**A Knowledge Legacy**

**Editorial by Makhtar Diop**

My last editorial to the Quarterly Knowledge report will try to look back at the reasons why we started the Brazil Economic Team and try to assess its impact.

But first I must underline the pleasure that it was working with the Brazil Economic Team and guiding its reports, and the satisfaction to see it now consolidated and a useful asset to many constituencies, in and out of the Bank.

The work initiated by Tito Cordella and continued by Pablo Fajnzylber, as coordinators of the Brazil Economic Team, was impeccable, and brought out consistently high quality, relevant and timely contributions from the many collaborators to the Quarterly, Monthly and Dailies. I would like to thank all the many contributors for their great work.

(Continued on page 20)

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**São Paulo City Study**

‘Do povo oprimido nas filas, nas vilas, favelas
Da força da grana que ergue e destrói coisas belas
Da feia fumaça que sobe, apagando as estrelas
Eu vejo surgir teus poetas de campos, espaços
Tuas oficinas de florestas, teus deuses da chuva.’

(Caetano Veloso, Sampa)

By Thomas Kenyon

São Paulo has played a key role in Brazil’s economic development. During the twentieth century, it was at the center of an integrated economic complex responsible for the country’s transformation from an agricultural to an industrial society. For much of this period it benefited from government policies that protected domestic manufacturing and encouraged the physical concentration of economic activity. Even now it remains Brazil’s largest city, its main financial center and the location of the headquarters of most its private corporations.

Over the past two decades the natural and political advantages that Sao Paulo enjoyed over other Brazilian cities have dwindled. In part this is the reflection of a natural tendency experienced by almost all large cities around the world: the dispersion of mature industries to smaller urban centers and the substitution of manufacturing by service activities. But in Sao Paulo’s case it has been accelerated by changes in Brazil and its relationship with the international economy. Trade liberalization in the early 1990s and the country’s growing specialization in commodities since 2000 have eroded the city’s position.

Sao Paulo’s performance has suffered accordingly. Growth has stalled. The last two decades have seen a rebalancing of growth in Brazil away from metropolitan areas in general and Sao Paulo in particular. In the 1980s, the city was richer than Belo Horizonte, the Distrito Federal, Porto Alegre and Rio de Janeiro. By the 2000s the reverse was true. Real per capita household income in Sao Paulo has never re-
gained the level it reached in the late 1980s.

Structural change has also had a dislocating effect on land and labor markets within the metropolitan region. The loss of traditional manufacturing jobs in the eastern districts of the city has not been compensated for by new activities in services or modern industry. Its southern, eastern and northern extremities have attracted new residents while failing to generate any significant employment opportunities. Private real estate investment and public service delivery have strongly reinforced the divide between a wealthy, relatively dynamic core and impoverished periurban areas.

Reversing this record of spatial inequality will require large investments in public infrastructure, social services and job creation. The municipality’s creative use of public-private partnerships (PPPs), urban concessions and other instruments for urban regeneration has allowed the redevelopment of previously abandoned or underused areas. The expansion of these initiatives could help Sao Paulo attract talent and exploit the agglomeration economies that distinguish a city of its size and diversity.

Sao Paulo’s inherent strengths - a large local market, a broad range of intermediate services and a diverse skills base - are at the core of the city’s strong potential as well as its ability to find a new vocation. This is likely to lie in some combination of high-end services with large returns to dense agglomeration; large, established industries for which persistent demand exists and in which Sao Paulo has a significant legacy base of skills; and new innovative activities that build from strengths as yet latent or realized on only a small scale.

All this requires public investment. The most immediate problem facing Sao Paulo is its fiscal situation is unsustainable. On current trends, the space for debt service and capital expenditures will fall to zero by 2030. Unless the city renegotiates its debt with the federal government, refines the balance at significantly lower interest rates and strengthens its capacity for budget planning and execution, it will not be able to afford the investment required.

