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UNIVERSITY OF BIRMINGHAM
International Development Department
School of Public Policy

Sector Wide Approaches in Brazil

Features, drivers and emerging lessons

Richard Batley, Lídia Cabral and Celina Souza

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Summary

Background, objectives and methods

This study was commissioned by the Brazil office of the UK Department for International Development in response to the growing interest in the role of sector wide approaches (SWAps) in middle income countries (MICs) such as Brazil. The aim of this study is to provide a synthesis of lessons learned from SWAps supported by the World Bank in Brazil, and to offer recommendations on how to take the experience forward. The study was undertaken through a desk review of the relevant literature and interviews with officials of development agencies, the Government of Brazil and the Government of the state of Ceará, focusing on three SWAp cases.

The international context

SWAps in Brazil have to be understood in the context of trends in aid flows and approaches in MICs. In response to the decline in the volume of lending to MICs and low execution rates of approved loans, the World Bank and the IADB have been devising more flexible financing mechanisms to make their services more responsive to the changing needs of borrowers.

SWAps originally emerged in very different contexts from that of Brazil. They developed in the early-to-mid 1990s, in aid-dependent and low income countries (LICs), in response to the perceived failure of existing aid practices – particularly the fragmentation and lack of coordination of development interventions resulting in high transaction costs and poor efficiency in the use of resources. SWAps were intended to enhance aid effectiveness by coordinating donors and government in a comprehensive approach to an entire sector, under government leadership and using government procedures. The question is whether this approach is relevant in MICs where aid dependency is low, there are few donors, and government structures and procedures are stronger.

The Brazilian context

Aid to Brazil constitutes about 0.05% of GNI, making it one of the least ‘aid dependent’ countries in Latin America. In that context, it is the multilateral development banks (MDBs: the World Bank and Inter-American Development Bank) which account for the largest gross flows of official development assistance. In Brazil, the SWAp concept has appealed to both parties (GOB and MDBs) not only due to its flexibility (amenable to tailoring to particular circumstances) but also for its close association with some of the basic principles which are driving contemporary aid relationships – particularly support for government leadership and budgeted priorities.

The study identifies four key drivers that influence the form that SWAps have taken in Brazil:

- the government's *policy of tight fiscal control*, i.e. of running primary surpluses so as to address debt service constraints at both federal and state levels;
- the *tied structure of the budget*, i.e. the high proportion of legally earmarked revenue, or non-discretionary expenditure;
- the *MDBs' need to reverse downward lending trends* and increase loan disbursement rates;
- the *MDBs' interest in engaging* with and *influencing programmes* related to policies which governments have given high priority.

Understanding Brazilian SWAps

The study focuses on three ongoing SWAp operations in Brazil. The Family Health Programme was initiated by the government in 1994 with the aim of converting a passive-provider and facility-based health care system into an active provider with an outreach model in which family health care teams deliver basic services at municipality level; the World Bank loan (initiated in 2002) supports an extension of the programme to large urban centres. The Bolsa Família Programme was created by the government in 2003 to unite and extend four already existing cash transfer programmes; the World Bank and IADB separately support the programme with loans and technical components. In the Ceará State Multi-Sector Development Programme, the World Bank agreed in 2005 to give loans and technical assistance for the development of social and infrastructure services and public sector management. These programmes have several common elements:

- *centrality of government's macro-fiscal policy objectives*: the loans do not result in an expansion of public expenditure in the programmes and therefore do not upset the government's primary surplus objective.
- *support to existing policy framework*: loans are provided to support and add value to an existing government-initiated and owned policy framework.
- *use of country systems*: as far as possible, loans are made using government financial management systems.
- *pooled funding*: pooling of MDB and government funds through the use of budgetary support.
- *emphasis on technical rather than financial support:* the development of management capacities is a crucial element of the programmes, although it accounts for a small proportion of the funding.
- *development of results-based management*: a concern with results is present in all three programmes but has grown from one operation to the next.

Although the SWAps have some distinct origins and features, this study argues that it is the bundling of these common elements that is characteristic of the Brazilian case, and that this has arisen from the GOB's and MDBs' response to the contextual drivers identified in the previous section. Though the influence of the SWAps should not be exaggerated, they have helped to increase the government's space for fiscal management, improve lending performance and aid effectiveness, yet further strengthen the strategic role of financial and planning agencies at federal and state level, and improve management systems.

Findings

The analysis concludes that:

These are not 'normal' SWAps: the Brazilian model has some special features that are not seen in SWAps in LICs where the approach first developed. Above all, MDBs do not add (at least for the larger part of the funding provided) to existing budgetary allocations but make disbursements on a reimbursement basis into the treasuries (federal or state), conditional on government's own allocations to selected sectors, programmes or eligible expenditures. SWAp loans thus support the policy of central fiscal management. This is unlike SWAps in LICs which normally principally support sector ministries.

The Brazilian SWAp is a product of flexible adaptation to specific circumstances: the approach has grown up as a way of escaping constraints on the freedom of action of all parties. From the MDBs' point of view, the SWAp model presents the opportunity of escaping more tightly defined traditional ways of lending. From the government's perspective, the SWAps help to unblock sector budgets by putting pressure on the Treasury to release them from the possibility of retention, and give the Treasury some fiscal space to repay internal debt or to release other sectors from constraints on spending. At the state level, budget support releases funds for investment and the repayment of debt.

SWAps have mainly impacted on the lending relationship, fiscal space and management culture: SWAps in Brazil support government initiated and led policies, having limited influence on the direction of policies and more on their implementation. Fiscal policy objectives were found to be central to the way the three SWAps were shaped, reflecting the strength of the planning and finance agencies of government; at federal level, increased fiscal room for manoeuvre seems to be one of the most important impacts of SWAps. However, SWAps are also contributing to changes in broader government management systems – as the spreading of the results-based management culture, particularly in the state of Ceará, demonstrates.

SWAps have had a different impact at federal and state levels: whereas at federal level, SWAps have directly addressed the fiscal policy objective, at state level (in Ceará) the SWAp has represented the opportunity for expansion of social and infrastructural investments.

Outstanding questions and recommendations

We identify questions that remain to be answered and suggest ways of taking them forward:

How successful are the Brazilian SWAps? It is not clear whether and how the relative success of SWAp approaches is being assessed in Brazil. We suggest the development of an evaluation framework which considers the relative advantages of the SWAp over other approaches as well as its opportunity costs. There is scope for a more systematic and collaborative process of drawing lessons from the experience with SWAps by both lenders and recipients.

How unique is the Brazilian experience? We have not been able to establish how far the conditions under which the Brazilian model has grown up are prevalent in other MICs and specifically in Latin American countries, but understand that some of the latter do share these characteristics. The recommendation is to conduct similar analyses in countries which share the characteristics of the Brazilian context (or some of them), particularly with regard to the centrality of fiscal policy and central government agencies and the structurally tied nature of the budget.

Should there be further expansion of SWAps across Brazilian states? The MDBs seem keen to pursue this route. The states would welcome access to concessional lending which would allow them to service their debt while releasing resources for public expenditure. Yet, the expansion of the SWAp framework at sub-national level is viewed by the federal government, with apprehension. The recommendation here is to promote discussion about lending to sub-national levels in order to generate criteria for selecting beneficiary states and consider the comparative advantages of the various lending approaches, including SWAps.

Is the Brazilian experience transferable to other countries? There is at least one general lesson: GOB and the MDBs found in the name of a 'SWAp' an opportunity for creative adaptation that allowed them to escape from the rigidities of their own existing practices to invent a new relationship which suited all actors. However, the 'Brazilian model' does assume some other underlying pre-conditions, which may not be easily found where:

- government ownership and capacity are weaker and external funding is more significant than in Brazil;
- government does not have sufficient resources to fulfil budgetary commitments, and international agencies do not have confidence in country systems of financial management, procurement, expenditure tracking and audit;
- government does not have resource liquidity or where resources are not trapped by budgetary and fiscal restraints; and
- government programmes are not well-structured and backed by medium-term expenditure commitments.

How might Brazil's role in South-South cooperation be developed? The Brazilian experience with regard to SWAps is likely to be of wider interest, for example in regard to the results-based management approach. There is a case for the government to develop a position with regard to its lending modality preferences. There is scope for DFID to play a role in assisting the government to draw lessons not only for internal use but also for consumption abroad, as part of the South-South cooperation agenda.

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List of acronyms

ABC	*Agência Brasileira de Cooperação*
APL	Adaptable Programme Loan
BFP	Bolsa Família Programme
CAS	Country Assistance Strategy
CEF	*Caixa Econômica Federal*
COFIEX	Comissão de Financiamentos Externos
DAB	Primary Health Care Department (*Departamento de Atenção Básica*)
DAC	Development Assistance Committee member countries of the OECD
DFID	UK Department for International Development
DPL	Development Policy Loan
EEP	Eligible Expenditure Programmes
FHE	Family Health Extension (*Expansão da Saúde da Família*)
FMS	Municipal Health Funds (*Fundo Municipal de Saúde*)
FNS	National Health Fund (*Fundo Nacional de Saúde*)
GBS	General Budget Support
GDP	Gross Domestic Product
GNI	Gross National Income
GOB	Government of Brazil
IADB	Inter-American Development Bank (*Banco Inter-Americano de Desenvolvimento*)
IBRD	International Bank for Reconstruction and Development (World Bank)
ICMS	Taxes on Goods and Services (*Impostos Sobre Circulação de Mercadorias e Prestação de Serviços*)
IDA	International Development Association (World Bank)
IFC	International Finance Corporation (World Bank)
IFI	International Financial Institution
IMF	International Monetary Fund
IPECE	*Instituto de Pesquisa e Estratégia Econômica do Ceará*
JICA	Japan International Cooperation Agency
LAC	Latin America and the Caribbean
LIC	Low Income Country
MDB	Multilateral development banks
MDS	Ministry of Social Development and Hunger Eradication (*Ministério do Desenvolvimento Social*)
MIC	Middle Income Country
MOF	Ministry of Finance (*Ministério da Fazenda*)

MOH	Ministry of Health (*Ministério da Saúde*)
MOP	Ministry of Planning (*Ministério do Planejamento, Orçamento e Gestão*)
OA	Official Assistance (to Part 2 countries)
ODA	Official Development Assistance (to Part 1 countries)
OECD	Organisation for Economic Cooperation and Development
PCU	Project Coordination Unit (PROESF)
PPA	*Plano Pluri-Anual*
PROESF	Family Health Extension Programme (*Programa de Expansão da Saúde da Família*)
PRS	Poverty Reduction Strategy
SAIN	International Affairs Secretariat/Ministry of Finance (*Secretaria de Assuntos Internacionais*)
SEAIN	International Affairs Secretariat/Ministry of Planning
SOE	Statement of Expenditure
SOT	Statement of Transfer
STN	National Treasury Secretariat (*Secretaria do Tesouro Nacional*)
SWAp	Sector Wide Approach

Chapter 1. Introduction

1.1 Background

This study was commissioned by the Brazil office of the UK Department for International Development (DFID) in response to the growing interest in Sector Wide Approaches (SWAps) in the Brazilian context, particularly among the Multilateral Development Banks (MDBs). The World Bank has been funding SWAp operations in Brazil since 2002, and has been involved with SWAps in other countries since they first developed. The Inter-American Development Bank (IADB) has also embarked on SWAps in Brazil in 2004 and is interested in further expanding this type of lending operation.

SWAps emerged in the early-to-mid 1990s as a response to the perceived failure of existing aid practices and delivery mechanisms – particularly the fragmentation and lack of coordination in development interventions resulting in high transaction costs and poor effectiveness in the use of resources. The approach was intended not only to enhance aid effectiveness but also to strengthen recipient ownership of the governance process. SWAps developed mostly in Sub-Saharan Africa, in aid-dependent countries with low capacity, weak management systems and a large number of donor agencies, especially in the main social sectors – health and education. Over the last ten years, however, SWAps have expanded to a wider range of countries and sectors.

A SWAp has been defined as: "a process in which funding for the sector – whether internal or from donors – supports a single policy and expenditure programme, under government leadership and using common approaches across the sector. It is generally accompanied by efforts to strengthen government procedures for disbursement and accountability" (ECDPM, 2002). This definition has been interpreted in different ways over the course of time, sometimes leading to a lack of clarity about the nature of SWAps and their adoption in different contexts. But it is now commonly agreed that a SWAp sets a path towards greater national ownership and coordination in policy design and implementation both within and between government and donor agencies.

As the terms of reference for this study (Annex 1) rightly point out, SWAps constitute an approach, and not an aid instrument *per se*. As an 'approach', SWAps constitute a response to the growing consensus on the requisites for aid effectiveness, revolving around the agenda set out in the Paris Declaration on Aid Effectiveness (signed by both the Government of Brazil and the World Bank), including ownership, alignment, harmonisation, managing for results and mutual accountability as key guiding principles of aid relations.

The relevance of SWAps in non-aid-dependent Middle Income Countries (MICs) such as Brazil needs to be seen in this wider context. MICs present very different characteristics from low-income, aid-dependent countries, ranging from more robust government systems and stronger capacity, both at the central and at the sectoral level, to more developed and diverse institutions outside government. In such environments, aid plays a very different role, also because of the small percentage of the budget it covers. Bilateral donors have smaller operations, while MDBs focus mostly on macroeconomic support and technical assistance.

But are the above SWAp objectives still valid in a MIC context? And are the motivations for developing a SWAp the same? SWAps in MICs like Brazil will inevitably take a different shape from similar approaches elsewhere, and need to be considered (a) in the wider debate about the role of aid in different sets of recipient countries, but also (b) as an opportunity to bring in some of the wider issues about aid effectiveness, which have not been so far at the forefront of the aid debate in MICs. This study is asked to consider whether the experience of SWAps in Brazil has brought about innovations, enhanced government leadership and use of government systems, and whether this experience can generate useful insights not only for Brazil but also for other Latin American countries and MICs elsewhere.

1.2 Objectives, research questions and preliminary hypotheses

The aim of this study, as set out in the terms of reference, is to provide a synthesis of lessons learned in key aspects of World Bank SWAps and offer recommendations on how to take the experience forward.

To this end, the study seeks to understand how SWAps operate in Brazil and the achievements and difficulties experienced in relation to the key SWAp objectives. The study also tries to identify critical lessons about the way in which SWAps contribute to improving aid relations and effectiveness and to better policy outcomes. These lessons should guide the Government of Brazil (GOB), the World Bank and other donor agencies in improving the effectiveness of SWAps and aid delivery mechanisms in general, both at federal and sub-national level.

Five overarching research questions provided guidance to the analysis:

(i) What are the defining features and objectives of the SWAp in Brazil – how different are they from the original SWAp concept?
(ii) How has the SWAp approach evolved in Brazil?
(iii) Have the SWAps improved aid effectiveness in Brazil?
(iv) What factors seem to determine the appropriateness and effectiveness of different aid approaches and instruments in Brazil?
(v) What lessons from the Brazilian experience with SWAps can be applied to other Latin American countries and MICs?

Some preliminary hypotheses were formulated at the outset of the study.

(i) SWAps in Brazil, a MIC, are likely to be different from SWAps in low-income and aid-dependent countries – and, particularly, the objective of improving aid coordination is not expected to be a significant concern;

(ii) The Brazilian experience with SWAps is likely to have been strongly determined by the general context of lending to MICs;

(iii) The relevance of the Brazilian SWAps to other countries (transferability of the experience) is expected to be constrained by the degree to which it has been shaped by country-specific circumstances.

1.3 Scope: the case-studies

The study concentrated on three programmes supported by the World Bank which are using a SWAp approach: Family Health Extension, Bolsa Família and the Ceará Multi-Sector Social Inclusion Development Programme. These three programmes make up a diversified selection of SWAp experiments. This diversity has enriched the study by allowing comparison of differences across policy areas, and offering the opportunity to observe the evolution of the 'SWAp approach' over time.

The Family Health Extension programme was the first SWAp experience in Brazil. The study seeks to understand the extent to which this earlier SWAp informed those that followed. The Ceará Multi-Sector Programme constitutes the only example of a SWAp at the sub-national level. The financial mechanisms used to manage this programme bear a strong resemblance to the budget support modality and hence provide a good basis for discussing progress in the aid effectiveness agenda. Bolsa Família constitutes another interesting example by being the only one where there is more than one aid agency involved. Both IADB and the World Bank have been providing assistance to the GoB to carry out this cash transfer programme. Bolsa Família therefore provides a good platform for discussing the issues of alignment and harmonisation in aid delivery. Bolsa Família is also a pioneer example of the use of results-based management with potentially interesting lessons for other countries.

Other possible SWAps, such as the Road Transport programme (the first SWAp outside the social sectors), which is expected to be approved, are discussed with the aim of tracking the evolution of the SWAp and aid relations over time.

1.4 Methods, qualifications and report structure

This report summarises the findings from a desk-review of relevant literature and two weeks of field work in Brazil. Three key sets of literature were reviewed as part of the preparation for work in the field: (i) documented experience with SWAPs, with special reference to World Bank policies in this area; (ii) aid effectiveness and trends in approaches to aid delivery; (iii) aid structures and trends in

MICs, with special reference to the Latin American region. These assisted in identifying the key issues and questions to be addressed by the study. Field work consisted of interviews with various relevant stakeholders in Brasília and Fortaleza and telephone interviews with Washington-based World Bank officials. The list of people interviewed is provided in Annex 2.

An important qualification to make is that this is not a detailed study of the selected programmes (i.e. their policy content, implementation framework or impact) but rather an analysis of the changing aid relationship underlying the approach being used to support those programmes. It is also worth noting that the reach and depth of the analysis were conditioned by the length of the study and hence this study should be seen as an initial contribution to debates on the evolving aid relationship and the future of development lending in Brazil.

This report is structured into six chapters. Following this introduction, Chapters 2 and 3 provide the relevant background for the analysis of the Brazilian SWAp experiences; Chapter 2 discusses the international context of aid relations in MICs, the concept of SWAps and its relevance to MICs; Chapter 3 analyses aid structure and trends, and public finances in the Brazilian context. Chapter 4 provides an overview of the programmes under scrutiny by describing some of their features and concentrating, in particular, on the financing instruments, financial management procedures and disbursement conditions being used. Chapter 5 analyses these SWAp operations and discusses the extent to which there is a specifically Brazilian model of SWAp and the drivers that have determined it. It also discusses the evolution over time and the effects being generated on policies, management processes, and the aid relationship and effectiveness. Chapter 6 concludes by summarising the findings of the study, discussing their implications, particularly with regard to replicability of the experience, and identifying issues for further enquiry.

Chapter 2. The international context

This chapter provides an overview of the international context of the SWAp as a mechanism shaping the relationship between multilateral agencies and recipient/borrowing countries. Section 2.1 introduces the issue of aid to Middle Income Countries (MICs), analysing what is different about MICs and discussing briefly the World Bank's lending strategy to these countries. Section 2.2 analyses the concept of Sector Wide Approach (SWAp), the context in which it developed and the rationale behind it. It also provides a very brief overview of experiences with SWAps in LICs where they were firstly introduced, highlighting some of the achievements and constraints noted in the literature. Finally, it discusses the relevance of the approach to MIC contexts.

