the time or number of steps required for procurement or payment, time required between the moment a decision is taken and it is implemented, number of irregularities (as identified through audits), manpower required to perform a task, etc.; (ii) review administrative processes and recommend streamlining, simplification, modernization; and (iii) define entity-level performance indicators (e.g. maintain at least 70% of the road network in good condition, decrease number of accidents by at least 10% a year, etc.). This would likely require the definition of a mission statement for each entity involved in a project, and as clear as possible a division of responsibilities between those of the entity and those of partner entities. For example: how far could the road administration be held responsible to meet its road safety performance indicator, if failure to do so results mainly from insufficient enforcement of traffic laws?

100. Outcome indicators (measuring the contribution of programs to the government’s overall development goals) also could be improved in two ways. Indicators could be refined to more clearly show the programs’ impact on the Área de Resultado. For example: is the level of investment in infrastructure a good outcome indicator of the contribution of infrastructure to the State’s Valor Agregado da Produção result area? More work seems to be needed to ensure that the chosen indicators require relatively low cost data collection efforts. For
example, data required to estimate road network conditions are relatively costly to collect.

101. In terms of possible future collaboration with the World Bank in the transport sector, the Partnership could explore possible financial support to the state road rehabilitation and maintenance program (budget: around R$250 million per year), as well as some of the following options for technical support.

Possible technical support:
- institutional strengthening in the sector, including help to consolidate sector policies, models, and norms;
- improved efficiency of expenditures under publicly financed programs in the sector, including support to: (i) detail and implement the Agenda Setorial do Choque de Gestão, (ii) structure operational “kits” to improve efficiency of key programs; and (iii) alignment of road administration structure and processes according to result-based management principles; and
- development of new models of partnership with private sector in the transport area, including strengthening of regulatory framework and of capacity to identify and structure partnerships, as well as undertaking pre-feasibility and feasibility studies.

f. Private Sector Development Assessment

102. The Minas Gerais authorities are convinced that improving the investment climate in the state is the best way to establish the conditions for long term growth and continuous job creation.\textsuperscript{14} Accordingly, Minas has created a series of programs that are related to the improvement of the investment climate. At least eleven of the 57 structural projects (projetos estruturadores) in the PMDI 2007-2023 during the next 4 years are directly related to the improvement of the investment climate in the state.

103. In this regard, the government commissioned a paper on the evolution of total factor productivity (TFP) in the state compared to its peers (Ferreira, 2007). According to this analysis, the TFP in Minas has been falling since 1989, following a pattern very similar to the country as a whole. More importantly, the state has been losing ground to some important competitors (e.g., Rio de Janeiro), while performing better than others (e.g., Sao Paulo). On the

\textsuperscript{14} The investment climate in a country or a region establishes the rules of the game and the environment within which all private sector firms must operate, focusing on policies and institutions that influence the return and the risk associated with investments. It thus includes regulatory policies, administrative procedures, infrastructure conditions, functioning of factor markets, as well as incentives embodied in institutional arrangements, such as security of property rights and the rule of law.
determinants of TFP level compared to other states, the author speculates on four hypotheses: a) the composition of production in MG is such that the rural sector is more significant, but less productive; b) the informality level in MG is higher; c) human capital levels are somewhat lower; and d) infrastructure availability and quality are inferior.

Figure 4 - PTF 4 (1985 = 100) BR, MG e SP: 1985 - 2003

Source: Ferreira (2007)

104. In the absence of an in-depth analysis of determinants of long term growth, a benchmarking assessment can be considered a second-best alternative. It provides information on areas where improvements are doable, and where best practices could be followed. As a starting point, the Doing Business in Brazil report, published in 2006, provides a useful tool covering at least part of the elements of the business environment.

105. As previously mentioned, the overall performance of Minas is good, ranking 3rd among 13 cities/states included in the analysis in the summary ease of doing business indicator. However, a closer look at the different indicators included in the report shows that there are a couple of areas in which Minas does not perform well (Table 7). In fact, there are two areas – Paying Taxes and Enforcing a Contract - in which Minas holds the last rank among the states surveyed. It is not difficult to see that if Minas had a high ranking in these two indicators, it would probably be the top state in the overall indicator of doing business. These two areas are therefore natural candidates to be included in a program to improve the business environment in Minas Gerais. Moreover, if informality plays a role in explaining the low levels of TFP, these areas are likely to have some impact on informality and, thus, on productivity. But there are other elements of the investment climate, not captured by the Doing Business indicators that are more related to the functioning of factors markets, like quality and cost of labor and capital. While many of these are generally beyond the scope of state
government control, one key variable usually identified as one of the determinants of productivity is innovation and technology adoption.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>MG/BH Rank</th>
<th>State ranked #1</th>
<th>State ranked #13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starting a business</td>
<td>1</td>
<td>Minas Gerais</td>
<td>Maranhão</td>
</tr>
<tr>
<td>Credit – creating collateral</td>
<td>1</td>
<td>Minas Gerais</td>
<td>Ceará</td>
</tr>
<tr>
<td>Paying taxes</td>
<td>13</td>
<td>Bahia</td>
<td>Minas Gerais</td>
</tr>
<tr>
<td>Registering property</td>
<td>5</td>
<td>Santa Catarina and Brasília</td>
<td>Mato Grosso do Sul</td>
</tr>
<tr>
<td>Enforcing a contract</td>
<td>13</td>
<td>Rondônia</td>
<td>Minas Gerais</td>
</tr>
<tr>
<td>Overall Ease of Doing Business</td>
<td>3</td>
<td>Brasília</td>
<td>Ceará</td>
</tr>
</tbody>
</table>