The Municipality’s long-term planning framework – Sao Paulo 2040 – recognizes the nature and scale of the problem. It acknowledges that reshaping the city’s economic geography is a generational challenge that will not be resolved in one mayoral administration. And its emphasis on catalytic projects in partnership with the private sector and civil society is an effective means of tackling the inefficiencies that undermine the city’s livability. Here are three additional ways in which, following our analysis, the municipal government might continue to respond:

**Step 1: Renegotiate the debt and improve expenditure management:**

*Renegotiate the debt:* Sao Paulo is currently renegotiating the terms of its debt with the national treasury. Our calculations indicate that on current trends the room for capital expenditure and debt amortization will fall to zero by 2030, when the municipality’s current option of capping debt service at 13 percent of net revenue expires. On the other hand, the various refinancing scenarios under discussion with the federal government – none of them necessarily endorsed by the World Bank or the Brazilian National Treasury – imply a significant increase in fiscal space for investment and other priorities. Our modeling shows that there is relatively little difference in long-run impact among the three proposals under discussion: one under which the city amortizes 20 percent of its outstanding debt and in return receives a lower interest rate of six percent plus IGP-DI on the balance; a second that applies a retroactive interest rate of six percent plus the IPCA when the municipal government might continue to respond.

*Step 2: Reform expenditure management:* But debt renegotiation will be insufficient unless backed by reforms to expenditure, and in particular investment planning and management. At present the expenditure envelope is not determined in a manner consistent with fiscal sustainability to meet required debt targets. Priorities are only tenuously transmitted to the two key decision phases of the process – the elaboration of the LOA, and then the weekly meetings to discuss the evolution of revenues and the reallocation of resources. And there is a very strong tendency simply to maintain existing programs and structures, adding on additional programs or investments as additional resources become available. Overall the current system lacks predictability.

**Figure 1:** Average Household Income: Selected Metropolitan

![Graph showing average household income](source: WB, calculated from PNAD)
There are several ways in which investment execution might be strengthened. One would be to limit the amounts that could be reallocated without a revision of the budget law in the assembly. This might be complemented by the inclusion of larger contingency allocations, based upon historical experience, to cover events which might reasonably be expected but whose consequences are unpredictable (such as flooding and landslides). Another mechanism for tightening budget management would be to require each unit to report on significant deviations from the planned budget. This would gradually eliminate systematic deviations and strengthen credibility.

**Step 2: Develop an explicit strategy for supporting private sector-led growth:**

Large cities like São Paulo typically have three inherent strengths: a large local market; a broad range of intermediate services; and a diverse skills base. Growth tends to be led by services, non-standardized manufacturing and R&D. Each requires a different policy approach.

**Retain high-end services:** Ensuring that business and technical services remain at the core of São Paulo’s vocation would be important for generating jobs that the financial sector alone will not provide. This would require continuing to attract a highly-talented labor force with the right mix of skills and lowering the transaction costs to those employees exchanging knowledge and commercializing new ideas. Congestion, high real estate prices and other intermediate factors affecting the quality of life pose serious obstacles to retaining very highly-skilled labor, which has a number of highly attractive global cities to choose from elsewhere.

**Nurture the competitiveness of high-demand industries:** But services alone will not generate the right mix of employment. Thus, the city could also aim to nurture the competitiveness of established industries for which there is persistent demand: both ‘legacy’ industries that are no longer competitive in their current form but elements of which might reemerge in some new form and those that are growing rapidly and are placed to benefit from large-scale shifts in demand. The first offers a means of finding higher-wage occupations for the hundreds of thousands of former manufacturing employees (e.g. automotive and textiles). But the largest driver of employment growth is likely to come from established activities for which there is predictable and rising demand. An obvious example is construction. Already one of the largest in the city, it is likely to grow further reflecting demand from social housing initiatives, local and national infrastructure projects and demographics. But generating innovative solutions to low-cost and carbon-efficient housing will require a combination of research capabilities, design skills, building materials and construction. This requires a well-articulated innovation system.

**And strengthen the innovation system:** São Paulo already benefits from the two key ingredients of a well-functioning innovation system: human capital and finance. It has over 570,000 graduate and undergraduate students enrolled in universities, colleges, university centers, and federal institutes. They are among the best in the country: the University of São Paulo is the only Brazilian university ranked amongst the top 200 in the world. Yet, these two crucial building blocks have not combined to generate an effective innovation system. The explanation appears to lie in a lack of integrated physical locations and a shortage of supporting services. Rather than increasing the supply of graduates or start-up capital, the city needs to concentrate on facilitating their interaction. This may involve a more pro-active role in providing the appropriate infrastructure (e.g. science and technology parks, specific investments in transport and logistics).

**Step 3: Extend the use of public-private financing mechanisms:**

In addition to developing a strategy for supporting the competitiveness of the private sector, the city could benefit from involving it as a source of finance and project management capacity. Fortunately, São Paulo has already introduced several important innovations in urban planning, as it gained the autonomy and territorial planning responsibility through national decentralization. There are at least two ways in which these innovations might be extended – to include the reclamation of contaminated ‘brownfield’ sites and to capture value created by infrastructure investments through tradable development rights.