2.1 Aid to MICs

Defining MICs

Since 2001, there has been increasing consideration of the position of MICs, of the justification for supporting them in the context of a commitment to poverty, and of whether there is a framework equivalent to the Poverty Reduction Strategy (PRS) for coordinating the efforts of aid agencies and governments. The case for considering aid policy for MICs is made broadly on the basis of:

(i) the scale of aid that goes to them – in 2004, they accounted for 36% of net official concessional loans and grants by DAC members, multilateral institutions and non-DAC countries (World Bank 2006a: table 6.11); and

(ii) the proportion of the world's poor people who live in them – they account for 40% of all those who live on less than US$ 2 per day (World Bank 2006b).

The above proportions are based on an income definition (shared with DAC) of MICs as having Gross National Incomes (GNIs) per capita of between US$ 826 and US$ 10,065 in 2004. However, the World Bank also often includes among the MICs all those countries that are eligible for IBRD funding or a blend of IBRD with IDA financing. This includes several low income countries (on the income criterion) that have access to IBRD loans (e.g. India), while excluding some MICs that are eligible for IDA funding.

The countries of Latin America and the Caribbean (LAC) form the largest group of MICs, but these include several small countries and territories of the Caribbean. Most South American countries are in the lower middle-income category (between US$ 826 and US$ 3,255 per capita in 2004), except for Argentina, Chile and Venezuela which are in the upper middle category (between US$ 3,256 and US$ 10,065 per capita), Nicaragua which is a low income country (< US$ 825 per capita), and Haiti which is among the least developed. Brazil moved from the upper middle-income category which it had occupied in 2003 to the lower middle-income category in 2004 (DAC Aid Statistics 2005).

Globally, the MICs are a diverse group in several ways (World Bank 2001: 1):

- a wide range of income levels within categories, which includes some LICs by the World Bank's extended definition,
- small island states as well as large federations,
- very variable levels of poverty incidence,
- developing and transitional economies with and without developed markets,
- countries with and without access to capital markets, and
- wide variation in performance against the MDGs (World Bank 2006a, DFID 2004).

The MICs demonstrate significant differences between themselves but, on the other hand, they are likely to be different from LICs in several ways that reduce the incentive to achieve common frameworks for aid between aid agencies and recipients. They are less aid dependent and have more access to non-concessional finance, reducing the capacity of aid agencies collectively to insist on strategies and mechanisms equivalent to PRSs. Fewer bilateral agencies are involved, they are involved on a smaller scale and many have little or no presence in the recipient country, reducing the need and capacity to coordinate. Concomitantly, most MICs do not suffer critical shortages of human and financial resources and management capacity. In the experience of both the World Bank (2004: 6) and DFID (2004), they have proven to be more concerned with developing strategies for growth and more resistant to the 'PRS rhetoric' of poverty and inequality, as well as to "the Millennium Consensus's holistic mechanisms for strategy formulation, government-donor dialogue and aid coordination" (Eyben, Lister et al 2004: 18).

Resource flows to MICs

By far, the most important source of international funding for MICs is private finance[1], amounting in 2004 to US$ 297 billion. This was about 14 times more than all DAC bilateral aid to MICs, six times more than the gross disbursements by all multilateral organisations to <u>all</u> developing countries and 17 times more than their net disbursements (World Bank 2006c: tables 6.8 and 6.12; OECD 2005: table 17).

Bilateral aid and lending by multilateral development banks (MDBs) to MICs have some particular characteristics. Bilateral aid to MICs in general and to the Latin American MICs in particular depends very largely on a few core donor countries. Globally, MICs receive about 40% of total net bilateral official development assistance (ODA), of which 70% is accounted for by the USA, Japan,

[1] Private finance includes foreign direct investment, bonds and equities, and bank lending.

Germany and France (OECD 2005, based on 2003-4 figures). Table 1 shows the distribution of ODA to all MICs by the ten largest DAC donors.

Table 1. ODA to MICs by ten largest DAC donors in 2003-04 (% of each donor's total net disbursements)

Donor country	**Lower MICs**	**Upper MICs**	**All MICs**
Spain	50.1	6.4	56.5
USA	48.1	1.9	50.0
Japan	32.4	8.6	41.0
Germany	28.6	5.2	33.8
France	26.4	7.0	33.4
Canada	27.2	5.4	32.6
Netherlands	29.5	2.9	32.4
Norway	26.0	4.9	30.9
Sweden	27.7	3.1	30.8
United Kingdom	21.1	3.5	24.6
DAC average	32.7	4.6	37.3

Source: OECD (2005: table 26) - http://www.oecd.org/dataoecd

Total net bilateral ODA given by DAC members to the LAC region in 2004 amounted to US$ 5,141.7 million. Of this, nearly 80% was contributed by the same four countries plus two others: USA (35.2%), Germany (12.9%), Spain (12.3%), France (6.5%), Japan (6.0%), and the Netherlands (5.6%). Table 2 shows the bilateral donors that contributed 10% or more of their gross ODA to LAC, and the share of the multilateral agencies and banks. The latter includes only that part of MDB lending which is offered on concessional terms (i.e. subsidized to below market rates).

Table 2. Donors contributing more than 10% of their gross ODA to LAC countries in 2003-04

Donor	**% of total gross disbursements**
Bilateral donors giving more than 10%	
Spain	47.5
Germany	16.6
Canada	16.4
Luxembourg	16.0
Switzerland	15.4
USA	14.3
Sweden	12.4
Netherlands	12.3
Finland	11.5
Italy	10.1
Japan	10.0
Multilateral agencies	
United Nations agencies	11.2
MDBs (concessional)	9.1
European Commission	8.8

Source: OECD (2005: table 27) - http://www.oecd.org/dataoecd

The largest part of MDB loans to MICs is on a non-concessional basis, unsubsidized but normally on better terms than those MICs themselves could obtain in the market. It was very largely the decline in the net value of non-concessional loans, particularly by IBRD, that brought about the World Bank's review of its strategy towards MICs.

Between 1990 and 1997, there was a stable level of annual commitments of IBRD lending of between US$ 14 and 18 billion. In response to the financial crisis of 1998 and 1999 and the collapse of private lending, there was a sharp upswing in IBRD lending to around US$ 22 billion. But this was followed by an even sharper downswing to reach levels in 2000 to 2003 that were 26% below the pre-crisis average. The decline was due particularly to falls in investment lending (except in the South Asia Region); adjustment lending was volatile, but grew over the period particularly in the LAC region. While IBRD lending commitments fell in this period, lending by other MDBs also declined but less than IBRD's, making them a more important source of lending to MICs by 2003 (World Bank 2004a and Linn 2004). As the volume of new lending declined, the repayment burden grew so that the flow of loan funds to MICs became negative in general, but above all to the Latin American MICs (Table 3).

Table 3. Net financial flows of multilateral institutions and net DAC aid in 2004 (US$ billion)

	Net financial flows from Multilateral Development Banks								Net aid by DAC countries
	World Bank		IMF		Regional banks		Other	UN agencies	
	IDA	IBRD	concession	non-concession	concession	Non-concession			
Income groups									
LIC	5.2	-0.01	0.1	-0.6	1.3	-0.6	0.4	1.1	2.1
MIC	0.9	-4.8	0.005	-14.1	0.2	-0.2	1.4	1.2	2.1
Regions									
SSA	2.8	-0.3	-0.1	-0.03	0.8	-0.1	0.3	1.0	17.1
SA	1.7	0.3	0.3	-0.6	0.1	-0.4	0.1	0.3	3.5
MEN	0.1	-0.7	-0.03	-0.5	0.2	-0.5	0.02	0.6	8.1
EAP	0.5	-2.4	-0.1	-1.5	0.3	-0.1	-0.2	0.2	5.3
ECA	0.7	-0.3	-0.03	-5.9	0.1	0.4	0.8	0.2	5.2
LAC	0.3	-1.3	0.4	-6.3	0.2	-1.5	0.7	0.4	5.1
Brazil	*0*	*-0.1*	*0*	*-4.4*	*0*	*-1.5*	*-0.01*	*0.1*	*0.5*

Source: Based on analysis of World Bank (2006c: table 6.12 and 6.13) - http://devdata.worldbank.org
Note: Regions are Sub-Saharan Africa, South Asia, Middle East and North Africa, East Asia and Pacific, Europe and Central Asia, Latin America and the Caribbean.

The World Bank's MIC strategy

Uncertainty of definitions, as well as the real differences between countries, makes it difficult and probably inappropriate to generalize about MICs, as the World Bank has concluded. The World Bank Group's Task Force was set up in 2000 to examine the Group's relationship with its middle-income members, and reported in 2001. A Working Group reported in 2004, focusing on the implementation of the strategy (World Bank 2004a). Based on this a Management Action Plan was developed (World Bank 2004b) and progress reports were made in February (World Bank 2005a) and December 2005 (World Bank 2005b). Recently, the Bank has announced an Independent Evaluation Group review of its support to MICs (World Bank 2006a).

The World Bank's 2001 Task Force on MICs concluded that it was not appropriate to categorize countries for operational purposes (i.e. for access to lending instruments) since rankings on elements of the categorization (income, policy performance, market access and poverty) were not consistently correlated, and the categories would be controversial. Instead, the Bank espoused the principle of developing country-relevant responses on a case-by-case basis but drawing on "a broad menu of analytic, lending and risk management instruments" (World Bank 2005b: 2). The Bank explains its commitment to MICs in three main ways:

(i) Its mission of global **poverty reduction** and the contribution of MICs to world poverty;

(ii) Its role in mobilizing finance and advice to improve the provision of **public goods** (macroeconomic stability, good institutions, infrastructure and social services) that are necessary for accelerated growth and poverty reduction at the national level; and in supporting MICs' contribution to global public goods (trade integration, international financial stability, control of communicable diseases, clean energy and environmental protection);

(iii) The decline in the volume of **IBRD lending** by a quarter between the early 1990s and early 2000s.

The World Bank's analysis (2004a) of the causes of the decline in lending found that, among four sub-groups of MIC (i.e. IBRD) borrowers, decline had occurred only in (1) countries with good policy performance and with good access to capital markets and (2) the poor performers with poor creditworthiness. Lending had increased to (3) the countries with satisfactory policy performance and volatile market access (including Brazil), and remained stagnant in (4) those with satisfactory performance and insignificant market access. The Bank found that the support for countries in group 3 was in line with its strategy of supporting MICs during crisis, but that it also needed to enhance support to the development efforts of groups 1 and 4. Its diagnosis was that the Bank had become a relatively unattractive partner for many countries (World Bank 2004a and 2005b). The main shortcomings were that Bank support was not felt by MICs to be aligned with their own development priorities (usually more oriented to growth than poverty reduction), was insufficiently oriented to infrastructure investment, was excessively complex and conditional, and was rigidly committed to World Bank Country Assistance Strategies (CASs) and unable to respond to opportunities.

The Bank's proposals (World Bank 2004b and 2005b) for short and longer term implementation therefore included:

- clarifying its role in lending for growth as well as poverty reduction,
- using national systems where possible,

- basing the CAS more on recipient countries' own development vision and making them more flexible,
- improving the Bank staff's own incentives and replenishing skills,
- developing an approach to support of sub-national access to domestic capital markets,
- not applying conditionality in specific projects but through analytic work and policy dialogue in policy-based lending and SWAps, and
- entering into development partnership with bilaterals, MDBs and MICs, recognizing their comparative advantages, using more joint analytic and advisory work, more joint operations such as SWAps and more combined funding.

Other MDBs are following suit. In 2004 the IADB approved an *Approach for Further Development of Lending Instruments and Operational Policies* which sets the direction towards more flexible lending instruments, including the use of the SWAp approach as a way of supporting government-led programmes and harmonisation of policies with those of other MDBs (IADB 2005b).

2.2 SWAps: concept, practice and relevance to MICs

In the light of the above, the emergence of the SWAp in MICs has to be seen as part of this revised lending framework. Before discussing this in detail, we start by briefly analysing the concept of SWAp and its rationale in the context where it originally developed.

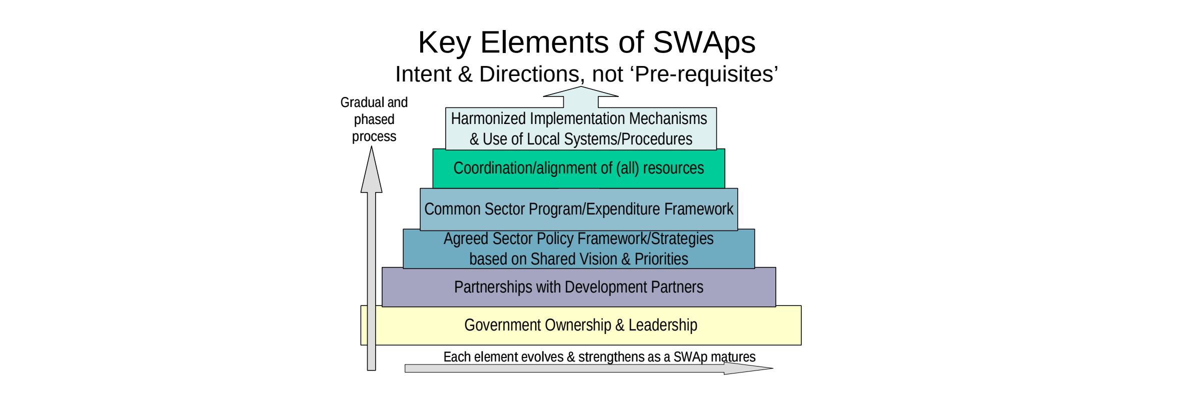
Defining a SWAp

A commonly used SWAp definition is that "all significant funding for the sector supports a single policy sector policy and expenditure programme, under Government leadership, adopting common approaches across the sector, and progressing towards relying on Government procedures to disburse and account for all funds" (Foster 2000: 9). Implicit in this definition are five components which are widely recognised as key features of a SWAp (although there might be slight variations across countries and aid agencies):

(i) government leadership,
(ii) engagement of most or all significant providers of funding or stakeholders,
(iii) comprehensive (or sector-wide) and coherent policy framework,
(iv) common planning and management procedures across the sector; and
(v) use of (or progress towards) government financial management systems and procedures.

In practice, these components are hardly ever present at the same time – or at least not to the same degree – and it is common practice to talk about SWAps as a dynamic process (or as an intended direction of change) towards an ideal type, rather that a static blueprint. A SWAp is therefore seen as defining an evolving working relationship between government and aid agencies and amongst aid agencies themselves. Figure 1 illustrates the SWAp evolutionary process as envisaged by the World Bank.

Figure 1. Key SWAp elements as an intended direction of change



Source: OPCS-World Bank (2006)

It is commonly argued, including by the Bank and OECD-DAC, that the SWAp is an approach and not a specific financing instrument. A SWAp can in fact be financed through budget support, pooled funding or through traditional project support modalities.

Origins of the concept and rationale

SWAps developed in the late 1990s as a response to the emerging insights from work on aid effectiveness (e.g. Dollar and Pritchett 1998 and Killick 1998), including:

- the need for sound institutions and good policy environment for financial aid to be effective,
- failure of policy conditionality as a driver of policy reform, and
- fragmentation and lack of synchronisation of donor-funded development interventions which were generating inefficiencies in the allocation and use of resources while undermining the government's policy processes and domestic accountability.

SWAps initially developed in low income and highly aid dependent countries (mostly in Sub-Saharan Africa) where the policy framework was weak and where the proliferation of projects and aid agencies was leading to a considerable fragmentation in development operations. A central objective of the SWAp has been, since its early years, to foster the development of government-led coordination mechanisms for policy dialogue and implementation which bring together all major sector stakeholders under an integrated policy framework, thereby contributing to greater efficiency and effectiveness in the use of public resources (both domestic revenue and aid resources). Foster (2000) listed the circumstances where SWAps were likely to be relevant and feasible:

- where public expenditure is a major feature of the sector,
- where the donor contribution is large enough for coordination to be a problem,

- where there is a basic agreement on policy strategy between government and donors,
- where there is a supportive macroeconomic environment, to allow budget planning with reasonable confidence,
- where institutional relationships are manageable (namely where the area of budget responsibility is with a single sector ministry – SWAps have proved difficult in cross-cutting sectoral areas – and where there is a relatively small group of significant donors), and
- where incentives are compatible with SWAp objectives (e.g. problems are likely to occur if the SWAp attempts to reduce the size/budget of the sectoral ministry leading the SWAp).

The approach was first introduced in the social sectors, especially in health and education, where many of the above conditions were present. More recently, SWAps have expanded also to sectors and countries where the above circumstances are not necessarily present, or at least not all of them are. The productive sectors (such as agriculture) constitute examples where the SWAp approach is arguably more difficult to apply. This is partly because the state is a relatively minor player, its role is less about spending or delivering services, and more about creating an enabling environment for private sector development (sound policies and regulation), and because there is usually a high degree of contestation on stakeholder roles and policies, making any attempt to coordinate government and donor policies and resource allocation a very challenging task.

SWAps are also being developed in MICs where aid dependency is relatively low and where coordination of aid agencies approaches and delivery mechanisms is often not a significant concern.

SWAps in practice

There is no up-to-date figure on the total number of SWAps in operation. This is partly due to the loose nature of the definition (SWAps being defined as an approach rather than a blueprint) and the context-specific character of SWAp experiences and names used to describe those experiences. The most recent estimate dates back to 2000 and puts the total number of SWAps or SWAp-like operations at 80, the majority of which were located in Sub-Saharan African countries (85%) and in the health (28) and education (28) sectors (Foster et al. 2000b).

Evaluations and reviews of experience with SWAps, particularly in the social sectors (Brown et al. 2001, Foster et al. 2000a, Foster et al. 2000b, Pavignani 2001), point to a number of achievements and difficulties.

Amongst the most noticeable positive changes are the following:

- improved policy dialogue between government and donors and between donors themselves,
- increased government leadership of policy processes,

- harmonisation of donor procedures and alignment with public financial management systems, and
- some progress in service delivery in specific sectors.

Yet, despite progress made, a series of important challenges remain and indeed the track record of SWAps continues to be somewhat controversial. Some of the constraints to address include:

- blueprint prescription irrespective of the context,
- excessive focus on the SWAp process itself rather than on policy outcomes,
- institutional capacity constraints to actually developing the coordination mechanisms,
- tendency towards re-centralisation of policymaking around central government agencies,
- difficulty in harmonising donor policy approaches and aid delivery mechanisms (such as disbursement calendars or procurement rules), and
- limited evidence of reduction in transaction costs.

Hence, SWAps are still, to some extent, work in progress. The recent trends around the aid effectiveness agenda – particularly the principles established in the 2005 Paris Declaration on Aid Effectiveness (OECD 2006) – are leading to further changes to the SWAp (at least in development thinking). Although the principles of ownership, harmonisation and alignment are in line with the SWAp, the Paris agenda is arguably moving the focus of aid relationships beyond individual sectors and towards the wider government policy framework (framed, for example, by Poverty Reduction Strategies).

Relevance of SWAps in MICs

There are different views on the extent to which the SWAp model and experience described above are relevant to MIC contexts. Indeed, if one assumes that the main reasons for having a SWAp are to overcome the fragmentation of development aid operations and strengthen government-led policymaking processes, then it is fair to ask whether the SWAp model is of relevance in countries where there are fewer aid agencies, higher levels of human and financial resources, and stronger governmental structures and procedures.