Table 7 – Selected Doing Business indicators

106. Overall, the government focusing on the objective of productivity increases, which is the most appropriate way of fostering sustained output growth and job creation. As part of nation-wide trend, Minas has shifted away from more short-run oriented policies, such as fiscal wars, which were frequently used by states through the 1990s.

107. Out of the 57 PEs established by the government, at least 11 (listed below) are directly linked to the improvement of the investment climate. Projects 1, 2, 4, 5 and 6 are under the responsibility of Economic Development Secretariat (SEDES), while projects 7 to 10 are under the Science and Technology Secretariat. Finally, projects 3 and 11 are under Planning and Finance secretariats, respectively. The following paragraphs assess briefly the group of projects on technology and innovation (7-10), the Descomplicar project (3), and the project on tax efficiency (11).

Projeto 1 - Promoção e atração de investimentos estratégicos e desenvolvimento das cadeias produtivas das empresas âncoras
Projeto 2 - Inserção competitiva das empresas mineiras no mercado internacional
Projeto 3 - Descomplicar - Melhoria do ambiente de negócios
Projeto 4 - Oferta de Gás Natural
Projeto 5 - Cresce Minas – Oferta e distribuição de energia elétrica
Projeto 6 - Parcerias para provisão de serviços de interesse público
Projeto 7 - Rede de Inovação Tecnológica (inclui BHTec, FAPEMIG)
Projeto 8 – Sistema de Certificação e Vigilância Sanitária da Produção Agropecuária
Projeto 9 - Arranjos Produtivos em Biotecnologia, Biocombustíveis, Microeletrônica e Software
Innovation and Technology Projects

108. The PMDI 2007-2023 places innovation and technology at the top of the agenda. The four PEs on innovation and technology are linked to five strategic objectives: three of them on innovation, one on training and the other on quality and certification. The indicators that are being considered – private investments in R&D in the state, overall spending with R&D, increase in innovative products – seem adequate but could include others, especially on quality and certification, where the metrics are less subjective.

The Descomplicar Project

109. The Descomplicar project, being led by the Secretariat of Planning, is clearly a high priority for the government. Three main areas are being contemplated: i) to further simplify the process of starting a business, through improvements and regional expansion of the Minas Fácil program (one-stop shops); ii) to focus on the simplification of the environmental licensing process; and iii) to improve government purchases. However, because the program is still under preparation, the indicators presented in the documents do not reflect yet these objectives. The latest Doing Business indicators to open a business (time and cost) and registering property (number of procedures, time and cost) could easily be used and will be targeted by the project. Specific indicators on time it takes to obtain environmental licensing should also be incorporated.

110. More complex is the problem of contract enforcement. This is an area where Minas performs poorly compared to its peers in Brazil. Dealing with this issue involves mainly the judiciary system; the role of the executive is limited. Notwithstanding this fact, the government is aware of its importance and is willing to work in partnership with the local courts to expedite the process of contract enforcement.

The Tax Efficiency Project

111. Under the tax efficiency project, the government, through the Finance Secretariat, wants to simplify procedures and collect taxes in a more efficient ways. The indicators for this project are under preparation and still don’t reflect their objectives, concentrating more on aggregate measures of tax collection. The recent Doing Business indicators, especially those on procedures (number of taxes paid, method of payment or withholding, frequency of payments and number of agencies involved) could be used as the main indicators for the project.
112. The government has a clear diagnosis on why the state has performed so poorly in the 2006 Doing Business in Brazil in the area of paying taxes. The lack of investments in information technology in the late 1990s and earlier this decade put Minas in this lagging position. This was a period in which most of the states invested in modernization; however, in contrast with other states, Minas did not even tap the resources made available by the federal government for modernization of tax collection, known as PNAFE.

113. Under the first PMDI 2003-2020, the government aimed at catching up with information technology investments. Now most services for taxpayers are available on the web. The government has also implemented regular surveys with the clients. The availability of electronic tax filing is a change that will have an impact on the Doing Business indicator on the number of payments, because where ever electronic filing is available, the tax is counted as paid once a year (even if the payment is more frequent).

114. The challenge for the government now is to adapt their systems to recent changes in tax administration adopted at the federal level, (e.g. the law for micro and small firms, and the use of a single electronic system aimed at integrating tax administration at the three levels of government to streamline business registration).

Potential Areas for Further Collaboration

115. Four possibilities are highlighted below, and the Minas Gerais-World Bank Partnership could explore these further. Consideration could be given to streamlining the current projects, by establishing clearer and more focused priorities for the next four years.