**Reclaim brownfield sites:** The withdrawal of industry has left a large residue of ex-industrial areas, including in the city core, some of them heavily polluted. Many have been redeveloped; but there is still a large stock of untouched sites. Given the dynamism of the property market and the projected demand for housing over the next decade or so most of these are likely to be profitable without government intervention. The first task is to improve the mapping of sites. An information management system for contaminated areas would stimulate private sector interest and make it possible for the city to make planning decisions involving contaminated sites. Second, the city could develop instruments to reduce barriers to private sector redevelopment. This could be done through existing instruments such as urban concessions and urban operations, by including private sector incentives within contracts and bidding specifications.

**Expand use of tradable development rights:** Existing instruments such as urban operations could be used to generate additional revenues for investment in strategic infrastructure, like the Line 4 Metro project. Transport demand in a large, developed metropolitan area like São Paulo is closely intertwined with developments in the real estate market. Investments that increase the relative accessibility of a section of the city change the economic geography of the city and are reflected in higher land prices. This represents an opportunity for value capture through the issue tradable development rights like Certificates of Additional Building Potential (CEPACs). So far CEPACs have also only been used in two urban operations – Água Espraiada and Faria Lima – due to administrative and legal complications in their implementation.
Impact of Shocks and Social Protection: Some Reflections from the Analysis of Brazil 2008–2009

By Anna Fruttero

During the past five years food prices and economic woes have alternated in capturing newspapers’ headlines. In 2007, after many years of growth below 10 percent, food prices started increasing rapidly, reaching about 40 percent in July 2008. As the prices of staples jumped sharply, food riots broke out in developing countries around the world. At the end of the summer 2008, the bankruptcy and bailout of major financial institutions, such as Lehman Brothers and AIG, led to a global financial crisis that was followed by what has become to be known as the “Great Recession”. During 2011 the world experienced a very similar pattern. In early 2011, food price increases were back in the headlines. After having fallen markedly during the Great Recession, food prices started accelerating in late 2010. And over the year the risks to global financial stability have increased substantially, as a result of Europe’s debt crisis and weak growth prospects in many advanced economies combined with a series of shocks to the global financial system.

These shocks induced a policy response in most of countries around the World. To address the negative effect of food price increases governments adopted import-tariff reduction measures, introduced food subsidies; or increased civil servant pay and pensions. To address the effects of the global financial crisis many countries adopted expansionary monetary and fiscal policies. Within fiscal policies, stimulus packages often included a diverse range of tax measures, infrastructure spending and increases in social protection. Within social protection, responses usually included a range of measures to increase the coverage or generosity of social assistance programs, as well as scale up school feeding programs or labor market programs.

Indeed, the effectiveness of a response to a crisis will depend on the instruments used and their ability to reach those individuals most affected by that specific crisis. In this note we reflect on the role of social protection programs in mitigating the negative effect of adverse shocks in Brazil during the period of 2008-09 when the country as the rest of the world was hit sequentially by the food price increase and the financial crisis followed by an economic slowdown.

Food price increases in 2008.¹

Brazilian inflation started increasing towards the end of 2006 and reached a peak of around 7 percent, in June 2008. It averaged 5.3 percent for the 2007-2008 two-year period. This increase was driven mainly by food prices which rose substantially during 2007 and 2008. Food price inflation peaked in June 2008 at about 18.3%. Price growth for all other categories was roughly constant around 5 percent - or lower, for housing, residential goods and communication items. Behind this large increase in the average price of food, there was substantial variation across both specific types of foods and regions of the country. The price of grains (cereals), which grew by 80 percent in the twelve months to July 2008, led the increase, followed by that of tubers and roots (50 percent) and meat (40 percent). Even within food groups there was a large variation across different parts of the country. Grain prices, for example, grew by 125 percent in Salvador, but by less than 50 percent in Fortaleza. The price of flour and pasta rose by almost 40 percent in Belém and Salvador compared to about 15 percent in Recife and Fortaleza.

High food prices affect households mainly through consumption and income channels: they increase the cost of a fixed consumption basket, thus coeteris paribus reducing welfare; and they increase incomes that depend directly or indirectly on agricultural markets. All households as consumers will be negatively affected by the food price increase. However, the overall net effect depends on whether (and how much) households also benefit in terms of their income. Our analysis suggests that despite living in one of the world’s largest food exporters, most of Brazil’s population experienced a decline in welfare as a result of the food price increase in 2008. Naturally, higher incomes arising from a greater value of agricultural production were particularly important in rural areas than in urban areas, where few people benefit directly from agriculture. Since Brazil is 80% urban, the aggregate picture for the country as a whole was one of reductions in average welfare as a result of higher food prices. Behind the average impact, however, the consequences of higher food prices are different across the income distribution. The poor – particularly the rural poor – either gain or lose less from higher prices than the middle groups. And the rich lose little, since they spend a small proportion of their incomes on food to begin with.