As noted in the previous section, MICs are likely to be different from LICs in ways that reduce the incentives to develop common frameworks between aid agencies and recipients. They are less aid dependent, have more access to capital markets (sources of financing) and their public sector institutions have stronger technical and management capacity. These put MICs in a stronger bargaining position and give aid agencies less capacity to influence policy decisions and the selection of aid delivery mechanisms. Besides, given that aid agencies' presence in the recipient country is lower, there is relatively less need for coordination of interventions.

Lavergne and Alba (2003) have argued that because programme-based approaches (or PBAs), such as SWAps, involve a fair to high degree of aid agency involvement in the recipient country's programming and budgeting processes, and hence a certain loss of sovereignty, the recipient country is likely to resist such an approach. They conclude that the most favourable conditions are where there is high aid dependence (i.e. in most LICs), as well as a fair degree of macroeconomic budget stability, and a sound policy framework at the programme level.

Moreover, aid agencies in MICs may not only have less leverage to pursue a common agenda but also have less inclination to do so. Eyben, Lister et al. (2004) note the concentration of a small number of donors with obvious regional and political interests in the four countries they studied (Bolivia, Colombia, Peru and Jamaica); only in Bolivia did they coordinate around a development strategy. Furthermore, DFID (2004: 3) indicates that "Poverty reduction is also not the starting point for many bilateral donors, who may be more committed to pursuing domestic political interests through their programmes in MICs". DFID also notes that, while all UN member states and all of the multilateral development agencies have signed up to the MDGs, these are not embedded in the MDBs' own lending policies for MICs.

By contrast, the World Bank's guidance note on SWAps (World Bank 2006b) argues that SWAps are suitable to both LICs and MICs, and points out that whereas SWAps in LICs focus on donor coordination and pooling, in the case of MICs, SWAps are used by the Bank to align its support to the government's existing programmes and systems through pooling or co-mingling of funds using existing channels, institutions and procedures.

It can also been argued that it is precisely where capacity is higher, such as in MICs, that SWAps and other PBAs are more likely to succeed. A forum organized by the Japan International Cooperation Agency (JICA 2005) specifically questioned Lavergne and Alba's thesis that interest in PBAs will be lower where aid dependency is low and that, when PBAs are used, one might expect less donor influence in policy dialogue. It referred to PBA cases in large countries with low aid dependence (India, China) or higher aid dependence but still relatively less than for most Africa countries (Bangladesh), and other cases in Cambodia, Sri Lanka and Vietnam. It found that these countries favoured the PBA approach and that PBAs "probably work best where capacity is high" (*ibid*: 7). In the case of a PBA on primary and secondary education, it was found to have "supported a coherent nation-wide policy reform process" (*ibid*: 27). Similarly, a study of general budget support in Vietnam found that the government favoured this approach not so much for the finance as because it gave access to policy dialogue, such as technical advice and policy alternatives (Bartholomew et al. 2006).

The chapters that follow describe the Brazilian context, why the concept of SWAp was introduced and how it has developed. The analysis seeks to provide evidence on the underlying 'SWAp model' being used in Brazil and how different it is from the approach described in this chapter.

Chapter 3. The Brazilian context

3.1 The politics of public finance

Since the late 1980s, Brazil has embarked on two simultaneous agendas: one focusing on macroeconomics and the other on re-democratisation. The former aimed to address a debt crisis which swept Latin American countries, followed by difficulty in controlling inflation. As a result Brazil embarked on monetary, fiscal and financial reforms. These reforms, which started in 1994 and which have remained the federal government's highest priority regardless of the governing political coalition, have stabilised macroeconomic indicators, particularly inflation rates, and allowed the country to regain access to international capital markets. The re-democratisation agenda aimed to re-construct political institutions, but also to address the social demands, particularly of large segments of the population who were excluded from the economic gains of previous decades. Such an agenda requires increased public resources to address the country's main economic and social constraints. The pursuit of these two agendas implies the reconciliation of severe fiscal discipline with expenditure on social programmes and investments in infrastructure.

Legacies from recent political and economic history

The current state of Brazil's public finances is the result of legacies of three different political and economic periods of its recent history. The first legacy comes from the military regime (1964-1985), which introduced financial centralisation, tax increases and external borrowing as a strategy for sustaining high levels of investment and two decades of rapid economic growth. Public revenue increased from 17% of GDP in 1960 to 26% in 1980 and the federal government increased its revenue from 10% of GDP in 1960 to 17% in 1980. The years of the "economic miracle", however, finished with the 1979 petrol crisis and the rise of interest rates in the international market in 1982.

The second legacy comes from the 1988 Constitution, fruit of the country's return to democracy. One important feature was that decisions related to changes in the tax system, expansion of social benefits and universalisation of certain social services were taken by the makers of the Constitution themselves, therefore politicising and constitutionalising the fiscal system and the design of social policies.[2] Furthermore, the 1988 Constitution and further constitutional amendments earmarked a large share of public resources to specific purposes (less developed regions, states and municipalities, social and sectoral programmes). The MOP estimates that 80.6% of federal budget resources are currently earmarked, as opposed to 55.5% before 1988, thus leaving only 19.4% to be allocated discretionarily (Ministério do Planejamento, Orçamento e Gestão 2003).

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[2] For more details about the making of the 1988 Constitution, see Souza (1997; 2001).

Earmarking of federal resources and details about social policies can be credited to the following reasons. First, the drawing up of the constitution was not a result of the inauguration of a new democratic order; rather it came into being as part of the political process of transition to democracy. This meant that constitution makers were unsure of its outcome, and therefore ‘constitutionalised’ a wide range of issues. Second, the main goal of the constitution makers was to legitimise the new regime; this meant reconciling conflicting demands and leaving no room for discussion on issues such as the public deficit, inflation control, fiscal adjustment and globalisation that would later confront the country. However, the tendencies to earmark federal resources and to legislate about public policies continued, probably as a reaction by lawmakers and sectoral ministries against the power gained by the Treasury as a result of the policy of fiscal control. It is worth noting here that the significance of earmarking in Brazil is quite unique and contradicts the generally accepted budgetary principle that revenue and expenditure decisions should be separate and that revenues should in principle be pooled for the financing of all expenditures rather than earmarked for the financing of a particular institution, programme or expenditure item (see, for example, Foster and Fozzard 2000).[3]

The third legacy began with the 1994 stabilization plan – *Plano Real* – which succeeded in controlling Brazil's hitherto uncontrollable inflation.[4] Fiscal adjustment became a priority and several constitutional amendments and federal laws were passed to sustain fiscal and budget control.[5] As a result of the rapid success in combating a decade of unbearable rates of inflation, the federal government managed to gain the approval of Congress to several constitutional amendments and laws intended to sustain stabilisation. On the revenue side, taxes were increased from 24.1% to 35.8% of GDP between 1985 and 2003, mostly benefiting the federal government. On the expenditure side, a fund was created which de-earmarked 20% of all federal transfers from mandatory spending, except those to states and municipalities. With regard to debt, policies detailed below contributed to the reduction of external debt but increases in domestic debt at the federal level. At the state level, a web of measures described below managed to control state finances. On the enforcement side, the strengthening of the *Secretaria do Tesouro Nacional* (STN) in 1995 created a solid bureaucracy in charge of administering fiscal control, both at the federal and at sub-national levels.

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[3] Foster and Fozzard note that earmarking of revenues to specific uses risks making the budget fragmented and inflexible: “[t]here is a risk that earmarked funds can become entrenched and difficult to dismantle, long after the original budget purpose which gave rise to them has ceased to be a priority of Government” (p. 10).

[4] In 1993, the annual inflation rate reached 2,708.2%.

[5] For the politics of constitutional reforms, see Melo (2005). For the dilemmas of tax reform, see Souza (2005).

Consequences and sequencing of macroeconomic policies

The 1994 stabilisation plan had important consequences, which, to this day, impact on public finances. It was a well-designed plan based on a sequencing of measures to avoid the failures of previous plans. Among its main consequences, the plan raised interest rates to unprecedented levels, thus aggravating the debt burden, in particular domestic debt. External debt, the country's nightmare for the last 20 years, has been rapidly decreasing lately vis-à-vis domestic debt, moving from 9.2% of GDP in 2005 (R$ 173,516 million) to 6.7% in 2006 (R$ 135,659 million). The main reason for this decrease is a policy of paying in advance debt contracted from foreign creditors (IMF, World Bank, Paris Club creditors, etc). This has been possible, among other things, because of high budget surpluses, coupled with the appreciation of the national currency. This contrasts with net domestic debt, which has increased from 25.4% of GDP in 2005 (R$ 478,038 million) to 26.9% in 2006 (R$ 544.433).[6] There is, however, a downward trend in interest rates, which have dropped from over 19% in 2005 to around 14% in October 2006.

This policy of fiscal adjustment has been complemented by 8 years of significant primary budget surpluses, which have stabilised at around 4.5% of GDP. The surplus has been sustained by all levels of government through a policy of not spending resources allocated in the budget, a process known as *contingenciamento*. This practice is possible because in Brazil the budget is not mandatory, i.e. the executive is not legally required to spend legislatively-allocated funds. Sustaining primary surpluses has allowed the government to have more resources to pay interest on domestic and external debts.

The public deficit, although very high for a developing country, has been declining lately, representing 58.2% of GDP in 2003 and 51.6% in 2005 (Afonso 2006).

Among the several measures adopted under the *Plano Real*, one of the most praised is the Fiscal Responsibility Law, approved in 2000. The law imposes ceilings on public sector debt and expenditure on payroll by the executive, the legislative and the judiciary, for the three levels of government, and prohibits the bailing out by the federal government of new debts contracted by sub-national governments. It also determines rules and ceilings for sub-national borrowing (but not for borrowing by the federal government).

The restrictions on important lines of expenditure brought about by the Fiscal Responsibility Law furthers and complements previous fiscal control policies, until then more focused on debt payments but insufficient to prevent future spending and commitments to new debts.

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[6] Data on external and domestic debt are available at www.stn.fazenda.gov.br.

State finances

The role of the states is crucial for the macroeconomic agenda because Brazil has become one of the most decentralised federations in the developing world. Sub-national governments today collect around 32% of all taxes collected in the country and 43% when transfers are added. In terms of spending, they are responsible for 70% of the payroll and 78% of social spending, excluding social benefits (Afonso 2006).

From a historical perspective, however, states have lost their financial importance vis-à-vis other levels of government, despite collecting the tax that generates the largest revenue in absolute terms – ICMS (*Imposto Sobre Circulação de Mercadorias e Prestação de Serviços*), a type of value-added tax which, unlike in many federations, is under states' jurisdiction. In 1960 the states had a 34% share of public revenue. During the military years, it dropped to 22%. With re-democratisation, the states' share reached 29%. After 1991, however, the states' share fell steadily, reaching 25% of public resources in 2003 (Afonso 2004). The states have not lost resources in absolute terms but their share of the total amount of resources levied by the three orders of government has decreased. There are several reasons for this decrease, among them the successful efforts of the federal government to make up for its financial losses, as shown above, and years of mediocre economic growth affecting the collection of ICMS.

The indebtedness of the states is rooted in the 1966 fiscal reform and in a federal policy of using new loans to finance old ones so as to maintain high rates of investment. The states not only had their own resources reduced but they were stimulated by federal incentives to borrow. With the promulgation of the 1988 Constitution, the low level of states' revenue was partially sorted out, but a web of unpaid debts remained. In 1994, the rise in interest rates further deepened their debts. Most of the states did not contract new debts after the Plan but the increase in interest rates led to their financial insolvency.

The indebtedness of the states only began to be addressed federally after inflation control. The federal government was then prepared to deepen fiscal mechanisms to control what was seen as one of the most important pillars of fiscal stabilisation in Brazil: to limit expenditure by the states and restructure their debt.[7] The states' debt had increased from 15% of the public sector debt in 1989 to 42% in 1997 (Rigoton and Giambiagi 1998).

The task undertaken by the federal government was not easy: since 1988, seven agreements with the states were signed to restructure their debts but these were systematically evaded by the states; one of the reasons being that they knew the federal government would bail them out because of the impact of their debt on public finances as a whole. Between 1997 and 1999 the federal government

[7] At the state level, fiscal adjustment is the main macroeconomic policy tool, whereas at the federal level there are other mechanisms, such as decisions on interest rates and exchange rates.

managed to change the terms of the agreements, introducing mechanisms authorising it to retain a share of a state's revenue whenever that state did not fulfil its obligation.[8] This shows that since 1994 Brazil has adopted two simultaneous but different types of fiscal control to avoid a repetition of the states' previous behaviour: a control based on new rules and central government control, following a typology developed by Ter-Minassian and Craig (1997). The new agreements meant that their debt was transferred to the federal government, amounting, at that time, to around R$ 95.4 billion (11% of GDP). Most states are to pay their debt back over 30 years, with a minimum interest rate of 6% per year, and an average of 13% of their net revenue being committed to monthly payments. Agreements also prohibit borrowing while the state's debt is higher than its real net revenue. The federal Treasury is responsible for following up the agreements.

A further incentive for fiscal control by the states derives from the fact that most financial resources for investment and poverty alleviation programmes at state-level are now coming from the MDBs. To access these resources states have to keep their accounts in order. Also, because of the agreements signed with the federal government, the federal Treasury has to approve the contracting of new loans by the states (in order to ensure that their monthly payments are satisfied). Loans from MDBs are not subjected to borrowing ceilings set up by the Fiscal Responsibility Law.

Controversies and impact of fiscal adjustment on other programmes

There is, hence, plenty of evidence to show the success achieved by macroeconomic policies in tackling inflation and in adjusting public accounts to make Brazil a global player. This success, however, has a cost and it is affecting the government's capacity for tackling Brazil's critical dilemmas, i.e., social inequality, poor access to and quality of social programmes, and infrastructure deficits that prevent the country from enhancing economic activities. It has also been pointed out that high interest rates, a tax system that heavily relies on businesses and the lack of a business-friendly environment are responsible for Brazil's mediocre economic growth rates of the last decade, in particular compared to other so-called emerging countries.

Some argue that Brazil has been going, at least until recently, in an opposite direction to OECD countries: while the latter have chosen to make fiscal adjustments by decreasing expenditure on interest and pensions, Brazil's choice is for high interest rates and budget surpluses. The policy of paying external debt in advance is seen by some as unnecessary because it was already in decline and because it puts too much stress on domestic debt. Others argue that budget surpluses have been achieved at too high a price, i.e., at the expense of infrastructure investments and social programmes. Furthermore, when investments are made in social sectors, which are, in general, labour-intensive programmes, they require the hiring of new personnel at the three levels of

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[8] For a review of previous attempts to renegotiate the states' debt, see Almeida (1996), Rodden (2003) and Souza (1996). For details about the late 1990s debt renegotiation, see Mora (2002) and Souza (2006).

government, thus increasing recurrent expenditure, which, according to some economists, is escalating too rapidly and putting additional pressure on public finances. As for the states, incumbent and recently elected governors agree that committing an average of 13% of their net revenue is no longer sustainable and is preventing them from implementing their own social and development policy agenda.

3.2 Resource flows and trends in the aid framework

Aid flows

Aid to Brazil was, in 2004, about 0.05% of GNI, making it one of the least aid dependent countries in Latin America. The volume of net ODA (that is grants and concessional loans less repayments from all bilateral and multilateral organisations) to Brazil fell from US$ 349 million in 2001 to US$ 285 million in 2004 (OECD 2005: table 25). It is important to note the relatively insignificant scale of aid and concessional lending by comparison with the scale of the economies of Latin America generally but particularly of Brazil. The LAC MICs generally have a very low level of aid dependency, measured by the ratio of net ODA receipts to GNI. Excepting the small island states, in only five LAC countries is the ODA/GNI ratio over 1%: Bolivia, El Salvador, Guyana, Honduras and Nicaragua. Brazil's like Mexico's 'aid dependency' was insignificant in 2004 (Table 4).

Table 4. Aid Dependency in MICs, world regions, LAC countries and Brazil in 2004

Group/region/country	Aid per capita – US$	Aid as % of GNI
All MICs	10	0.4
- Lower MICs	10	0.6
- Upper MICs	12	0.2
Regions		
- Sub-Saharan Africa	36	5.3
- Middle East and North Africa	35	1.7
- Europe and Central Asia	25	0.7
- Latin America and Caribbean	13	0.4
- East Asia and Pacific	4	0.3
Major LAC countries		
- Argentina	2	0.1
- Bolivia	85	9.1
- Brazil	**2**	**0.05**
- Chile	3	0.1
- Ecuador	12	0.6
- Mexico	1	0.02
- Peru	18	0.7
- Uruguay	6	0.2

Source: World Bank (2006c: table 6.11)
Note: 'Aid' includes Official Development Assistance (ODA) and Official Assistance (OA).

The MDBs are the most influential aid agencies in Latin America, because of their importance in adjustment (mainly the IMF and World Bank) and investment (mainly IADB and the World Bank) lending. Table 5 indicates the scale of the operations of the principal multilateral institutions in

2004, the fact that the operations of the MDBs then represented net outflows, the predominance of non-concessional finance, and the importance of Brazil in their portfolios.

Table 5. Net financial flows from multilateral institutions to LAC and Brazil in 2004 (US$ million)

Institution	**Latin America & Caribbean**	**Brazil**
World Bank		
- IDA	323.6	0.0
- IBRD	-1,314.4	-116.3
IMF		
- concessional	35.4	0.0
- non-concessional	-6,291.7	-4,356.8
IADB		
- concessional	202.0	0.0
- non-concessional	-1,532.8	-1,468.2
Other IFIs	746.7	-4.5
UN agencies	350.6	136.1
Total	**-7,480.7**	**-5,809.7**

Source: World Bank (2006c: table 6.13) - http://devdata.worldbank.org

Globally, IBRD commitments (both for investment and for adjustment lending) fell between the mid-1990s and the early 2000s, stimulating the World Bank's concern with its relative position in MICs. However, in Latin America and particularly in Brazil, adjustment lending (now known as development policy lending) grew strongly in 1998/99, then declined – though it remained at a higher level than in other regions (World Bank 2004a). IBRD lent about US$ 3.2 billion over the first two years of Brazil's Country Assistance Strategy (CAS) 2004-2007 and anticipated lending a total of US$ 6.6 billion for the overall CAS period (IBRD 2006). The IBRD/IFC[9] 2006 progress report on the Brazilian CAS expected the net negative flows to Brazil soon to become positive. It also noted that Brazil represents IFC's second largest country exposure (after Russia): "as of March 31, 2006, outstanding and committed portfolios for IFC's own account totaled US$ 1,024 million and US$ 1,554 million respectively, representing 7.6% and 8.1% of IFC's portfolio" (IBRD/IFC 2006: 9).

The IADB disbursed US$ 6.8 billion to Brazil between 2000 and 2003, considered by the agency to be high given the strict budgetary constraints and the low volumes of new loan approvals (US$ 3.7 billion) due to the debt reduction policy (IADB 2004c). IADB funding accounts for about 56% of aid disbursements in investment, emergency and sector lending. For a number of years the agency ranked first in terms of volume of financing provided although the situation is now changing. Table 6 shows who are the ten largest donors to Brazil; among the multilateral agencies, only the IADB appears as an important contributor of gross ODA.

