



<b>1. Project Data:</b>		<b>Date Posted :</b> 08/15/2002	
<b>PROJ ID :</b> P048870		<b>Appraisal</b>	<b>Actual</b>
<b>Project Name :</b> Br Mt State Priv.	<b>Project Costs (US\$M)</b>	281.0	430.7
<b>Country:</b> Brazil	<b>Loan/Credit (US\$M)</b>	45.0	45.0
<b>Sector(s):</b> Board: PSD - General industry and trade sector (56%), General education sector (21%), Roads and highways (16%), Sub-national government administration (4%), Health (3%)	<b>Cofinancing (US\$M)</b>	20.0	20.0
<b>L/C Number:</b> L4189			
	<b>Board Approval (FY)</b>		97
<b>Partners involved :</b> IDB	<b>Closing Date</b>	06/30/2001	09/30/2001
<b>Prepared by :</b>	<b>Reviewed by :</b>	<b>Group Manager :</b>	<b>Group:</b>
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## 2. Project Objectives and Components

### a. Objectives

The main objective of the project was to support the reform efforts of the State of Mato Grosso (MTG) to enhance its efficiency in the delivery of public services through the privatization, restructuring or liquidation of state enterprises, and concessions of public services.

### b. Components

The project included the following fundamental reforms in the structure of the Government: the closure of the state commercial bank (BEMAT), the state housing agency (COHAB) and the state development agency (CODEMAT); privatization of the state power company (CEMAT); and decentralization and concession of water/sewerage services operated by the state water and sewerage company (SANEMAT).

### c. Comments on Project Cost, Financing and Dates

The completed project is estimated to cost US\$430.7 million or 53.3 percent greater than the US\$281.0 million appraisal estimate. The increase in cost was mostly due to a significantly higher cost of the reform program than the one estimated at appraisal (US\$265.2 million in lieu of US\$187.0 million), mainly caused by non-severance losses from privatization of BEMAT. The US\$45.0 million Bank loan was fully disbursed in four time slices: one of US\$25.0 million at Board presentation, one of US\$10.0 million at the first annual review and two of US\$5.0 million at floating dates linked to reform completion. The time slices were released after compliance with key milestones of the reform program. The loan financed severance payments for voluntary departure and incentives for early retirement from state enterprises being privatized (US\$19.7 million), high priority investments such as road maintenance and rehabilitation works (US\$14.8 million), consulting services, training and office technology equipment (US\$9.7 million) and grants for eligible social activities (US\$0.8 million) over a period of 4 years. The IDB's National Fiscal Administration Program financed US\$20.0 million and MTG financed a balance of US\$365.8 million. The loan was closed on September 30, 2001 after an extension of the closing date by one year. The extension entailed a split of the original US\$10.0 million floating date time slice in two US\$5.0 million time slices.

## 3. Achievement of Relevant Objectives:

The project objectives were substantially achieved. In some areas such as the liquidation of state enterprises the project exceeded the original targets. Except for limitations in the water sector, all its targets in the restructuring, closure and privatization program of state enterprises were achieved. Fiscal and financial objectives were also met. The environmental objectives were substantially met or are likely to be met soon. Institutional development was substantial.

#### **4. Significant Outcomes/Impacts:**

BEMAT was extinguished in 1998 after the deposits amounting to Rs.178 million were transferred to Banco do Brazil in 1997 and several attempts were made to restructure its debt. Severance payments of about Rs.40 million were made to 829 employees dismissed.

COHAB, the state agency in charge of developing popular housing programs and administering the use of funds of the National Housing System was liquidated in 1996 and extinguished in 1999. Cumulative losses of COHAB were Rs.32.1 million and its annual operating losses reached Rs.6.7 million. Its land portfolio was transferred to the State Land Institute. The dismissal of all 384 employees cost about Rs.5.5 million in severance payments. There is still outstanding labor court actions of about Rs.1.1 million and supplier courts actions estimated at about Rs. 51 million.

CODEMAT, the state development agency, was in charge in the provision of infrastructure (roads, electricity and telecommunications) necessary for colonization, as well as in arranging the titling of colonization areas. It was liquidated in 1996, extinguished in 1998 and its assets (Rs.14.1 million) and liabilities (Rs.28.9 million) incorporated to METAMAT, a mixed capital enterprise of the mining sector. At that time, its losses reached Rs. 27.2 million, its negative equity was Rs.22.4 million, and all its revenues were direct government transfers. Dismissal of 719 employees cost about Rs.7.6 million and about Rs.8.7 million in labor court actions.