Brazil has two main income transfer programs targeted to the poor: the Continu-
ous Cash Benefit program (BPC) and the Bolsa Familia program. BPC is a monthly unconditional cash transfer targeted to the elderly over 65 and to individuals of any age with severe disabilities, with family per capita income below one-fourth of the minimum wage. It started in 1995 and is coordinated by the Ministry of Social Development. Bolsa Familia is a cash transfer program which resulted from the unification of a series of pre-existing conditional cash transfer programs and was launched in the end of 2003. The program provides a minimum level of income to poor and extreme poor families and the transfers are conditional on compliance with several requirements, with benefits varying according to the monthly per capita income of the family and its composition. Bolsa Familia is the largest conditional cash transfer intervention in the world, with over 13 million beneficiary families (about 25% of the Brazilian population), presence in all 5,565 Brazilian municipalities and an annual budget of R$16.7 billion in 2011. The objective of the program is twofold: (a) reduce poverty and inequality and (b) break the inter-generational transmission of poverty through investment in human capital.

As part of its response to the food price increase Brazil, as many other governments, announced it would use Bolsa Familia to help mitigate the impact of rising food prices on the population. While this program is intended to address chronic poverty, it has been a useful instrument in mitigating the effects of the food price increase. The existence of a program with such high-coverage allowed the government in 2008 to swiftly channel resources to a large part of the population, through an increase in the benefits transferred to beneficiaries of the program (about 11 million families then). This policy was well-targeted as most of the beneficiaries in Bolsa Familia are poor or extreme poor, and it was successful in protecting the poorest. The increase in transfers was substantively protective for the poorest 10 percent of the urban distribution and the poorest 20 percent of the rural distribution.

However, it could not fully compensate the negative welfare consequences of the increase in food prices, in particular for the urban poor. This is due mainly to the limited size of the increase relative to the welfare losses and to the higher share of the rural poor than of the urban poor covered by the program (Figure 1), which left most of them unprotected. Indeed, most CCTs in Latin America began as targeted to the rural extreme poor. And even large nationwide programs like Bolsa Familia and Oportunidades (Mexico) still cover a higher share of the rural than the urban population. This leaves the urban poor particularly vulnerable to crisis. Expanding the program could be one solution. However, this should be done with caution since there are reasons for the lower coverage of CCTs in urban areas. The existence of more work opportunities in urban areas increases the opportunity cost of households’ time and the benefit offered by CCTs is relatively low compared with urban household incomes. In addition, there are important differences in health and education coverage in urban compared with rural areas. School enrollment and health service usage are normally higher, so there is less need for demand side stimuli to increase them and there is need to tailor the CCT programs to groups where there may be more impact such as the youth to provide them with incentives to stay and complete secondary school. Thus, CCT programs can be an effective measure to mitigate the effects of a crisis like food price increases for the existing beneficiaries, but there remains a large share of the poor, mostly the urban poor, that cannot be easily reached through these programs.

In 2008 the minimum wage was increased by 10 percent which resulted in an equivalent increase in the value of the BPC transfer. This measure protected the

2. This is equivalent to US$8.9 billion, Ministry of Social Development and Fight to Hunger (MDS), information as of December 2011.

3. The basic transfer of Bolsa Familia increased by R$4 (8 percent) and the transfer per child by R$2 (13 percent).


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**Figure 1: Coverage of Social Assistance by deciles of per capita income**

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<th>Panel a – Coverage by rural and urban areas</th>
<th>Panel b – Coverage of BPC and Bolsa Familia</th>
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Note: Social Assistance programs include Bolsa Familia and BPC
Source: World Bank SP Adept using PNAD 2009
purchasing power of BPC beneficiaries. However, it did not have substantial aggregate effect, given the low coverage of this program. It is interesting to note that despite BPC having a much lower number of beneficiaries (2.8 million individual beneficiaries in May 2008) compared to Bolsa Familia (11.1 million families beneficiaries in May 2008) the increase in the total cost of BPC and Bolsa Familia implied by the increase in benefits were equivalent because of the significantly higher value of the BPC benefits.