[9] International Finance Corporation of the World Bank.

Table 6. Brazil aid profile in 2004

Population (million)			184
GNI per capita (current US$)			3,000
Net ODA/GNI			0.05%
Top ten contributors of ***gross*** ODA (US$ million)		Main bilateral contributors of ***net*** ODA (US$ million)	
Japan	153	Germany	51.9
Germany	76	Japan	41.7
France	52	France	31.1
USA	27	Netherlands	16.3
IADB	17	UK	11.1
Netherlands	15	Spain	9.9
EC	14	Canada	9.1
UK	12		
Italy	12		
Canada	9		
Bilateral share of gross ODA	68%		

Sources: OECD 2005 - http://www.oecd.org/dataoecd, World Bank (2006c: table 6.12)

Trends in aid agency framework

This section does not claim to describe the aid policies of the principal aid agencies in Brazil but to identify some of the main tendencies in terms of the aid framework and instruments they are adopting. Most attention is given to the case of the World Bank whose use of SWAps is the subject of this study.

A process of re-definition of the aid framework is underway in Brazil. The IADB and World Bank have been moving towards supporting government leadership, adopting more flexible financing instruments and strengthening their relationship with sub-national governments. Partly as a consequence, most bilateral donors and UN agencies have been scaling back their independent project-based activity, sometimes replacing this with an attempt to work in stronger partnership with the government and MDBs, and sometimes focusing on a narrower range of specialist themes. We understand that the only bilateral programme that is expanding its funding is Spain’s. The transformation of DFID’s programme is probably one of the most profound: cutting its own direct project aid and replacing it with a strategy of producing studies to foster dialogue among national stakeholders and international agencies, encouraging a closer working relationship between the World Bank and IADB, supporting the Government of Brazil in South-South relations, and sponsoring learning and exchange at regional level.

Both the World Bank and IADB have gone through processes of review of their lending strategies, coming up with similar recipes to those set out for the World Bank in section 2.1; these are reflected in their country programmes (IBRD/IFC 2006 and IADB 2004c). They emphasize increasing government ownership and responding to government priorities, supporting initiatives that already exist in the government’s multi-year plan (*Plano Pluri-Anual* – PPA), using more flexible aid policies and procedures (including SWAps) to reduce delays in disbursement, shifting more lending to the sub-national level, encouraging results-based approaches to public sector management, and encouraging joint operations with other aid agencies. Within the LAC Region, IADB has been consciously following a path that was being carved out by the World Bank: "The World Bank has been very active in the development of lending instruments and adoption of more flexible policies" and "has experienced a substantial increase in its share of lending to the Latin American Region in the last years" to bring it up to almost the IADB level in 2003 – US$ 6.8 billion (IADB 2005b: 18). The World Bank had been under greater pressure to adjust since its lending had fallen more drastically.

Yet, both the IADB and the World Bank have encountered constraints on their ability to engage in new forms of lending which have driven the direction of their reforms towards SWAps in Brazil:

- the policy of strict budgetary constrains and reduction of public debt has affected demand for lending (as described in the previous section);
- lending to sub-national governments has been constrained by sovereign lending requirements against lending direct to states; and
- IADB policies have not allowed it to pool its funding in a common account with government or other partners, and have required it to follow its own financial management, disbursement and procurement procedures (IADB 2004b: 4-5).

In Brazil, the decision of the government to maintain a primary surplus made lending to the federal government difficult, IADB made a major shift to lending to sub-national bodies (IADB 2004c). However, IADB's Brazil country strategy did not make a particular commitment to SWAps; we heard that the drive to adopt this approach had come from the GOB after it had had experience of similar World Bank operations.

The World Bank, on the other hand, made a slower shift to sub-national lending and a more rapid move to the use of flexible and innovative instruments (especially SWAps) which allowed quicker disbursement of funds (IBRD/IFC 2006). The review of its CAS found that the World Bank had been able to 'leverage' its relatively small financial role and have 'catalytic' effects by adopting a formula of: "(…) a Programmatic DPL [development policy lending] combined with targeted AAA [analytic and advisory activity] supporting an agreed reform agenda, one or more SWAp operations with well targeted TA in support of 'core' Government programs, and strategic support to specific, cross-cutting development challenges at the local, state or regional level" (IBRD/IFC 2006: 8). In response to the GOB's request and the positive record of experience, the Bank will shift to SWAps as the primary investment lending approach: "[SWAps] are highly valued by the Government as a way to supporting priority programs with needed technical fine-tuning while providing flexible financing that does not compound the problem of budgetary earmarking" (*ibid*: 10).

Brazilian cooperation management – agencies and lending approach preferences

In Brazil, there is a range of government agencies involved in decisions regarding grants and loans from bilateral and multilateral organisations, most of them linked to the MOF and MOP:[10]

- The Brazilian Cooperation Agency (*Agência Brasileira de Cooperação,* ABC) which is part of the Ministry of Foreign Affairs and whose objective is to negotiate, implement and follow up programmes and projects of technical (rather than financial) cooperation – mainly from UN agencies and bilateral agencies.
- The National Treasury (*Secretaria do Tesouro Nacional,* STN) of the Ministry of Finance. This is responsible for assessing and monitoring loan operations signed by the public sector as a whole. It is also a loan guarantor.
- International Affairs Secretariat of the Ministry of Finance (*Secretaria de Assuntos Internacionais*, SAIN) which is in charge of issues related to Brazilian economic performance vis-à-vis other countries and international agencies. Among its roles is the monitor Brazil's foreign debt.
- International Affairs Secretariat of the Ministry of Planning (*Secretaria de Assuntos Internacionais,* SEAIN), is in charge of providing guidelines, to plan and to harmonise policies for the negotiation of resources accruing from multilateral organisations and foreign governments destined to the public sector.
- External Financing Commission (*Comissão de Financiamentos Externos*, COFIEX), an intra-governmental agency in charge of selecting projects to be financed by multilateral and bilateral agencies.

Once a decision has been made to move ahead towards approving a loan agreement, many other institutions are involved, including the Senate, and several governmental agencies, including sectoral agencies. Understanding the division of labour between these agencies, and the processes of loan negotiation and management, is not always straightforward and this may constitute an obstacle to a clear policy on cooperation and lending approaches/strategies.

The major question is whether there is any strategy for aid on the part of the Government of Brazil (GOB); given the relative unimportance of ODA to Brazil, a national budget of around US$ 650 billion, and no shortage of liquidity or of foreign reserves, 'aid' is surely an inappropriate word. If some complain about the web of agencies and the lack of clarity about the "rules of the game", there are signs of progress in the design of policies and strategies, despite the fact that they are not stated in a written document.

[10] The MOF occupies the Brazilian seat on the board of the World Bank and the MOP on the board of IADB.

GOB has indeed expressed its leadership by determining the form of MDB loan that it finds acceptable. Interviews in the MOF and MOP indicated that traditional investment lending for specific projects was now found to be unnecessary and associated with bureaucratic complexity, slow disbursement and low execution rates. The preference in these ministries is for lending instruments which support the government's own budgeted priorities, are channelled through the Treasury on a re-imbursement basis (more on this later), and which therefore operate through national systems using national procedures (e.g. on procurement). The Banks' expertise is primarily valued for its contribution to the quality of expenditure management in sector ministries. The emerging 'SWAp model' is favoured as a more flexible approach that is aligned with national priorities. We learned (from sector ministries, the MDBs, the MOF and the MOP) that there had initially been some resistance from the sector ministries and the Senate[11], which under this arrangement would no longer receive direct funding from the MDBs, but that this had now been largely dispelled. The MOF and MOP appeared broadly to support a shift of the attention of the MDBs to the sub-national level, where resources remained scarce, but there was some caution about extending the SWAp model on anything but a very selective basis, and a view that for most states traditional investment loans would be more appropriate. This may be for fear of lack of fiscal discipline at state level.

In 2005, the Ministry of Planning organised a workshop with key stakeholders in the cooperation domain – IADB, JICA, World Bank, UN agencies and other federal government agencies – and presented the following guidelines on policies and strategies on foreign lending.

Table 7. Policies and strategies towards foreign lending, by level of government

Level of government	Policy	Strategy
Federal	To reverse financial flows Technical assistance to specific areas	Use of SWAps DPL projects
State	Strengthened fiscal adjustment (*)	Programmatic projects Social and infrastructure projects
Local	Loans to middle-size municipalities because many have borrowing capacity Investment to address their common problems (urban infrastructure, sanitation and water provision)	Projects of smaller size (US$ 15 to 30 million) Projects focused on the three sectors

Source: SEAIN (2005).
(*) According to SEAIN, because of fiscal constraints due to interest payments and to rules limiting state borrowing, the states have low borrowing capacity.

As can be seen from the guidelines above, SWAp operations are intended to be the favourite loan modality at the federal level, but not at the sub-national level, at least from SAIN's perspective.

[11] Foreign loans have to be approved by the Senate.

Chapter 4. SWAps in Brazil

This chapter describes the Brazilian SWAps[12]. There are currently two federal and one state government programmes in Brazil receiving loans from MDBs under a SWAp framework: Bolsa Família Programme, Family Health Extension Programme and Ceará Multi-Sector Development Project. Agreements between MDBs and the federal government and the government of Ceará were signed, respectively, in 2002, 2004 and 2005. This chapter describes some of the features of these SWAp operations, concentrating in particular on the financing instruments, financial management procedures and disbursement conditions being used.

4.1 Family Health Extension Programme

Background

In the last two decades Brazil has implemented policy reforms intended to universalise and to improve the organisation, financing and provision of health services. A radical reform was driven by the 1988 Constitution, which established universal access to health care. The Constitution also determined that the provision of many social services should be decentralised and made participatory. In the health sector, decentralisation transferred to local governments the responsibility for basic health care management and service delivery. In 2002, a constitutional amendment earmarked a percentage of federal, state and municipal resources for health care programmes.

The Family Health Programme (PSF) is an important element of the government's policy reforms. Federal grants are transferred to municipalities that agree to implement a proactive primary health care model. Initiated by the Ministry of Health (MOH) in 1994, PSF was a relatively small initiative in its early years. However, it rapidly expanded and it is currently one of the largest federally-funded health programmes, covering all Brazilian municipalities. The primary objective of the PSF is the conversion of a passive-provider and facility-based health care system into an active-provider with an outreach model in which family health care teams deliver basic services.[13]

The MOH's *Departamento de Atenção Básica* (DAB), is responsible for PSF. Implementation responsibilities are shared with state and municipal heath secretariats. The management of the programme is complex because of its municipalised feature and because of uneven capability across Brazil's more than 5,000 municipalities.

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[12] We use the term 'SWAp' because this is how they are described by the government and MDB's

[13] Family health care teams comprise one family doctor, one nurse, one nurse assistant and six community health agents. In larger teams, dental services are also provided.

The public sector health care system is currently funded through two main federal grants to municipalities, which are transferred into the National Health Fund (FNS). First, fixed per capita payments, known as *piso básico* in Portuguese, support basic health care delivery. This is paid in equal monthly instalments and is used to pay personnel (excluding family health teams) and goods and services related to the delivery of basic care. The allocation of this grant is not based on performance. Second, variable transfers, known as *piso variável*, finance the implementation of PSF, mainly going to pay the personnel who make up the family health teams. The latter is calculated on the basis of population coverage and the number of family health teams established by each municipality, thus being to some extent based on performance.

The SWAp operation

The Family Health Extension Programme (PROESF) was the first SWAp operation implemented in Brazil, having the World Bank as its only financier apart from the government. It was negotiated by the government of 1994-2002, for which health care was of the highest social priority. The programme is part of the PSF and its objective is to extend PSF to urban centres with more than 100,000 people and to be a pilot project for improvements to PSF, particularly in tying financial transfers to performance in service delivery.

The World Bank loan agreement under PROESF includes support to four components: (1) Municipal Expansion and Institutional Modernisation, which directly supports the expansion of the programme in selected municipalities by enhancing their human, administrative and information capability; (2) Human Development Resources, which supports the qualification and performance of PSF teams; (3) Monitoring and Evaluation, which supports the development of coordinated monitoring and evaluation methodologies to assess the structure, processes, outputs and impact of PSF; and (4) Project Management, which comprises project management support for all the other components, including the design and implementation of a monitoring information system and specific studies related to seeking solutions to implementation problems. Components 1 and 2 absorb the bulk of resources. Components 3 and 4 account for a relatively small proportion (15%) of the total loan of US$ 18 million.

PROESF has a Project Coordination Unit (PCU), created specifically for the programme's implementation. PCU reports to DAB and the majority of its staff, as is true of much of DAB's, are not civil servants but personnel hired by UNESCO whose costs are covered by the loan.[14]

[14] It is common in Brazil to find UN agencies providing services to the government related to procurement and contracting of personnel. This practice developed in response to a number of constraints, including: strict budget ceilings on payroll, bureaucratic procedures required by law of holding open public competition for positions in the civil service which slowed down the recruitment process and did not ensure the best selection, and the lack of government capacity with regard to procurement and the extent of burdensome bureaucratic procedures which caused procedural delays and low execution of programmes. Although this has contributed

The programme's estimated total cost is US$ 500 million for a seven-year period to be implemented in three phases. The loan agreement states that 55% of the total costs are covered by the World Bank loan and 45% correspond to GOB's counterpart funding, although the participation of the federal government is much higher than what is estimated in the loan agreement. The second phase is currently being negotiated and its implementation is due to start in 2007.

Unlike PSF, the SWAp arrangement for PROESF is that the transfers do not go to every single municipality; instead, transfers are made on the basis of a process of selection. In order to become eligible, municipalities have to agree to a plan for reforming their health services and achieving specific performance targets (technical, fiduciary and financial performance targets), known as a Municipal Conversion Plan. Performance incentives also include prizes for the best-performing municipalities, and that those municipalities which perform well during phase 1 will receive higher allocations in phase 2.

Financing instruments, financial management procedures and disbursement conditions

The loan is an Adaptable Programme Loan (APL) which makes use of two distinct financing instruments: a budget support modality to fund part of component 1[15] and a conventional funding modality to fund components 2-4 – see Box 1 for definition of APL.

Box 1. Adaptable Programme Loans – what are they?

An APL is a form of World Bank investment lending used to provide phased (in several tranches) support for long-term development programmes. This instrument was introduced by the Bank in 1997 to provide more innovation and flexibility in loan provision. Its key features are the long-term lending framework and the use of government systems and procedures.

APLs are used when sustained changes are needed, requiring sequenced activities – including investments, institutional strengthening, policy reforms and constituency building. The use of an APL requires a clear agreement between parties (lender and borrower) on the long-term development programme and objectives and the evolution of policies in each APL phase. APL loans have triggers, i.e. conditions that define when funds for the next phase can be released. A sequence of APLs starts with a first loan to fund the initial set of activities. Subsequent funding is provided when agreed conditions for realizing the programme's objectives are met. APLs also provide incentives, through phased disbursements, for borrowers to implement long term programmes.

Sources: World Bank (1998: box 4.1) and Burdescu and Parel (2006)

Under the SWAp, the MOH continues to use its mechanisms and procedures to manage resources and finance activities. This involves the transfer of funds from the Treasury to the National Health

to the speeding up of procurement procedures, it has not improved government capacity. The federal government has now decided to phase out this type of arrangement and to focus more on the government's own systems.

[15] The Bank reimburses GOB for an amount corresponding to 30% of the costs of goods, works and services needed to implement Municipal Conversion Plans.

Fund (FNS). World Bank funds are therefore pooled together with the multiple sources of funding which make up the FNS.

Funds provided through the budget support modality are disbursed by the World Bank as a reimbursement to the Federal Treasury of a proportion of the advance transfers made to FNS. Funds received by the FNS are then transferred to the Municipal Health Funds (FMS) of municipalities which have qualified to benefit from PROESF. The Project Coordination Unit (PCU) prepares a Statement of Transfer on the basis of the actual cash transfers made by the National Health Fund into the municipal health funds, and this is reviewed and approved by the national treasury, which in turn withdraws funds from a special account (with Bank funds) to replenish the initial transfers to the municipalities, which are always pre-financed by the government.[16] Once the Treasury withdraws these funds, they stay at its disposal and can be used to fund other expenditures (debt repayments or other priority programmes)

It is important to note that although World Bank financial resources provided through the budget support modality do not add to resources already allocated in the federal budget to the FNS (they represent a reimbursement of expenditures made by GOB), they do add to the resources that actually reach municipal treasuries. Hence, while for the MOH as a whole this is not new money, it is so for the states and municipalities.

Expenditures associated with components 2, 3 and 4 are managed directly by the PCU, which does not transfer them to the municipal health funds.[17] PCU submits Statements of Expenditure to the Treasury, which, in turn, withdraws funds from the loan special account and deposits them in the National Health Fund (differently from what happens with reimbursements under component 1). For these components (as well as for expenditures in component 1 associated with international competitive bidding and quality and cost-based selection), standard World Bank procedures are applied, and disbursements are based on conventional lending procedures in which documentation such as contracts and invoices are required for withdrawal applications.

4.2 Bolsa Família Programme

Background

In 2003 the federal government introduced an ambitious and massive cash transfer programme – Bolsa Família Programme (BFP), which became President Lula's government flagship programme.

[16] Other loan disbursement conditions for component 1 are: (a) signed agreements between MOH and participating municipalities, which include technical and fiduciary performance indicators that are used to decide eligibility for participation in the 2nd phase; and (b) regulations by MOH to finance implementation, including operational procedures and fiduciary requirements. Disbursements for component 1 do not require a Statement of Expenditure because funds are not tied to specific activities.

[17] The World Bank finances 90% of total costs on components 2 and 3, and 50% of costs on component 4.

Although BFP results from the merging of four social protection programmes implemented under the previous administration[18], its main impact was an exponential increase in the number of beneficiaries over a few years.

BFP was formally instituted in January 2004 and in the same year the Ministry of Social Development and Hunger Eradication (MDS) was created to administer the various social protection programmes, including BFP.

Under BFP, cash transfer payments are made preferentially to the mother of the household and transfers are conditional upon all relevant members of the family complying with certain requirements, such as: school attendance by children and adolescents, prenatal visits by pregnant women, vaccinations and use of other social services. Families entitled to join the programme include: (i) those families in a situation of extreme poverty, whose per capita monthly income is up to R$ 50 and (ii) families in a situation of poverty or extreme poverty, with pregnant women, mothers who are breastfeeding, children between 0 and 11 years of age or adolescents, and whose per capita monthly income is up to $R 100. Transfers range from R$ 15 to R$ 95 (US$ 7 to 43).[19] On a per capita basis, the average transfer per beneficiary represents about 6% of Brazil's minimum wage and 19% of the poverty line used by the World Bank. In August 2006, cash transfers reached 11.2 million families (44 million people) in every Brazilian municipality.

The main management tool for targeting beneficiaries as well as for administering and overseeing policy planning is a Unified Household Registry (known in Portuguese as the *Cadastro Único)*.