CEMAT, the state power company was privatized in 1997. It was the worst-performing power company of Brazil: its losses were Rs.265 million in 1996. ELETROBRAS and BNDES undertook the task of restructuring and privatizing CEMAT that led to the auction of 85 percent of all ordinary shares of Rs. 391.5 million or 21 percent higher than the minimum price. The 30-year distribution and concession contracts were agreed between the new owners of CEMAT (the consortium EEVP/REDE) and the power sector regulatory agency.

Three state agencies were restructured (CEPROMAT, EMPAER and METAMAT) by downsizing their staff and reorganizing functions and procedures in order to improve their efficiency.

Fiscal objectives were fully met. For example: (i) the stock of debt has grown at a lower pace than the increase in net current revenues and their ratio decreased from 3.0 in 1996 to 2.4 in 2000, which is better than the 3.5 appraisal estimate; (ii) personnel expenditures has been contained by decreasing to 57 percent of current revenues in 2000 from 83 percent in 1996; (iii) the operational deficit decreased to about 3 percent in 1999 and 2000 from a 41 percent in 1996.

The ICR estimates that the ERR, NPV (at 12 percent annual discount rate) and pay-back periods of the incremental costs, pre-existing liabilities, court cases, and benefits of the reform program are, respectively, in the range 212 to 288 percent, Rs.\$306.3 to 461.9 million, and 11 months to 4.6 years. The lower figures result if MTG assumes all pre-existing liabilities and loses all outstanding court cases.

#### **5. Significant Shortcomings (including non-compliance with safeguard policies):**

Following several failed attempts by MTG and the Bank, the decentralization and concession of water/sewerage services operated by SANEMAT, the state water and sewerage entity were transferred to municipalities, and efforts are now being made to privatize these services.

A bill creating a new State regulatory agency for water, sewerage, and electricity did not surmount political opposition at the State Assembly. Instead, the existing law was amended by the State Assembly in 1999 by re-defining the main features of the multi-sector regulatory agency, AGER. In late 2001, without a sustainable source of financing for its budget, AGER was not fully operational.

The Government failed to carry out environmental audits of CEMAT and SANEMAT. However, the new owners of CEMAT have environmental awareness and have improved its environmental quality performance.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
<b>Outcome:</b>	Satisfactory	Satisfactory	
<b>Institutional Dev .:</b>	Substantial	Substantial	
<b>Sustainability:</b>	Likely	Likely	
<b>Bank Performance:</b>	Satisfactory	Satisfactory	
<b>Borrower Perf .:</b>	Satisfactory	Satisfactory	
<b>Quality of ICR:</b>		Satisfactory	

**NOTE:** ICR rating values flagged with '\*' don't comply with OP/BP 13.55, but are listed for completeness.

#### 7. Lessons of Broad Applicability:

Conditions regarding liquidation/closures (often used inter-changeably) should be formulated more precisely. Closure means that all agencies and offices are closed, operations have stopped and most employees have been dismissed. Liquidation is a long process with steps not always under the control of the liquidator. Conditionality should refer either to the start of liquidation (decreeing liquidation and liquidator in office) or to completion of liquidation (extinction).

Regulatory agencies are best established as early as possible to allow it to build-up capacity before the privatizations start.

In a Federative Republic it is advisable and essential that key features of regulatory agencies be established in Federal laws in order to avoid easy changes to regulatory bodies created by State laws.

The Bank should provide more specific guidelines on how to carry out the economic cost-benefit analysis of severance payments and on how to evaluate the restructuring of benefits.

#### 8. Assessment Recommended? ☒ Yes ☐ No

**Why?** The design of the Mato Grosso State Privatization Project was in fact a proxy for an adjustment lending operation from which best practices on privatization and liquidation of state-owned entities could be drawn.

#### 9. Comments on Quality of ICR:

The ICR complies satisfactorily with the Bank guidelines for the preparation of ICRs. It presents a very good but too detailed (90 pages or three times longer than the PAD) description of project results and evaluation. It contains excellent economic cost/benefit analyses of the liquidation of state-owned entities. It included comments made by the Government of the State of Mato Grosso. The IDB did not comment on the ICR. The reader would have benefited from a more succinct account of project results and evaluation.