116. Further analytical work on determinants of productivity and of long-run growth in the state. In spite of the data limitations, it seems advisable to work further on the main determinants of growth in the state, especially those under control of the state authorities. Interviews with the private sector may be useful in this regard. It also would be useful for Minas Gerais to participate in the next International Climate Assessment (ICA).

117. Strengthening the Science and Technology Secretariat (SSTS). Regarding innovation and technology, the government has plans to strengthening this secretariat, through better equipment and capacity building. A World Bank report on Innovation and Human Capital Development for Brazil is being concluded and the possibility of follow up with a case study on Minas Gerais could be explored.

118. Increased focus in the Descomplicar project. While the current emphasis on streamlining environmental licensing procedures seems adequate, this project could explicitly include issues on enforcing contracts. The Bank could provide technical support in both areas. A World Bank report on environmental licensing
for Brazil is being concluded and the possibility of follow up with a case study on Minas Gerais could be explored.

119. **The tax efficiency project seems to be on track, but more focus on simplifying procedures could be adopted**, given that this is an area of very poor performance of the State. As part of the World Bank Group, the International Finance Corporation’s Financial Investment and Advisory Services unit (FIAS) has identified Brazil as a candidate for some technical assistance work on simplifying procedures for paying taxes. Minas could be a pilot for this project at the state level.

### 3. A Way Forward

120. **The Executive Summary of this document recapitulates the main findings and conclusions that could serve as a foundation for a possible Bank follow-up operation to the DPL that finished disbursing in early 2007.** On Bank support for Minas Gerais development policies at the sectoral level, the sectoral assessments, which are also summarized in the Executive Summary, indicate a set of possible non-lending technical assistance and knowledge sharing activities that could be pursued. However, added coherence could be obtained if many of these activities could be linked to a Bank operation, because an operation could ensure continuity of interactions between Minas Gerais and the Bank, as well as the necessary resources to jointly pursue sound policies and programs.

121. **This section attempts to distill the key elements and principles for any such follow-up operation.** For example, a follow-up operation would likely include a strong technical assistance lending component for focus sectors. More focus on programs, projects, and related indicators would be central to such an operation and fit closely with the Minas Gerais development plan. Given the Minas Gerais spotlight on applying their public sector reforms more effectively in the sectors, the core sectoral work in a follow-up operation would cover public sector management and public financial management reforms. One key principle would aim to complete the next generation of public sector management challenges, spreading these advances more deeply in sectoral work, with a view to improving public sector services and enhancing economic growth.

122. **These elements and principles would provide the incentives and motivations for the choice of focus sectors under a Bank operation with Minas Gerais.** The sectors covered in this Partnership document represent areas where the Minas Gerais authorities have concentrated attention and resources, and where the Bank has a comparative advantage to contribute to the authorities’ objectives, policies, and programs. However, because this document was part of an initial exercise in the dialogue process, not all sectors are covered, and even for the sectors that are included, full information has not yet been assessed.
123. **Key interlocutors to extend the Minas Gerais – World Bank Partnership** and pursue a possible follow-up operation will continue to interact (between the Governor and Deputy Governor, on one hand, and senior Bank staff, including the Brazil Country Director). At the same time, intensified discussions would also continue between senior officials working with the Vice Governor on the *PMDI 2007-2023* and other senior officials in the Secretariats of Planning, Development, and Finance, representing Minas Gerais, and senior Bank staff, including the Lead Economist and Lead Specialist on public sector management. Given the shift in focus to sectoral work (relative to the areas covered under the DPL that finished disbursing in early 2007), it would be useful to pursue enhanced interactions between the Secretariats involved in the execution of the *PMDI 2007-2023* and sectoral Bank specialists and experts. Depending on the topic, avenues may need to be explored to reach out to the private sector, think-tanks and academics, and representatives of civil society, to further open communication about the reform efforts and to guide those efforts to better serve the citizens of Minas Gerais.

124. **In practical terms, the bilateral discussions on a possible follow-up Bank operation with Minas Gerais must also include close collaboration with the federal authorities, especially Treasury.** With the Minas Gerais authorities taking the lead in this triangular consultation, the next agreement between Minas Gerais and Treasury under the PAF would need to explicitly include reference to possible borrowing from the Bank, especially the amounts, terms and conditions, and fiscal and debt impacts of such borrowing. The Bank stands ready to assist both Minas Gerais and Treasury with the detailed information surrounding such a possible follow-up operation to make a clear assessment of the implications, benefits, and fiscal and financial impacts.

125. **Timeline issues will depend in part on the triangular discussions with Treasury;** however, if such an evaluation leads to an outcome favorable to a follow-up operation, then the design and processing could take place reasonable quickly. The Minas Gerais authorities would need to agree to the package of measures being supported by the Bank, and detailed arrangements on sectoral work would need to be clearly identified and documented. Experience with the recent DPL would facilitate and accelerate the process, which could possibly be completed within a 12 month period.
References