Technical management of the programme is the responsibility of the *Secretaria Nacional de Renda da Cidadania* within MDS. Financial management is carried out by a programme implementation unit (PIU – *Diretoria de Programas*, in Portuguese), which administers all loans within the MDS and is responsible for negotiations, reporting and financial monitoring.[20] Monitoring and evaluation of all MDS programmes is also concentrated in one department – *Secretaria de Avaliação e Gestão da Informação*. The Ministry of Education and the MOH also play a role in monitoring and in providing information about education and health-related entitlement conditions. Cash transfer payments are made by *Caixa Econômica Federal* (CEF), a government-owned commercial bank. States and municipalities play a minor role, mainly training community councillors and local and state agents in overseeing and following up the fulfilment of the cash transfer entitlement conditions.

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[18] Bolsa Escola (an income transfer programme conditional on school attendance), Bolsa Alimentação (nutrition programme), Cartão Alimentação (another nutrition programme) and Auxílio-Gás (cooking fuel supplement programme). All these were instituted under Fernando Henrique Cardoso's administration and were managed by four different federal government agencies.

[19] Exchange rate as of August 2006: US$ 1= R$ 2.2.

[20] Having only one PIU within a ministry to serve all loans is a new and so far unique experience in the federal government because ministries usually have a PIU for each project.

The SWAp operation

BFP is the second World Bank operation in Brazil to adopt a SWAp framework and it is the first one adopted by IADB in the country. This also makes it the only SWAp in Brazil that has the participation of two MDBs, albeit under separate contractual agreements.

As with PROESF, the SWAp framework was designed in response to GOB requests, in particular to fit the fiscal policy of not adding resources to those approved in the budget. Although no new resources are added to finance the main purpose of the loans (the cash transfer), since funds stay at the Treasury's disposal, a small percentage of the loan does reach the MDS to finance a technical/institutional component.

The total amount of the current loans is approximately US$ 1.5 billion: US$ 572.2 million from the World Bank (including their own fees, and for the first phase of their loan) and US$ 1 billion from IADB. These contributions represent a relatively small proportion of the overall government programme which is worth US$ 8.5 billion, and which in 2006 was transferring about US$ 4 billion to beneficiaries.

The World Bank loan agreement has two phases, the first one running until 2007 and the second one starting in 2008 and adding another US$ 520.2 million. The IADB loan has a single phase. Each loan agreement includes two distinct component types: (i) earmarked financial contribution to the government's conditional cash transfer (which in effect is a reimbursement made to the government for its expenditure on the BFP) and (ii) institutional and technical support components designed to strengthen the government's capacity to implement the programme.

Activities under the institutional and technical support components include improvements to the *Cadastro Único*, improvements to support systems (information management systems, monitoring and evaluation, etc.), training of programme managers, elaboration of specific studies and surveys, and payments of consultants and technical assistants working on the programme and who are not civil servants, etc. Although the content of the technical component for each of the agencies' loan agreement has overlapping areas, there is to some extent a degree of specialisation – with the World Bank's contribution focusing more on support to programme management and IADB's on evaluation. [21]

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[21] The World Bank technical and institutional components are: strengthening the system for identifying the target population (*Cadastro Único*), developing a monitoring and evaluation system, and institutional strengthening (including strengthening of programme management). The IADB's components include: expansion and consolidation of the *Cadastro Único*, integration of the various complementary social protection programmes, capacity building and training of social policy managers at municipal level and BFP operative managers, and evaluation of BFP. In reality, IADB funding ended up being shifted from activities related to the improvement of the *Cadastro* into activities related to evaluation of the programme – this was because in the meantime significant improvements had already been made to the *Cadastro*. This flexibility is an improvement that the SWAp approach made possible.

Although the institutional/technical components represent a minor proportion of the overall volume of the lending operations (approximately 1.5% of the IADB loan and 2.5% of the World Bank loan), they are considered by both Banks and by the MDS in particular as the most important element of the agreements, because they contribute to improving MDS's systems and strengthening its capacity to deliver better policies.

Financing instruments, financial management procedures and disbursement conditions

Similarly to PROESF, the BFP SWAp agreement includes two types of financing instruments: a budget support modality and a conventional project modality. The budget support modality is used by both Banks to reimburse the federal treasury for payments made into BFP (corresponding to the conditional cash transfer). These funds are pooled together and are subject to the government's financial management procedures. The project modalities are used to fund the institutional and technical support components and are managed separately, using separate bank accounts and the lending agencies' procurement, accounting, reporting and auditing procedures.

It is worth mentioning that, despite stated intentions of harmonising requirements and procedures, each MDB remains with its own contractual requirements. There is, however, a degree of flexibility for MDS in changing activities funded under the project-funded components, as long as the economic structure of expenditure (salaries, goods and services, capital expenditure, etc.) does not change. For the implementation of the institutional/technical components, agreements have been signed by MDS with UNESCO, UNDP and FAO, mainly for contracting of personnel and procurement.

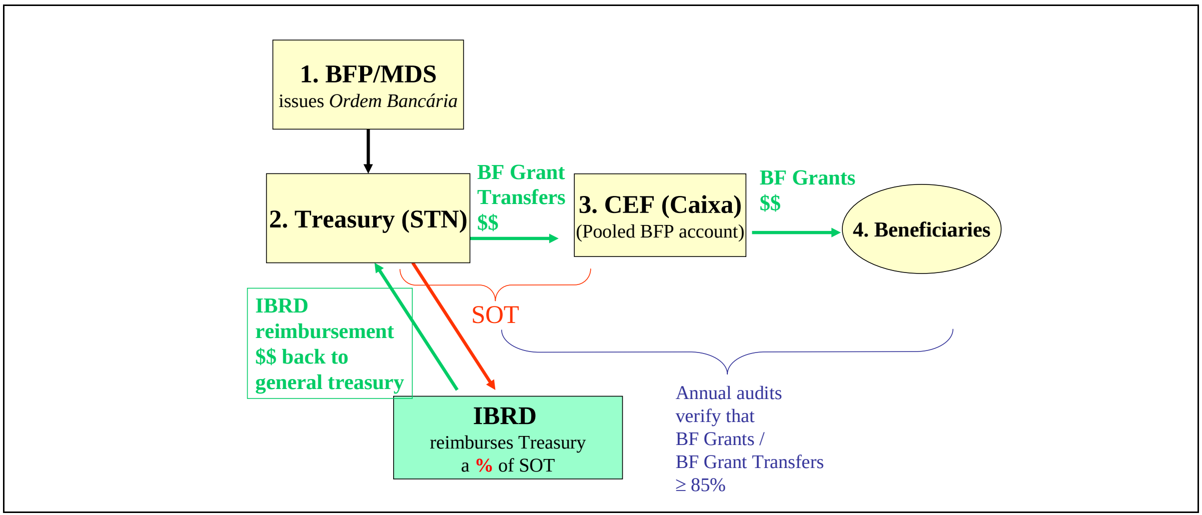
The disbursement scheme for the conditional cash transfer component works as follows: every month the *Caixa Econômica Federal* (CEF) informs the Treasury about the amount paid to the beneficiaries, who are identified by MDS on the basis of the *Cadastro Único*. The Treasury transfers the money to CEF and requests the MDBs for a reimbursement of an agreed proportion of the transfers made into CEF (demonstrated through a Statement of Transfer). The funds disbursed by the Banks can then be freely applied by the Treasury (to other sectors/programmes or to service the debt) The BFP flow of funds is illustrated in Figure 2.

Conditions for releasing funds vary according to each component. For the cash transfer component, in the case of IADB, disbursements are conditional on proof by CEF of payments made[22], and in the case of WB a statement by MDS. Programme-specific targets are also required, such as 85% of

[22] According to the loan agreement, IADB will reimburse a percentage of expenditures of Bolsa Família upon the presentation of copies of specific documentation: (i) CEF's monthly disbursement request to SENARC, which details the number of families and corresponding payment; (ii) authorization issued by the Secretary of SENARC to the General Coordination of Budget and Finance of its Department of Operations to proceed with the transfer of resources to CEF; and (iii) SENARC's statement of commitment of funds and issuance of payment order to CEF's pooled account which triggers the transfer of resources to the CEF.

mothers receiving the benefit and 70% of target families reached. Information provided by MDS and CEF are the guarantee that resources are used on BFP and reach the beneficiaries.

Figure 2. Flow of funds under Bolsa Família



Source: de la Briere et al. (2006)

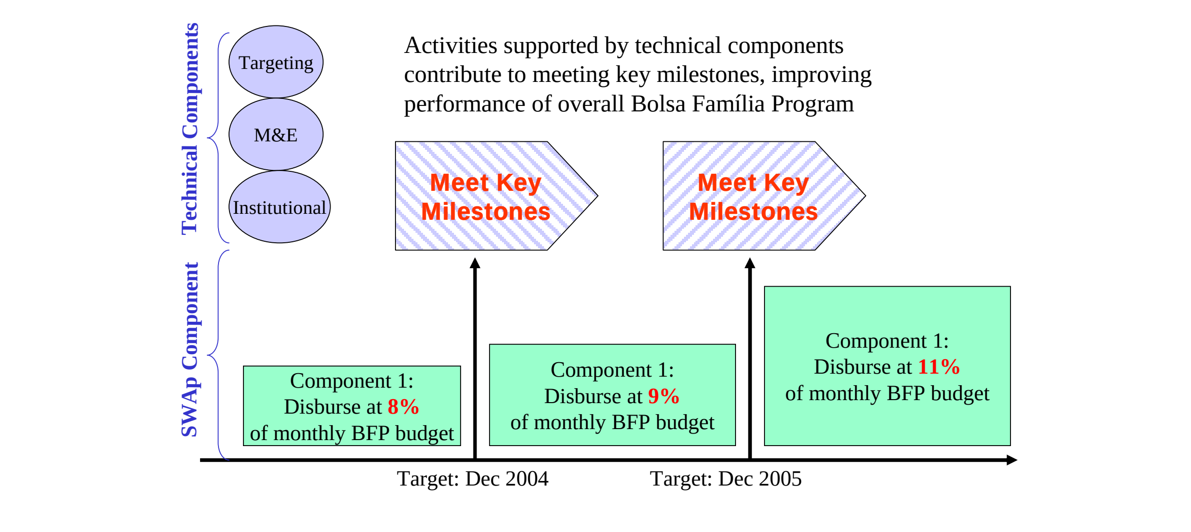
Although there is a fixed schedule of payments to the beneficiaries (every month beneficiaries withdraw their benefits using electronic cards at the nearest CEF agency), there is no agreed calendar of reimbursements and it is up to the Treasury to decide whether and when to request them from the Banks.

For the technical/institutional components, traditional procedures for the use of funds are applied. For both components the release of funds is conditional on the achievement of results, although targets are relatively broad and rather easily achieved given the small share of resources coming from MDBs. Because BPF is the government’s highest social priority, allocating resources for the programme is not restricted by the policy of fiscal control.

The World Bank loan has an incentive mechanism linking performance of the technical component to financial disbursements into the cash transfer component: reimbursements began as 8% of the total monthly cash transfers made by GOB and then, as conditions of the technical component were met, the percentage was set to rise to 9% and then to 11% - Figure 3.[23] In the case of IADB, there are no such incentives because its annual disbursements into BFP were programmed to decline yearly, from 16% of the overall BFP budget to 10% in 2007.

[23] Since performance has been very positive and the technical targets were actually reached 18 months ahead of schedule, reimbursements in 2006 have reached 11% (rather than the 9% expected) of GOB’s cash transfer payments.

Figure 3. The World Bank's incentive mechanism for Bolsa Família



Source: de la Briere et al. (2006)

4.3 Ceará Multi-Sector Development Project

Background

Ceará is a poor state of Brazil's Northeast. Nevertheless, Ceará has made great progress in the social sphere over past decades. The state has been a leading recipient of World Bank loans. However, like the majority of the states in Brazil, Ceará has been experiencing low growth and decreasing revenues. Although all Brazilian states are paying their debt commitments to the federal government and to MDBs, they are struggling to make these payments. This has been reflected in the states' performance and cash flows with repercussions on public investments and social programmes. As stated by interviewees during this study's fieldwork, in 2003 Ceará began to have cash flow problems because of (a) a decrease in taxes and in federal transfers to the states in general, and (b) due to debt payment schedules (2003 required the highest level of debt payments) thus increasing cash flow problems, although Ceará's fiscal adjustment has been highly praised.

The SWAp operation

The aim of the Ceará Multi-Sector Development Project is to assist the government of Ceará (GOC) to achieve fiscal sustainability and social inclusion goals by supporting nine budget programmes along three axes and six sectors. The three axes are: (i) public sector management, (ii) human development, which includes education and health, (iii) sustainable resource management, which includes water supply, sanitation, water resource management and environment. The first axis plays the role of an "umbrella" programme that aims to improve efficiency in all sectors.

The Ceará loan agreement (commonly referred to as CE SWAp) was signed in 2005 by the GOC and the World Bank, with the guarantee of the GOB.[24] It is a five-year World Bank loan in two phases, amounting to a total of US$ 240 million: US$ 149 in the first phase (2005-2007) and US$ 91 in the second phase (2007-2009). The Ceará programme is the first SWAp in Brazil to have a multi-sectoral scope and the one where result-based management is most prominent, apart from being the first case at sub-national level.

The loan agreement between GOC and the World Bank has five main features (Holanda, undated): (i) a commitment to preserving the fiscal balance on the state accounts, known as the 'golden rule'; (ii) a results-based management framework to guide decision-making and resource allocation with 16 socio-economic indicators and corresponding targets which also serve as loan disbursement conditions; (iii) nine priority programmes (Eligible Expenditure Programmes, or EEPs) in the six sectors mentioned above, linked to the 16 indicators – the agreement also sets state budgetary allocation 'floors' for each of these priority programmes; (iv) the state's commitment to ensuring satisfactory financial execution of the three ongoing World Bank loans to the state (water resource management, education and rural poverty); and (v) technical assistance to support the design and implementation of a results-based management framework for Ceará state.

According to one interviewee, the negotiation process faced two main difficulties. First, there was resistance from the federal Treasury with regard to certain details of the agreement.[25] Second, there was dispute about the selection of indicators and their corresponding ranking in terms of degree of importance in determining disbursements.

The CE SWAp loan has two components: (i) eligible expenditure programmes in the six sectors, which represents the bulk of resources and (ii) technical assistance, which represents only 3.3% of the loan (US$ 4 million) and is mostly directly towards the development and implementation of results-based management. The technical assistance component finances the results-based management programme, mainly designed by IPECE (see below) with the support of consultants from Canada, UK and Chile brought in by the World Bank. This component also aims to strengthen internal and external auditing.

The agency in charge of the negotiation and the implementation of CE SWAp is the *Instituto de Pesquisa e Estratégia Econômica do Ceará* (IPECE), an agency linked to the Ceará Planning

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[24] The guarantee of the federal government is a common requirement of institutions when lending to states and municipalities.

[25] Article 32 of the Fiscal Responsibility Law authorises the MOF to control debt agreements of all three levels of government. Within the MOF, the Treasury is responsible for this control, thus CE SWAp had first to gain the Treasury's approval. According to one interviewee, negotiations were difficult not because of disagreements with the cash flow diagnosis but rather because a new loan to sort out the lack of cash flow could be interpreted by other states as a debt renegotiation and therefore they could ask for similar treatment. Another disagreement was that the Treasury wanted to increase the ratio of Ceará's primary surplus.

Secretariat (*Secretaria do Planejamento*). IPECE runs a project implementation unit (UGP, or *Unidade de Gestão do Programa*). It is made up of three people, only one paid for by the loan. UGP is responsible for programme coordination and validation of sectoral plans. Line secretariats meet monthly with UGP to discuss progress of performance indicators and financial execution of priority programmes. Secretariats involved are responsible for measuring the indicators. Unlike the other SWAp operations, in this case there is no external agency (such as UNDP or UNESCO) involved in implementation because, according to one interviewee, GOC has always opted to create in-house capacity.

The programme is supervised by a management committee (*Comitê Gestor*) instituted by the governor and made up of five core state secretariats: *Secretaria do Planejamento e Coordenação, Secretaria da Fazenda, Secretaria da Administração, Secretaria da Controladoria* and *Secretaria do Governo*.

Financing instruments, financial management procedures and disbursement conditions

As in the programmes described above, CE SWAp combines two different financing instruments: a budget support modality for the Eligible Expenditure Programmes (EEPs) and a project modality for the technical assistance component. Resources provided through the budget support modality are subject to the government's financial management procedures. The technical component is managed separately and uses the World Bank's procurement, accounting and auditing rules.

For the budget support-funded component, disbursements are made into the State Treasury as a reimbursement for transfers made into EEPs. This reimbursement corresponds to a maximum of 35% of the state's expenditure in the eligible programmes. As a general rule, for these funds to be released by the Bank, the State Treasury has to demonstrate it has already transferred 70% of the agreed budget allocations for the EEPs. The requirement to maintain a primary surplus is also set in the agreement as an unbreakable rule.

In addition, there are other disbursement conditions for each of the five disbursements which make up the first tranche of the loan – Table 7. The 1st disbursement was retroactive against selected expenditures already undertaken, thus providing the GOC cash flow relief. The 2nd disbursement was based on estimated expenditure for the following six months in the priority programmes. For the 3rd disbursement, there was a condition of completing sector strategic plans for the six selected sectors in line with the results-based management framework being developed. Furthermore, from the 3rd disbursement onwards, the State Treasury is required to submit proof of expenditures made relative to previous disbursements. To access the 4th disbursement (which was due at the end of

2006), there is an additional condition of achieving the agreed targets for a selection of indicators which form the core of the results-based management framework being developed.[26]

Table 8. Ceará SWAp: disbursement schedule and conditions for first tranche

Disbursements	June 2005	Dec. 2005	June 2006	June 2007
Retroactive disbursement against actual EEP expenditures	US$ 29 Justified by targeted sector results			
6 month disbursement advance against projected EEP expenditures	US$ 35			
6 month disbursement advance against projected EEP plus conditions of disbursement supporting results-based goals		US$ 25 Results based condition: completion of 6 strategic sector plans	US$ 25 Results based conditions (2005 results): General conditions: - primary surplus - satisfactory rating for Bank's portfolio Sector conditions: - Required EEP expenditure levels - Reaching agreed targets for selected indicators	
Final disbursement against actual EEP expenditures plus conditions of disbursement supporting results-based goals				US$ 30 Results based conditions (2006 results): General conditions: - primary surplus - satisfactory rating for Bank's portfolio Sector conditions: - Required EEP expenditure levels - Reaching agreed targets for selected indicators
Technical assistance	US$ 2.5 million		US$ 2.5 million	

Each of these targets has been weighted according to its relative importance. Failure to reach them has implications for the total amount disbursed by the Bank – for example, failure to reach one indicator implies a reduction of the amount disbursed in proportion to the relative weight of the unmet target. However, even if a target is not met, there is still the possibility of requesting the World Bank for a 'waiver', i.e. forgiveness for not reaching the target. This request has to be accompanied by convincing justification for the failure, which may or may not be accepted. There is

[26] The list of indicators is available at http://www.ipece.ce.gov.br/SWAP/resumo2005.pdf.

also an incentive mechanism rewarding good performance: in return for achieving the 2006 indicator levels, disbursements are increased by 20% over 2005 levels. Finally, there are a number of triggers (seventeen across the six sectors) which determine access to the second phase of the loan. These are related to systems performance, particularly with regard to consolidation of results-based management.

Chapter 5. Understanding Brazilian SWAps

5.1 Features of the Brazilian SWAps: what is unique about them?

The three programmes described in Chapter 4 make up quite an assorted selection. Each programme has its particular sectoral dimension (health, social welfare and multi-sectoral) and scope of intervention (sub-sector, programme and state), as well as its own specific implementation channels and devices. They developed at slightly different points in time and responded to particular concerns and circumstances. Yet, despite the differences between them, the mechanisms used for providing external support to these programmes (in this case, MDB's lending) share a number of characteristics which together make up the 'Brazilian version' of the SWAp. This section analyses Brazilian SWAps by highlighting their distinctive features and comparing them with the SWAp model described in Chapter 2.

Six specific features seem to stand out.

(i) ***Centrality of government's macro-fiscal policy objectives***. Fiscal discipline represents an important underlying aspect of the three lending operations, reflecting the centrality of the macro-fiscal environment in determining the nature of lending operations. Hence, in the current context of tight fiscal control, these loans are macro-fiscal responsible in that, for example, they do not result in an expansion of public expenditure in the selected programmes (loans provided match, to an agreed extent, expenditure made by government in selected programmes and accrue to the Treasury for fiscal management) and hence do not upset the government's primary surplus objective.

(ii) ***Support to existing policy framework***. Loans are provided to support and add value to an existing government-initiated and owned policy framework. The lending arrangement does not add new policy dimensions (at least not immediately) but builds on policies/programmes which are already being implemented. Selected programmes correspond to policy areas/interventions of high priority to the government (primary health care was the top priority for the previous federal government and Bolsa Família is President Lula da Silva's flagship programme).

(iii) ***Use of country systems***. Loan disbursements, management and reporting are made using, as much as possible, the government's financial management systems and procedures.

(iv) ***Pooling of funding with government***. Linked to the above but particularly important and innovative is the pooling of MDBs' lending with government's own resources through the use of budgetary support.

(v) ***Emphasis on technical (rather than financial) support***. Although relatively smaller in terms of volume of funding, a technical (or capacity building) component is present in the three programmes and considered, by both recipient and lender, as a crucial element of these lending operations. This reflects the fact that, in Brazil, scarcity of financial resources (at least at federal level) is not an important constraint whereas management and execution capacities are – not least because of the limitations to hiring new personnel and complex bureaucratic procurement rules. The technical support component focuses heavily on systems development, and particularly on the introduction of results-based management (most evident in the Ceará programme), to improve public sector performance and the quality of public spending.

(vi) ***Results focus, reflecting a change in approach to management***. A strong results focus is present in the three programmes. This is both related to management improvement objectives as well as concerns over the loan performance. The results focus has been reinforced from one SWAp operation to the next and it features most strongly in the Ceará SWAp.

It is worth noting that each of these features is not necessarily exclusive to the SWAp and can potentially be found in other types of lending operation. It is, however, their combination, i.e. the bundle of these six attributes found in the three lending operations, which is, according to our analysis, quite unique to the Brazilian SWAp.

How does this Brazilian approach to SWAps relate to the SWAp model described previously? SWAps in Brazil are different in at least four ways: (a) they are mechanisms for providing loans (not grants); (b) with the exception of the relatively small technical component, the associated loan does not, in most cases, constitute an expansion of public expenditure in the beneficiary sectors/programmes; (c) they support either specific programmes under a sector (in the case of PROESF and BFP) or eligible expenditures within selected programmes (in the case of Ceará) and, crucially, (d) there are only one or two (two in the case of Bolsa Família) lending agencies, the World Bank and IADB. Table 8 contrasts the Brazilian SWAps and the SWAp model described in Section 2.2.

Differently from SWAp experiences elsewhere, SWAps in Brazil are not about promoting donor coordination, an objective which was so central to the development of SWAps in aid dependent LICs. They share, however, the principles of supporting a government-led policy framework and alignment with the government's financial management systems and procedures (pooling of resources within government's system). It was partly this emphasis on ownership and reliance on government systems which has led to the selection of the SWAp concept to describe the approach being devised in Brazil. The flexibility of the concept – an 'approach' and not a 'blueprint' – was also considered to offer advantages over traditional lending mechanisms in a context of unsatisfactory lending performance and very peculiar borrowing circumstances.

Table 9. Features of a typical SWAp and their applicability to the Brazilian SWAps

SWAp features	Health Extension	Bolsa Família	Ceará
1. Government leadership	Yes, in the design of policies being supported by the SWAp. Some degree of negotiation with the lender in the design of the SWAp operation.	Yes, in the design of policies being supported by the SWAp. Some degree of negotiation with the lender in the design of the SWAp operation.	Yes, in the design of policies being supported by the SWAp. Relatively higher degree of participation of the lending agency (World Bank) in the design of the SWAp operation.
2. Engagement of most or all significant providers of funding or stakeholders	No. The SWAp is about the component of the health programme funded by the World Bank. There are other development agencies (bilaterals and multilaterals) providing funding to the health sector.	Yes – the World Bank and IADB.	No. The SWAp is about selected area supported by the World Bank. There are other development agencies (bilaterals and multilaterals) providing funding to the state government.
3. Comprehensive and coherent single policy framework	Yes, within the specific family health programme (rather than the sector as a whole)	Yes, with links to other social welfare government programmes (e.g. PETI, the government's programme for the eradication of child labour)	Unclear since the programme focuses on eligible expenditures in selected sectors.
4. Common planning and management procedures across the sector	Across the specific programme, rather than the sector.	Across the specific programme, rather than the sector.	Results-based management framework applied to the selected sector and expanding beyond these.
5. Use of (or progress towards) government planning and financial management systems and procedures	Partly – only for the budget support component (transfers to FMSs). Separate management procedures for components 2-4.	Partly – only for the budget support component (conditional cash transfer). Separate management procedures for technical component.	Partly – only for the budget support component. Separate management procedures for technical component.

5.2 Drivers of Brazilian SWAps

So what has driven this particular SWAp version? Several factors seem to have determined it. They relate essentially to the particular Brazilian fiscal context and the needs and motivations of the MDBs. We highlight the following:

- (i) the government's **policy of tight fiscal control**, i.e. of running primary surpluses to reduce the debt/GDP ratio, which is largely related to debt service constraints at both federal and state levels;
- (ii) the **tied structure of the budget**, i.e. the high proportion of legally earmarked revenue, or non-discretionary expenditure;
- (iii) the MDBs' **need to reverse downward lending trends** and increase loan disbursement rates; and
- (iv) the MDBs' interest in **engaging** with and **influencing** programmes related to policies which governments have decided to grant high priority.

The Brazilian fiscal framework appears as one of the key drivers of the SWAp model. The tight fiscal control policy described in 3.1 – in particular the policy of maintaining a primary surplus (set at 4.25% of GDP, although it has been occasionally higher than the target) – implies that there is no fiscal space for additional spending in the public sector budget and that resources allocated in the budget do not actually get to be disbursed by the Treasury (*contingenciamento dos recursos*). There are, hence, limitations to the use of traditional lending modalities, which earmark external resources to specific and additional budget items and normally require a proportion of counterpart funding from the government (increasing the level of spending).

In addition, at the federal level, because the structure of public sector debt has changed and external debt is now relatively small (compared to domestic debt), the need to get quick access to foreign exchange to service external debt while keeping reserves stable has reduced[27] and hence the government now favours lending instruments with a longer timeframe.

Cash flow problems at the state level (at least in Ceará State), related to decreases in state taxes and constitutional federal transfers due to a decade of low economic growth and to an unbalanced debt payment schedule[28], triggered the need for the SWAp. Or, at least they triggered the need for a lending modality which would provide the state with fiscal space for servicing the debt (to the federal government and to the MDBs) while preventing the further undermining of public sector investment, particularly in social programmes. The SWAp seems an advantageous solution to all parties. It allows the state to use resources to preserve both debt service payments and investments in priority programmes. For the World Bank (the lending agency supporting the Ceará programme) it is a way of ensuring re-payment of its own loans while providing an opportunity for engaging with policy implementation at the state level – e.g. the development of a results-based management framework by the state government seems to be of particular interest to the Bank.

The tied structure of the public sector budget is another important determinant of the lending approach chosen, particularly the reimbursement mechanism devised. Resource allocation in Brazil is heavily constrained by the fact that a large part of government revenue is legally tied (*vinculação de receita*) to specific uses. There are various sources of budget rigidities: taxes which are legally tied to specific uses[29] and constitutionally-defined resource allocation to priority social programmes and less developed regions (see section 3.1). Combined with the government's fiscal policy (of running a primary surplus), this level of budget stringency implies that in practice resources statutorily allocated to sectoral ministries are in fact retained by the Treasury (*contigenciamento*). Sectors are hence prevented from accessing and using the resources allocated to them by law. The

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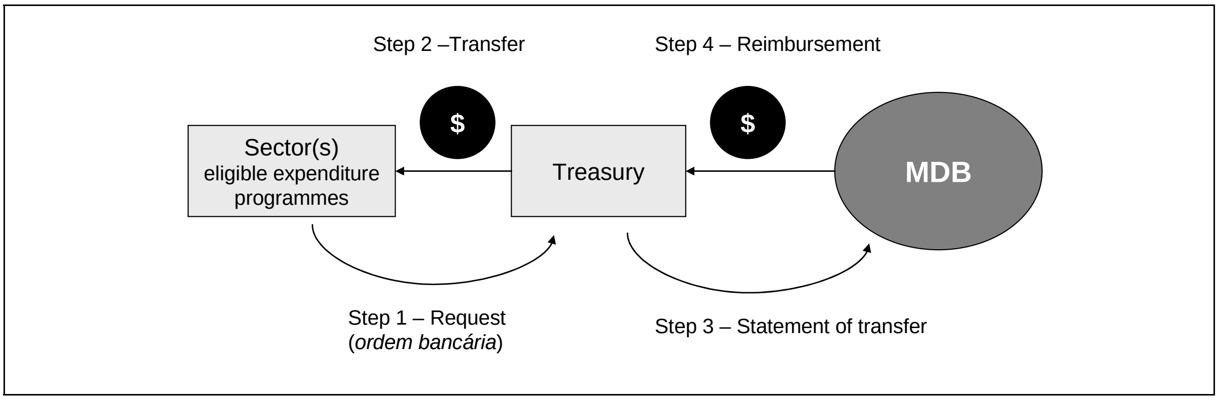
[27] This was one of the reasons for using DPLs (see section 3.2).

[28] Due to the programmed debt schedule, repayments (to both federal government and especially MDBs) peaked in 2003 and will continue to be disproportionately significant until 2009. This uneven payment schedule resulted from the fact that loan portfolio management used to be very fragmented with loan negotiations taking place separately with each beneficiary sector (*secretaria setorial*).

[29] For example, according to a constitutional amendment, revenue from CIDE – a fuel tax – can only fund expenditure in the roads/transport sector.

SWAp reimbursement mechanism helps to unblock some of these retained funds (at least those allocated to the selected programmes) by making the Bank's disbursements into the Treasury conditional upon transfers made by the Treasury into the selected expenditure programmes – Figure 4. But the SWAp also gives the Treasury more flexibility in managing its fiscal policy, by creating some space for making debt repayments or releasing funding to other sectors and programmes.

Figure 4. The SWAp reimbursement model



From the MDBs' perspective, SWAps constitute a practical response to lending needs in a country where there is no shortage of resources at the federal level but severe restrictions on public spending at all levels. Also, the poor performance (low disbursement and execution rates) of traditional lending instruments, due to strict conditionalities which were difficult to meet coupled with difficulties of the government in releasing its corresponding counterpart funding, called for the development of more flexible instruments.

But increasing lending and speeding up disbursements is, of course, not all the Banks care for. They are also concerned to engage in policy development in the spheres of economic growth and the reduction of poverty and inequality. Hence, the SWAp is not only about providing loans but also about supporting and influencing policies, and learning from experiences which may be relevant not only to Brazil but also to other countries where the Banks operate. Part of this is about contributing to improvements of government's capacity to implement its policies – hence the capacity building component. This component, and the results-based management framework in particular, also works as a performance guarantee for the loan.

Although the selection of sectors to be supported under the SWAp was made on the basis of government priorities, from the Treasury's perspective there is also another type of consideration, which relates to the scope the selected programme provides for fiscal management. From this point of view, SWAps are seen as being useful in sectors: (i) with large expenditure budgets (which justify larger loans), (ii) with a high proportion of tied funds (hence the Treasury is already under pressure to release funds to them), and (iii) where disbursements into the sector can be made relatively quickly and easily, simplifying and speeding loan disbursements – Bolsa Família is ideal in this sense, since transfers can be made and recorded very easily.

Although a set of common drivers can be identified, this does not exclude the fact that the lending operations associated with the specific programmes also had more circumstantial and sector specific determinants. For example, a key driver for PROESF might have been the major shift in financing and management approaches in the health sector.

Other factors were mentioned by the interviewees as motivations for the SWAp, namely: (i) the focus on an entire sector or programme rather than just isolated activities; (ii) the establishment of a longer term engagement between lender and borrower than is possible under traditional investment loans; (iii) the legitimacy that the presence of the MDBs provides to programmes with high visibility (and high resource absorption) – particularly at the outset of contentious programmes; (iv) the benefit to the government of having access to the high level of technical expertise and international experience offered by the MDBs; (v) the opportunity for the MDBs to gain experience with aid approaches which can be applied elsewhere (as a testing ground); and (vi) the MDBs' interest in strengthening their presence in a country such as Brazil which is an increasingly important player in the global economy, and their need to re-design their policies and strategies in MICs. Table 10 summarises the motivations of each stakeholder.

Table 10. Stakeholder interests in the SWAp

Stakeholder	Motivations for the SWAp
Government as a whole	• Flexibility in accessing loans and simpler management mechanisms • Support for consolidation of ongoing government priorities on a long-term basis • Improve execution of programmes and the quality of public spending • Legitimacy given to programmes (with high visibility and which are sometimes politically controversial) by having the endorsement of external partners • Focus on an entire sector/programme rather than isolated activities • Access to MDBs' technical expertise helps to improve design and implementation of government policies • Release of earmarked resources (from *contigenciamento*) – by introducing more flexibility into fiscal management[30]
Treasury (federal and state levels)	• Greater control and more flexibility in fiscal management – to overcome fiscal constraints (high level of earmarking, debt and fiscal discipline) and gives control of Bank funds to the Treasury which can use the loans to make debt (internal and external) interest payments and to release resources for priority government programmes • Results-based framework creates incentives for core agencies to press line ministries for better performance ('challenge function')
Line ministries/secretariats (federal and state levels)	• Release sector budgets from retention of funds by the Treasury (*contingenciamento*) • Access to the technical expertise to improve programme design and implementation • Guarantee of the maintenance of the programme (*blindagem*) • Creation of incentives for further investments in the sector (particularly in Ceará) • Additional funding (in the case of PROESF beneficiary municipalities)

[30] It is worth noting that the freeing of earmarked resources is seen as a secondary objective for the federal treasury whereas line ministries see it as one of the main advantages of the SWAp.

Stakeholder	Motivations for the SWAp
Multilateral development banks	• Overall, raise level of lending • Better disbursement and execution rates – which the greater flexibility and simplicity of conditions and procedures contribute to • Longer-term lending framework in a strategic country • Entry point into policy making and implementation (e.g. through results-based management and M&E culture) • Provision of intellectual capital (technical advisory inputs) – with the focus on programme performance and systems improvements providing legitimacy to the loan • Testing ground for new aid approaches

We do not argue that the motivations listed above were absolute determinants of the specific model devised (with the general features described in 5.1); however, they were certainly important in determining the need for a lending approach which would be flexible enough to suit the interests and needs of the various parties.

5.3 Evolution and the road ahead

Has there been an evolution from one SWAp to the next?

An evolutionary pattern can be discerned in the development of SWAp operations in Brazil, and this in itself constitutes one of the strengths of the experience. PROESF, the first SWAp in Brazil, introduced the idea of alignment with the government through the pooling of resources (under the National Health Fund) to be managed according to the government's own financial management rules. It also introduced the reimbursement mechanism with non additionality of funding for resources transferred into municipal health funds.

Bolsa Família took that idea of the SWAp further by developing mechanisms for strengthening programme implementation and performance-based incentives for accessing resources. Bolsa Família is also the only SWAp operation which is funded by two lending agencies. Yet, despite the fact that both emphasise the need for alignment with government systems, the two agencies have their own contractual arrangements with the government. There are discussions about further harmonisation of procedures between them but this is unlikely to go beyond information sharing and conducting joint audits.

The Ceará SWAp further expanded the idea of performance-based disbursements by introducing a strong focus on management by results, affecting the state administration beyond the programme itself. The Ceará programme was also innovative in getting down to the sub-national level and introducing a multi-sectoral scope to the SWAp, breaking with the single sector tradition. As discussed below, these two features of the Ceará operation are proving important in stimulating inter- and intra-sectoral dialogue and coordination around the achievement of results.

This evolutionary pattern seems to have resulted more from adaptation to particular circumstances rather than from an intentional sequential process. Indeed, according to our interviewees, there seems to have been very limited cross-sectoral learning and sharing of information and experience, not only within the government, but particularly inside the World Bank.

What future is envisaged for SWAps in Brazil?

The experience with SWAps is widely perceived as very positive, particularly in the Banks and in Ceará State Government. Elsewhere, perceptions vary in line with the motivations listed in Table 2 above. For example, whereas for the Federal Treasury the SWAp mechanism has clear advantages, for sectoral ministries the benefits are less significant. Yet, it is worth noting that in the case of PROESF the MOH as a whole does not gain in terms of additional resources but the beneficiary municipalities do.

There is talk of introducing additional SWAps and even expanding existing ones (adding, for example, more sectors into the Ceará SWAp framework). A fourth SWAp operation, funded by the World Bank, was being negotiated at the time of this study.[31] This is designed to support the roads/transport sector, breaking with the tradition of SWAps being in the social sectors but in line with the Bank's objective of contributing to economic growth, given that the current situation of roads has been identified as one of the bottlenecks to economic growth. As with PROESF and PBF, resources for the transport sector are legally earmarked through CIDE. The model is basically the same as is used in the other SWAps: (i) the loan supports an existing policy framework; (ii) there is a purely financial component and a technical component (technical advice for the institutional restructuring of the *Departamento Nacional de Infra-estrutura Terrestre* – DNIT); (iii) a mix of financing instruments is used (budget support for financial component and traditional investment, loan for the technical component); (iv) the financial contribution is disbursed according to a reimbursement scheme. The one specific feature of this SWAp is that, for operations above US$ 20 million, international procurement rules have to be used.

Expansion of SWAps at the state level is a more contentious issue. Both the World Bank and IADB seem quite interested in pursuing this strategy and the World Bank has already identified possible candidates (Minas Gerais and Bahia were mentioned by several interviewees) on the basis of their capacity and, particularly, fiscal management conditions (states with low fiduciary risk). MOP, SEAIN and SAIN all seemed receptive to the idea. However, the federal treasury (*Secretaria do Tesouro Nacional* – STN) is cautious about accepting it perhaps because of concerns that the loans

[31] However, there were some doubts as to whether this operation was actually going ahead. Part of the difficulty in accepting such types of operation in the roads sector seems to be related with the lack of confidence in existing management systems in that sector.

will contribute to debt payment stresses thus affecting the states' fiscal accounts.[32] Endorsement by STN is essential due to the conditions set in the debt restructuring agreements between the federal Treasury and the states. The Treasury also plays the role of approving loans that are guaranteed by the federal government, a common request by lenders.

According to the World Bank, its next SWAps will need to be large operations (hence supporting sectors/programmes and absorbing a large volume of resources) to match the Bank's lending envelope for Brazil ($6-7 billion over the next 4 years). IADB also anticipates an expansion in SWAps and other instruments offering a degree of flexibility to the lending operations.

5.4 Impact: what is being influenced?[33]

This study has identified five dimensions in relation to which the SWAps seem to have had considerable impact: (i) fiscal management space, (ii) lending performance, (iii) 'aid effectiveness', (iv) distribution of lending benefits across levels of government, and (v) government's management processes.

Impact on fiscal management

SWAps in Brazil have contributed to widening the government's space for fiscal management by helping to circumvent budget rigidities and meet the primary surplus objective. In a context of hard budget constraints (due to the peculiar significance of budgetary earmarking and the government's policy of running budgetary surpluses), the SWAp provides room-for-manoeuvre for fiscal management – including for servicing the debt and maintaining a budget surplus while freeing up resources for key priority areas. It is interesting to note that this is unlike SWAps in LICs which normally create pools of funds which benefit particularly sectoral ministries. Are SWAps essentially a financing operation for assisting fiscal management (particularly for servicing the debt)? They are clearly playing that role but they are also doing more than that.

Yet, the scale of this type of impact should not be overstated, not least because MDBs' SWAp lending in Brazil represents a relatively small proportion of the government's fiscal responsibilities.

Impact on lending performance

SWAps have proved flexible enough to allow tailoring to circumstantial needs and to address the shortcomings associated with conventional lending instruments. Although this study did not

[32] Indeed, according to some interviewees, one of the reasons why the federal treasury ended up not objecting to a SWAp operation in Ceará was because this state had a strong record of tight fiscal policy (in fact, at the cost of public investment) and good debt servicing.

[33] In this section, we do not look at the policy achievements of the particular programmes but analyse, rather, the influence the SWAp has had in shaping the nature of the relationship between the Banks and the government as well as the government's management processes.

undertake a thorough comparison between different lending modalities, the view consistently expressed by this study's interviewees was that performance of SWAp loans is better than conventional loans. This is because: (i) the nature of the conditionality framework is different and negotiated on more favourable terms (less stringently top-down and more partnership-based), (ii) the programmes supported represent government's top priority interventions that were already in the process of implementation rather than new areas of focus, (iii) there is no need for government counterpart funding (which is normally a major obstacle to loan disbursement, due to liquidity problems on the government's side), (iv) and the implementation mechanisms are simpler and better adjusted to Brazil's own systems. Hence disbursement and execution rates are arguably higher that with traditional lending modalities, making these better performing operations.

Impact on 'aid effectiveness'

SWAps have emphasised a form of interaction between the lending agency and the government as a whole in which, as noted above, central government agencies (the planning and budgeting functions) play a prominent role. Whether this represents a significant change in approach (for example, are World Bank SWAps fundamentally different from adjustment lending?) or an improvement in the nature of the aid relationship in Brazil is debatable, but the Brazilian SWAps seem to be broadly consistent with what is now the prevailing understanding on aid effectiveness. Indeed, the Brazilian SWAp model is in line with at least three of the five core commitments established under the 2005 Paris Declaration on Aid Effectiveness, endorsed by the World Bank, IADB and the Government of Brazil (OECD 2006): (i) partner countries exercise effective leadership over their development policies and strategies, and co-ordinate development actions; (ii) donors base their overall support on partner countries' national development strategies, institutions and procedures; and (iii) results-based management and decision-making are introduced. The commitment to donor harmonisation, which is a central element of the aid effectiveness agenda, is hardly evident in the Brazilian experience with SWAps. Bolsa Família is the only SWAp supported by more than one agency and even in this case there are separate arrangements in place for each agency. It can be argued, however, that donor harmonisation is not such a pertinent principle in a country where there is a relatively small number of development agencies providing a relatively small share of resources.

Impact on distribution of benefits from lending

Central government agencies (federal treasury at federal level, and treasury and planning in the State of Ceará) play a prominent role in the SWAps and seem to be the major beneficiaries of the model in use. This is particularly evident in Bolsa Família, where a significant volume of resources is provided to the treasury in the name of a programme which already has dedicated government funding. At sector level, SWAps are perceived (at least by some) to be helping to legitimise new sector programmes and provide a degree of protection to the selected programmes. The reimbursement mechanism constitutes, indeed, a guarantee that part of budgeted resources (and therefore legally due to the sectors) are actually transferred and spent on the designated priority interventions. Yet, one could question the extent to which SWAps are really making a difference to the sector finances, since the programmes supported under the SWAp are already flagship programmes enjoying a high degree of protection from the fiscal constraints set up by the government. Would the implementation of these programmes be threatened if the SWAp were not there? Perhaps so if they stopped being in the spotlight – as seems to be happening to PROESF, which was a key priority area under the previous government. Is the PROESF SWAp supporting the continuity of the programme?

The extent to which there are financial gains for beneficiary line ministries under the SWAps remains unclear.[34] If, on the one hand, the SWAp does not provide additional financial resources, on the other hand, there may be significant benefits resulting from a reduced level of budgeted resources being retained by the treasury (*descontingenciamento*). Yet again, being flagship programmes, one could question the extent to which retention (*contingenciamento*) would be significant without the SWAp.

Impact on government's management systems

Where the impact of the SWAp at the sector level seems clearer is in the improvement of management systems and in the 'quality of spending', as some of our interviewees put it. In some cases, these improvements have also led to actual increases in resource allocation. For example, the activities supported under the technical components of Bolsa Família (e.g. the development of new *Cadastro Único* questionnaires) have contributed to improving the overall performance of the programme (all parties seem to agree on this) and have led to increases in the volume of loan resources available to the programme.

The pooling of MDB and government funds for disbursement through jointly agreed government channels, rather that through parallel systems as in traditional lending arrangements, is having a positive impact on government's own fiduciary system, by strengthening domestic ownership and capacity. This constitutes an important change in the nature of the fiduciary relationship with the MDBs, which reflects, to some extent, increased confidence over the proper use of funds through domestic systems.

Another noticeable evidence of the impact of the SWAp on government management systems is found in the Ceará programme. The Ceará SWAp has helped to develop a culture of results-based

[34] Some interviewees mentioned the difficulties of convincing line ministries, secretaries and senators (the latter because of their role of approving loans from foreign lenders) of the advantages of a SWAp, given the fact that (in Brazil) it gives little additional resources to programmes and agencies.

management and promote dialogue and coordination of actions between core and sectoral secretariats. Although the technical assistance provided to support the development of this framework is funded through a conventional project modality, it is the reimbursement mechanism of the budget support component which makes results-based management work – if the programmes/sectors do not perform well (against pre-established targets) the budget support component of loan is not disbursed into the state treasury, unless there is justifications for not having achieved the targets. Hence, both sectors and core government agencies (at state level) have incentives to work together under this modality. Box 2 describes the experience with results-based management and how the failure to reach one indicator has contributed to a better understanding of the cross-sectoral nature of policy interventions and hence the need for stronger policy coordination.

Box 2. Results-based management in Ceará: towards multi-sectoral policy coordination?

Results-based management constitutes a key feature of the Ceará SWAp operation. The agreement, signed by the GoB and the World Bank, establishes annual targets for sixteen socio-economic indicators related to government priority interventions in six selected sectors: public sector management, education, health, water and sanitation, water resource management and environment. These targets are set as conditions for disbursement, to be effective from the 3rd disbursement of the first tranche of the loan (2005-07). Access to the 4th disbursement (due at the end of 2006) is hence conditional upon reaching the targets set for selected indicators. Each indicator has its price, and failure to reach each of them has implications in the amount of resources disbursed by the Bank to the state treasury. However, in case of failure to reach a target or targets, the government can still request 'waiver' from the Bank – i.e. request forgiveness and non-application of the penalty – which may be accepted if a convincing justification is provided.

The government has indeed failed to reach the target set for one of the indicators. The percentage of hospital admissions of 5 year-olds or younger for diarrhoea was, at the end of 2005, measured at 25% rather than the 21% set as a target in the loan agreement. What were the implications of this? The Ceará government had to produce, as part of the 'waiver' request, a study analysing the reasons for not reaching the target and proposing corrective measures. This study brought the various sectors together to work out the reasons behind the poor performance of that particular indicator. The exercise is widely perceived as having constituted a very fruitful experience in that it demonstrated the need for inter-sectoral coordination. The analysis produced indicated that the diarrhoea indicator was affected not only by performance in the health sector but also by interventions in education and sanitation. It was found, for example, that the indicator was higher in municipalities where there was not a good record of control of the quality of water for consumption. It was acknowledged that the causes of poor performance of the indicator reached beyond the mandate of the health sector, and that shared responsibility between different sectors was required. The exercise has also shown that improvements can be made in intra-sectoral coordination; within the health sector, for example, poor communication was found between epidemiology teams (those monitoring hospital admissions for diarrhoea) and sanitary control teams (doing water quality control) at the municipality level.

The experience with results-based management has also contributed to an improvement of understanding about the complexities of indicator selection and target setting. One of the lessons learned is that targets have to be carefully set to strike a balance between policy ambition (which creates the incentive to pursue those targets) and realism (what is feasible given existing constraints).

Furthermore, the results-based management framework devised for the SWAp operation seems to be producing effects reaching beyond the SWAp. SEPLAN and IPECE, on behalf of GOC, presented to the 2006 opening session of the state legislature results-based management as the new public management framework to be adopted by the whole of Ceará state's government – *Modelo de Gestão Pública por Resultados* (Governo do Estado do Ceará, 2006). This framework is illustrated in Figure 5.

Figure 5. Ceará government's results-based management framework

Source: Governo do Estado do Ceará (2006)

Hence, although it is too early to measure the extent to which SWAps are actually making a difference in terms of policy outcomes, it is clear that there are improvements taking place in management systems which the SWAp is contributing to.

Chapter 6. Summary of findings, outstanding questions and recommendations

6.1 Summary of main findings

These are not 'normal' SWAps

What is important about the Brazilian experience is not whether it conforms with any particular understanding of what a SWAp is or should be, but whether the experience has been positive in developing effective relationships between multilateral agencies and government, leading to better outcomes, and whether this experience offers lessons for further application in Brazil and beyond. However, it is important to be clear about what distinguishes the Brazilian 'SWAps' so as to avoid confusion with experience elsewhere.

Brazilian SWAps do conform, in broad terms, with the spirit of the definition set out in Chapter 2: 'all significant funding for the sector supports a single policy sector policy and expenditure programme, under Government leadership, adopting common approaches across the sector, and progressing towards relying on Government procedures to disburse and account for all funds' (Foster 2000: 9). However, the Brazilian arrangement is not typical of SWAps as they have grown up in other contexts. In aid-dependent LICs, donors have used SWAps to strengthen government leadership, improve coordination between recipient and donors and amongst donors themselves, and support the development of sector policy frameworks, planning and management systems. In the three Brazilian examples it has been more a matter of the MDBs backing an already strongly led and financed government programme, where those conditions are already in place and where only one or two aid agencies are involved. The issue of agency coordination has not been a focus of much attention and seems to be a lesser issue. Having said that, the Ceará SWAp is something of an exception, where the World Bank was more formative of the cross-sectoral policy and where new lending was important in resolving the state's cash flow problem.

The Brazilian model has some special features that are not seen in SWAps elsewhere (see section 5.1). Above all, MDBs do not add (at least for the larger part of the funding provided) to existing budgetary allocations but make disbursements on a reimbursement basis into the treasuries (federal or state), conditional on the government's own allocations to selected sectors, programmes or eligible expenditures. These disbursements are also conditional on performance of the sector/programme against agreed criteria to do with results and process reforms. Paradoxically, perhaps, SWAp loans thus financially benefit the policy of fiscal management. This is unlike SWAps in LICs which have normally created pools or funds for sector ministries and have thereby reinforced the position of sector ministries vis-à-vis planning and finance ministries.

The Brazilian SWAp is a product of flexible adaptation to specific circumstances

We found that the approach that has developed in Brazil has grown up as a way of escaping constraints on the freedom of action of all parties.

From the government's perspective, SWAps essentially reflect the centrality of macro-fiscal objectives. In particular, the underlying driver is that despite generating enough resources to finance its programme (at least federally) their use is constrained by the fact that (i) a large part of government receipts are tied constitutionally to certain uses, and (ii) fiscal policy demands the maintenance of a primary surplus, i.e. a budget surplus (excluding interest payments) of at least 4.25% of GDP – this leads the Treasury to retain part of the budgets that have already been allocated to sector ministries. MDB loans do not add new money to sector budgets (except for the relatively small proportion corresponding to technical support), but 'reimburse' the Treasury (on the basis of loans) for part of executed expenditure. This helps to unblock sector budgets by putting pressure on the Treasury to release them from the possibility of retention, and it gives the Treasury some fiscal space to repay internal debt or to release other sectors from constraints on the spending of their budget. In the case of Ceará State, the loan's budget support component releases funds for investment (which otherwise would not occur) and for the repayment of debt to the government and to the World Bank itself.

It is worth noting that the driving forces of the Ceará SWAp are to some extent different from those at the federal level: the latter has resources but a high proportion of tied earmarked revenue (which puts pressure on the primary surplus target), whereas the former is severely resource-constrained because of debt commitments and related cash-flow problems. Thus, the flexibility of approach allows government and MDBs to address two quite different financial circumstances.

From the MDBs' point of view, the SWAp model presents the opportunity of escaping more tightly defined traditional ways of lending, allowing them to raise the level of lending (as well as loan execution rates) and thereby maintain their influence. Traditional lending is difficult to sustain under Brazil's approach to fiscal restraint, because it adds resources to budgets for specific uses and requires counterpart funding by government. Moreover, it had been associated with low disbursement rates due to strict imposed conditionalities and accounting requirements. Under the SWAp, disbursement is quicker, easier and does not challenge domestic fiscal and financial management rules.

Precisely because 'a SWAp is an approach, not a lending instrument or a particular financing arrangement' (World Bank 2006b), it creates room-for-manoeuvre in which the parties can define the lending instrument that is suitable to circumstances. The resolution is a combination of (i) support for programmes the government will execute in any case, (ii) an 'adaptable programme loan' (APL) to allow for a longer term lending horizon, (iii) financial budgetary support to assist fiscal management while keeping an eye on selected sector programmes, (iv) technical support to strengthen management and institutional capacities, particularly the development of a results focus.

The pre-conditions for this to operate are that government priorities are acceptable in terms of the MDB's priorities (to do with macroeconomic stability, economic growth and poverty reduction) and that the MDBs have confidence in country systems of financial management, procurement and safeguards. There is yet another coincidence of interest around the commitment to results-based management. An orientation to results would normally be just an element of a sector policy and strategy that might be supported by a SWAp (OECD 2006). In the Brazilian case, it is a core part of the SWAp philosophy itself, particularly in the Ceará programme but also in the Bolsa Família and Family Health Extension programmes. This was built-in both through a capacity-building component but also, and perhaps most significantly, through the incentives generated by the budget support component (provided on a reimbursement basis). It is worth stressing that this does not seem to be an MDB imposition but reflects a widespread desire in government to improve the quality of public expenditure and a pre-existing commitment in principle to performance management (in both the federal government and in Ceará state). The Banks, on their side (like all OECD partners), have accepted that imposed conditionality does not work and that there are problems in basing aid delivery on multiple conditions. The results focus is a more creative way of addressing the issue of performance targets relative to conventionally imposed conditions – it allows the retention of some aspects of conditionality but changes its nature to a shared approach to the definition of indicators and targets. Once the budget support model had been adopted, the MDBs needed some indication that resources allocated via the treasury do indeed lead to results at sector level. Results assessment for the purpose of MDB disbursement has then catalysed the development of results management in the wider programmes that each of the SWAps supports.

It would probably be an exaggeration to claim that each of the World Bank SWAps had evolved separately in response to the same environment. However, we found little evidence of conscious learning from each other, except through a modest degree of rivalry. On the other hand, the IADB's support for the Bolsa Família did adopt approaches from the World Bank, but the lesson learning seems to have been strongly mediated through the government's expectations that a similar model be adopted.

SWAps have mainly impacted on the lending relationship, fiscal space and management culture

SWAps in Brazil support government initiated and led policies and, unlike in other contexts, have limited influence on the direction of policies. This constitutes in itself an important change in approach by the lending agencies (probably an inevitable one in a middle-income and low aid-dependent country like Brazil) whereby government ownership is not undermined. There is, of course, a degree of negotiation between the lending agency and recipient which is evident in the use of conditionalities. Yet, it can be argued that the Brazilian SWAp represents an evolution in the principles governing the ‘aid’ (in the Brazilian case, lending) relationship, particularly in the emphasis placed on alignment with recipient systems and processes.

Fiscal policy objectives and the structural features of the Brazilian budget were found to be quite central to the way the three SWAp operations were shaped, reflecting to some extent the relative strength of the planning and finance government agencies (*Planejamento* and *Fazenda*) in the governance process. Increased room-for-manoeuvre for fiscal management (i.e. the release of earmarked revenue to be able to run fiscal surpluses and repay debt) seems to be one of the most obvious impacts of the SWAp (at least at federal level).

In addition to changes in the lending relationship and in fiscal space, SWAps are also contributing to important changes in government management systems – as the spreading of the results-based management culture, particularly in the state of Ceará, demonstrates. It needs yet to be demonstrated, however, to what extent result-based management generates more effective management.

SWAps have impacted differently at federal and state (Ceará) levels

As noted above, the circumstances for the SWAp were significantly different at federal and (Ceará) state level. Ceará had been severely restricting investment expenditure (due to debt commitments and the fiscal responsibility law) and got to the point of being on the verge of defaulting on its debt obligations (due to an unbalanced schedule of debt repayments). The SWAp not only released pressure on debt payments (virtually representing an exchange of old debt by new debt) but also allowed the state to free up retained resources due to priority sectors. Whereas at federal level the SWAp addressed directly the fiscal policy objective (running primary surpluses without failing to comply with the high level of earmarked revenue to the health sector and income transfer programmes), at state level it represented the opportunity for a *de facto* expansion of investments.

Furthermore, the multi-sectoral dimension of the Ceará SWAp (with its common performance framework) was an innovation which generated positive incentives for promoting cross-sectoral (and even intra-sector) coordination.

6.2 Outstanding questions and recommendations

SWAps in Brazil are still a relatively new and still evolving phenomenon and a number of questions remain to be answered. In this section, we identify issues where our own analysis has not led to definite conclusions and where there may be room for further action and enquiry by government and international partners. We also offer some recommendations on how this might be taken forward.

How successful is the Brazilian SWAp?

This report argues that the SWAp has been strongly shaped by the country's circumstances, particularly the centrality of macroeconomic stability (fiscal discipline) and the need to find a more suitable lending arrangement. Flexibility and adaptation are, no doubt, positive attributes but does the SWAp really represent a more cost-efficient and effective way of using MDB loans? So far, it is not clear how the relative success of SWAp approaches can be or is being measured in Brazil. This is not a comment on the measurement of project objectives but of the assessment of the particular form of SWAp as a method of engagement by international partners with government. For example, success of the SWAp framework might be assessed against:

- the volume of lending it releases
- the distribution of resources across government and the quality of public expenditure
- the quality of programme management
- the objectives of the various parties – for example, as we have identified them in Table 9 of Chapter 5
- the effect of the results-based disbursement mechanism on (i) the incentives for government staff running the programmes, (ii) the adoption of results-based management more broadly within the government, (iii) the pro-poor nature of the results established, and (iii) the actual achievement of results.

We suggest the development of an evaluation framework which takes into account not only the motivations of the influential parties but considers the relative advantages of the SWAp over other approaches as well as its opportunity costs. This should be the basis for establishing the extent to which Brazilian SWAps are a success story to be built on, both domestically and internationally.

Furthermore, there is scope for a more systematic and collaborative process of drawing lessons from the experience with SWAps (identifying pre-conditions and best practices) and comparison of alternative approaches, by both lenders and recipients, as a basis for a better informed and more responsive transfer of practices into other sectors or states within Brazil or into other countries in the LAC region and beyond.

How unique is the Brazilian experience?

We have identified the special conditions under which the Brazilian model has grown up (fiscal and legal restraints on the use of budgetary resources), and also some of the conditions that may be necessary to sustain the model (strong government ownership and systems; and budgetary resources are available if they can be released). We have not been able to establish how far these are prevalent in other MICs and specifically in Latin American countries, but understand that some of the latter do share these characteristics.

The recommendation here is to conduct similar analyses in countries which share the characteristics of the Brazilian context (or some of them), particularly with regard to the centrality of fiscal policy and central government agencies and the structurally tied nature of the budget. The World Bank has ongoing SWAp operations in Mexico, as well as other LAC countries (and indeed MICs in other regions such as Poland and India). What can be said, for example, about the features, drivers and effects of Mexican SWAps? What are the similarities and differences in relation to the Brazilian experience? Are there other lending approaches/mechanisms being used to address similar circumstances?

Further expansion of SWAps across Brazilian states?

Expansion of the SWAp to other states is still an open question. The MDBs seem very keen on pursuing that route (the World Bank has already identified potential recipients). The states, many of which are seriously resource constrained, would certainly welcome access to concessional lending which would allow them to service their debt (including debt with MDBs) while releasing resources for public expenditure (particularly for much needed public investment). Yet, the expansion of the SWAp framework at sub-national level is viewed by the federal government, and the Treasury in particular, with apprehension. The state of Ceará is regarded as an exception, due to its strong record of good compliance with fiscal policy and debt management targets (albeit to the detriment of public investment). There is concern that most other states would not be able to maintain the same level of fiscal discipline if given access to this form of lending. The degree of economic, social and fiscal heterogeneity across states makes it difficult for the Federal Treasury to have a declared policy on SWAps at sub-national level.

Recent debates about accelerated economic growth, and the criticism that GOB is not doing enough to stimulate economic growth, are likely to bring to the fore the issue of budgetary constraints and investment retrenchment at state level and may increase the pressure to introduce more flexibility in the rules for accessing loans by sub-national governments. The recommendation here is to promote discussions about lending to sub-national levels in order to generate clear and objective criteria for selecting beneficiary states and pondering the advantages and disadvantages of the various lending approaches, including SWAps.

Transferability of Brazilian SWAp to other countries – are there required pre-conditions?

With regard to transferability to other countries, the question is whether the SWAp experience is such a specifically Brazilian story (see the discussion about the uniqueness of the experience) that it can only offer lessons for that particular environment.

There is at least one general lesson which is that, in the name of a 'SWAp', the World Bank, Government of Brazil and Government of Ceará all found a flag of convenience which allowed them to escape from the rigidities of their own existing practices to invent a new relationship which suited all actors. The relationship reflects many of the principles of the Paris Declaration on Aid Effectiveness (OECD 2006) rather than just the characteristics of SWAps. It was buttressed by mutual respect and the reality that the Government of Brazil would not accept loans except on terms that suited it. The rigidities in the Brazilian case were tied budgets, fiscal restraint based on the need for a budget surplus, and, on the part of the MDBs, the unattractive inflexibility of their existing lending instruments. Elsewhere the SWAp label may provide a similar sphere for creative adaptation. However, the fact that GOB does not fundamentally need external resources (at least federally) and that it has had a very clear sense of its own priorities has provided a level playing field on which the actors have achieved a balanced relationship.

The specific aspects of the Brazilian model do assume some other underlying pre-conditions, which may not be easily found elsewhere:

- Results-based disbursement may be in danger of becoming imposed conditionality and an excuse for micro-managed interventions, where government ownership and capacity are weaker and where external funding is more significant than they are in Brazil.
- The reimbursement mechanism depends on government having sufficient resources to fulfil budgetary commitments, and on international agencies' confidence in country systems of financial management, procurement, expenditure tracking and audit.
- The reimbursement mechanism is attractive to a government which has resource liquidity but also where resources are trapped by budgetary and fiscal restraints (and hence the role of the loan as a financial operation to manage cash flows).
- Support by multilateral agencies for budgeted government programmes through medium-term lending instruments (such as APL) implies the existence of well-structured government programmes backed by medium-term expenditure commitments.

The Ceará case presents an argument for cross-sectorality (ironically for a programme that goes in the name of a sector-wide approach) in conjunction with a results-based approach to disbursement (see Box 2 in Chapter 4):

- Since World Bank disbursement depends on the achievement of wide-ranging targets, there is a cross-sectoral mutual interest in the performance of government as a whole, contributing to cross-sectoral diagnosis and action. This makes it a very atypical SWAp, in the positive sense that it overcomes the usual problem of SWAps that they privilege certain sectors. Perhaps it also overcomes the problem of general budget support that it is seen as transferring power to core ministries; here there are evident short-term mutual benefits.

From SWAps to Brazilian cooperation policy – what linkages?

This study has noted that responsibility for cooperation is spread across a number of agencies in the Brazilian governmental system. Furthermore, Brazil has recently increased its aspiration to become not only a recipient but also a donor country. Yet, if the country aspires to reach a more prominent position in South-South cooperation, there is bound to be increased pressure to do some house tidying with regards to cooperation policy. Obvious gaps, in relation to the SWAps, are for the government to develop a position on lending modality preferences as well as alignment and harmonisation best practices. On the other hand, the Brazilian SWAp experience and some specific aspects of it (such as the results-based management framework and the incentives required for it to be effective) potentially constitute rich ground for lesson learning and for consideration of relevance to other countries (in the region and beyond) which Brazil is in a position to support.

DFID has been playing an important catalytic role in its support of and engagement with the MDBs through studies, support for trust funds that operate through the MDBs at regional level, and influence through networks of stakeholders. There is now scope for attempting also, as a neutral player, an active role in assisting the government in drawing lessons and identifying best practices on development cooperation (and lending in particular) not only for internal use but also for consumption abroad, as part of the South-South cooperation agenda.

These are some of the questions and issues that may pave the way for further enquiry and debate on the evolving SWAp experiment and the new dimensions the approach is gaining in LAC and middle-income contexts.

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Annexes

Annex 1. Terms of reference

Background

The interest shown by donors for sector wide approaches (SWAps) has grown increasingly over the last ten years. An indication of this increased interest is the considerable literature available detailing the successes, failures and lessons learned, synthesizing the experience of donors. However, some of these studies are now outdated and therefore do not reflect more recent experiences such as those being implemented in Latin America, in Middle Income Countries (MICs) as well as at subnational level.

These studies generally reflected a snap-shot of these countries at one point in time, summarizing the successes so far and the challenges still remaining. They do not reflect the situation in countries with a 'mature' sector programme – that is, a sector programme that has overcome any initial teething problems and developed some kind of longer term stability and equilibrium. Donors, especially IFIs are still in a learning phase regarding SWAps, and its support to these programmes varies considerably between geographical departments/countries.

Since their emergence, numerous SWAps have been financed primarily by the bilateral donor community, with some participation from the World Bank and the Regional Development Banks.[35] There is no current data on the total number of SWAps that have been financed to date. The most recent data provides information until 2000. By 2000, a total of 78 SWAps had been financed in Africa, Asia and Latin America. They were found exclusively in highly aid dependent countries. The majority (85%) were in Sub Saharan Africa, followed by Asia (12%) and Latin America (3%). Over half (56%) of the SWAps were concentrated in the health and education sectors and 17% in the transport sectors. The remaining SWAps were in agriculture, and a few in energy, environment, urban development and water.

[35] The IDB has recently introduced a series of new financial instruments that enables the Bank to offer a more flexible lending program that is more responsive to the needs of borrowing countries. Among the new lending tools and approaches now being offered by the IDB are performance-driven loans, conditional lines of credit for investment projects, programmatic policy-based loans and loans using the SWAp. The Bank has used the SWAp in loans to Brazil (Bolsa Familia) and El Salvador, both in the social sectors. The African Development Bank approved its SWAp policy in 2003 to better align its instruments with those of sister institutions. Asian Development Bank is also increasingly pursuing SWAPs to programming assistance.

From DFID point of view, it is interesting to learn what is going on in SWAps in Latin America[36] countries given that SWAPs [as aid instruments] are key elements of development effectiveness, which is considered integral to the achievement of our regional goal of enhancing the impact of IFIs in poverty reduction**.** Donnor harmonisation and alignment via SWAps and other mechanisms (e.g. PRSP) is another of the key focus areas of DFID Regional Assistance Plan (2004-2007). Yet, DFID recognizes that recent countries' experiences can offer a good perspective to the IFIs that are now increasingly embarking on SWAps operations for Latin America countries.

World Bank Experience with SWAps

The WB involvement with SWAps started in the mid 1990s. Historically, their SWAps have concentrated primarily in the social sectors and in countries with many donors. At year end 2001, the WB had approved seven operations that reflected most fully the typical characteristics of a SWAp. Numerous other SWAps have been approved since then, however, the exact number is not known since, because it is an approach and not an instrument, there is no formal WB recording of SWAp loan approvals.

Demand for SWAps has notably grown in the last two years. In 2004 alone five substantial loans using the SWAp approach have been approved, with numerous others under preparation. Of the five SWAps approved two where for Latin America.

It is interesting to note that as the features of SWAps have evolved interest in the approach has extended to MICs, particularly LAC countries. In 2002, the WB approved the first SWAp for a MIC (Brazil-Family Health Extension Project) and the first SWAp that contained pooled funding with the government. Since then, demand from MICs has steadily increased. In 2004, SWAps were approved for Brazil (Bolsa Familia Programme), Mexico and Poland, with others under preparation (e.g. transport sector in Brazil). The Ceara Swap was approved in 2005, the first SWAp at subnational level anywhere. It innovated in a number of areas and built upon other recent SWAp innovations[37]. Considering Brazil's limited fiscal space, the GoB is currently working with the IFIs

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[36] For instance, in 2001 DFID commissioned a paper to provide background information on the concept of SWAps and the scope of its implementation in Latin America. Further, in 2003 DFID draw lessons from its engagement in the Nicaragua Health SWAp process.

[37] Some important innovations include: (i) a truly integrated, multi-sector approach, (ii) the forging of a partnership between central and line secretaries through incentives despite disbursing to Treasury, (iii) multiple disbursement linked indicators/conditions of disbursement, and (iv) five disbursements, each with different caps on disbursement amounts according to client and project need. It is also noteworthy that the client supported the array of conditions imposed upon the Ceara SWAP because programmes and indicators were clearly in the State's best interest and an integral part of its own development agenda and commitment to the Ceara population.

to identify further SWAp possibilities as more effective lending instrument than traditional investment lending.[38]

The performance of WB SWAps generally compares favourably with that of the rest of their portfolio. According to a review of SWAps done by the WB, as of June 2001 the execution ratings and development objective ratings were classified as satisfactory or better for six of the seven SWAps in execution. In addition, five of the seven operations had procurement ratings that were satisfactory or better, and there were no overdue audit reports for five of the seven projects.

The review did note that the cost and time it took to prepare and supervise these SWAps were significantly above the average for the rest of the portfolio.[39] Overall, the average cost of preparation and supervision was more than double that of the WB average. In addition, the average time it took from preparation to Board approval was also double the Banks average. The high cost involved in the preparation and supervision of these SWAps was the result of the large number of donors that needed to be coordinated and harmonized and the weak local capacity. In MICs with stronger local capacity and no donor participation, the time and cost of preparing and supervising a SWAp would not be expected to vary from that of the average investment loan.

In addition, once a SWAp is established for a sector in a donor dependant country, the preparation and supervision costs of subsequent SWAp operations in that sector should be substantially reduced. WB experience with SWAps indicates that streamlining fiduciary systems and requirements enables the lender to substantially improve its supervision process - by focusing on technical advice in sectoral issues rather than as a watchdog looking for procedural errors.[40]

The WB has re-learned repeatedly that clients generally know what they want. To respond effectively, especially to MICs, the Bank must continuously innovate in the way that it develops and packages lending instruments. Yet innovation of this sort is not only hard work, it is time consuming. Often, it requires approval at the highest levels of Bank policy making; and from the beginning of any effort, all involved departments must be brought into the process.

Objective of the study

The main aim of this study is to provide a synthesis of lessons learned in key aspects of Bank Swaps and guide the WB and GoB in improving the effectiveness of SWAps be it at federal or at subnational level. SWAps are not a simple lending instrument but rather an approach that can be

[38] The IDB also recently approved their first SWAp in Brazil to support the Bolsa Familia Programme and it considers to developing others.

[39] Fiduciary Arrangements for Sector Wide Approaches, World Bank, April 2002.

[40] In 2002, the Bank adopted special procedures for the application of its financial management, procurement, and disbursement policies to enable the pooling of Bank funds with those of the government and other development partners participating in SWAps. See Fiduciary Arrangements for Sectorwide Approaches, World Bank, April 2, 2002.

supported by any of the Bank's investment lending instruments. Therefore the study will seek to understand why it has worked, the critical factors for success, what did not work so well and why, and what lessons there may be for further SWAps in Brazil over the next CAS period. Furthermore, this study lays the foundations for more in-depth country case studies on SWAp potential to be funded by the Facility (Trust Funds) in Washington.

Key issues to be addressed by the study

The SWAp concept is a flexible one (and multi-faceted) that allows for a wide range of intervention and reflects international trends in thinking about development cooperation. Ultimately, the point of SWAp is to highlight a number of internationally recognised principles of aid effectiveness (e.g. Paris Declaration), and to systematise their application in a coherent and consistent way. Therefore the study should focus on the following issues:

- Leadership, Ownership and Alignment;
- Harmonisation, Partnership and Conditionality;
- Managing the SWAp Process (structures, disbursement mechanisms, the annual appraisal and planning cycle);
- Dealing with Poverty Alleviation, Inequalities and Inequities (e.g. gender, race);
- Participation and Political Accountability;
- Capacity Building and Knowledge Dissemination;
- Target Setting and Monitoring;
- Financial Accountability and Common Procedures/Country Systems (fiduciary oversight, procurement, safeguards and M&E);
- Technical Assistance Component (the right mix of financial support and TA: how the SWAp is leveraging the RBM process, public sector reform, civil service reform etc).

The above could initially constitute the core issues to be covered by the study. However, based on a preliminary scanning and analysis of relevant material by the consultant, the steering committee may decide to include other issues/perspectives to be addressed by the study.

Program of work to be undertaken

The Consultant will carry out a comprehensive study to identify the lessons learned from SWAps experiences in Brazil (Three operations so far – Health, Bolsa Familia and Ceara State).

Under the guidance of a small steering group composed of DFID, the World Bank, the GoB and possibly other interested parties, the consultant shall:

- Collect, review and analyze relevant material, such as project documentation, previous evaluation reports, policy papers on the subject etc.

- Develop a work plan, which will include the methodology to be used, and discuss it with the members of the steering group. This exercise will consist of both a synthesis and inception mapping/analysis of the work undertaken to date, and field research, in order to explore further issues which have yet to be addressed and future perspectives.
- Conduct field studies which should include interviews and discussions with relevant officials and personnel (Bank and Government) as well as other stakeholders such as the UNDP and the civil society organizations involved in the implementation of the SWAps.
- Draft a report, based on the aforementioned research, including lessons learned and recommendations. The report should provide specific examples to demonstrate good practices or how positive lessons from experience have been applied.
- Present the main findings of the study to the steering committee.
- Prepare a final version of the report (Technical Note), integrating Committee’s comments and suggestions.

The study should last no more than three months.

Annex 2. List of people interviewed

Person	Institution	Position
Ernesto Jeger	DFID	Governance Adviser
Miranda Munro	DFID	Head DFID Brazil
Paulo de Sá	World Bank	Lead Operations Officer
Carlos Lampert	Ministério do Planejamento	Coordenador de Projetos do Setor Publico - Secretaria de Assuntos Internacionais (SEAIN)
Francisco Gaetani	UNDP	Coordinator, Governance Team
Marcos Guimarães Aumara Feu	Ministério da Fazenda	Advisers – Secretaria de Assuntos Internacionais (SAIN)
Eduardo Coutinho Guerra Eduardo Gaudard	Ministério da Fazenda	Coordenador Geral – Secretaria do Tesouro Nacional Gerente de Responsabilidades Financeiras
Ethan Weisman	World Bank	Chief Economist
Chiyo Kanda	World Bank	Senior Operation Officer, OPCS
Rita Sorio	Inter-American Development Bank	Social Development Specialist – Bolsa Família
Jeni Vaitsman Daniela Peixoto	Ministério de Desenvolvimento Social e Combate à Fome	Secretario de Avaliação e Gestão da Informação
Rosani Evangelista da Cunha (head of the unit) Bruno Camara	Ministério de Desenvolvimento Social e Combate à Fome	Secretaria Nacional de Renda e Cidadania Negotiated the SWAp
Valdomiro Luis de Sousa	Ministério de Desenvolvimento Social e Combate à Fome	Director de Programas (Unidade de Gestao de Programas – Project Implementation Unit)
Kathy Lindert	World Bank	Country Sector Leader/Human Development Sector – was Task Manager of Bolsa Família, now country sector leader
Chris Parel	World Bank	Public Sector Specialist – Task Manager of Ceará SWAp
Marcos Holanda	Secretaria do Planejamento e Coordenação	Director Geral, Instituto de Planejamento e Economia do Ceara (IPECE), linked to Secretaria de Planejamento
Gil Teixeira	Secretaria da Infra-estrutura	Coordenador de Saneamento Ambiental
Monica Clark	Secretaria da Controladoria	Secretária
Vera Coelho	Secretaria da Saúde do Estado do Ceará	Coordenador de Saúde
Maria Hortense Marcier	Ministério da Saúde	Family Health Extension (UGP – Project Implementation Unit – Manager of the WB loan)
Adriana Leal Ana Vicente	Secretaria Municipal de Saúde de Fortaleza	Responsável pelo PROESF
Gerard la Forgia	World Bank	Health Specialist – FHE Task Manager
Francisco Thormann Peter van Hagen	Ministério dos Transportes, Departamento Nacional de Infra-estrutura de transporte	Assistente DIT Engenheiro Civil