**Economic Slowdown in 2009**

As food prices started decreasing over 2008, a global financial crisis led to a major recession in all regions of the planet. In 2009 GDP declined worldwide on average by 2.65%, with large variation across regions and countries. North-Africa experienced a reduction in growth rates while most other regions exhibited actual negative growth rates. Average GDP growth in Latin America and Caribbean was negative 2.44% in 2009, with Mexico experiencing the largest contraction in the region with negative growth of 6.3%. While Brazil was not amongst the hardest hit in the region, GDP contracted by 0.6% in 2009. The first three quarters of 2009 showed the worst performance, in terms of GDP growth, since 2002. Industry and agriculture were the two most affected sectors, while services only experienced a mild deceleration.

This economic crisis had a negative impact on labor markets across regions, with the global unemployment rate increasing from 5.7 in 2007 to 6.3 in 2009, Brazil, like most Latin American countries for which timely data are available, showed an increase in unemployment right as the slowdown started unfolding. Between December 2008 and March 2009 unemployment experienced its largest increase ever, going from 6.8 to 9 percent. However, this increase in unemployment reversed during the second quarter of 2009.

Also during this crisis, Brazil made use of existing social protection policies to mitigate the effect of the crisis: it extended the duration of unemployment insurance for specific sectors and it raised the benefits and increased coverage of Bolsa Familia. Unemployment insurance is the obvious “automatic stabilizer” when the labor market is affected. It is the classic program for income replacement for individuals losing their job, and a desirable instrument in the event of a temporary crisis or shock, as it does not need specific policy triggers. Indeed, the demand for unemployment insurance increased substantially towards the end of 2008 and the government increased its duration by two months for the “most affected sectors”, which were determined at the state level. However, in countries with still a large share of workers in the informal sector coverage of unemployment insurance is low. While increasingly formalized, Brazil still has about 40 percent of its labor force in the informal sector. Moreover, minimum length or density of contribution requirements further restricts eligibility. Thus, this program is more likely to cover workers in the upper half of the income distribution, leaving out workers who are most likely to be more vulnerable.

To protect the poorest, in July 2009 the government increased by 17 percent the eligibility threshold for Bolsa Familia. This resulted in an additional 1.8 million families being included in the program. It also increased benefits by 10 percent. However, as we have seen in the case of the food price increase, this program does not reach a large share especially of the urban poor. In general, the use of CCTs in response to this type of shock may be limited for the following reasons. First of all, they need to have the ability to expand to include those beneficiaries affected by the crisis or shock. This requires flexible targeting mechanisms and a continuous open enrollment program. In the case of Bolsa Familia, eligibility is based on self-declared income and enrollment can be done on a continuous basis. However, it is not an entitlement program, since there are beneficiary caps at the municipality level that can prevent households from entering the program despite being eligible. Second, in response to a temporary crisis programs should have well established triggers for returning to pre-crisis benefits, coverage and rules. However, scaling back programs or decreasing benefits is not simple. Indeed, in Brazil the increase in benefits was permanent. Mexico introduced an additional benefit for Oportunidades’ beneficiaries in 2008. It was called “Vivir mejor” and was intended to specifically compensate for the increase in the price of food and to be distributed only in June and December 2008. However, it is to this day one of the types of transfers of the program. For such large and well established programs in middle-income countries this may not be a problem. However, in other settings this could jeopardize the program’s long run sustainability and governance.

The last four years have shown how the investment made to strengthen its social protection system has made Brazil well equipped to face aggregate shocks. The broad array of social protection programs at its disposal has provided the government of Brazil with useful tools to respond to the adverse events that affected the country as well the rest of the World in 2008/09. A program like Bolsa Familia represented an almost perfect instrument to protect especially the rural poor as food prices increased. During the global economic slowdown, the unemployment insurance program protected the income of formal workers who lost their jobs. However, the recent crises also highlighted how some groups remain unprotected. This is particularly the case for the poor in urban areas and for informal workers who are not protected by the existing instruments designed for the formal sector (e.g., unemployment insurance). Clearly, a program like Bolsa Familia is aimed at addressing chronic not transient poverty and some of its characteristics may end up limiting the effectiveness of this instrument in time of a crisis. In the case of unemployment insurance, the main problem is that in a context of high informality a large share of the population cannot benefit from it. Brazil, as countries across the World, is investing in increasing the range of instruments available to protect different groups and different situations over time. In this context, it would be important to ensure that pre-established crisis-response procedures are in place so that programs can return to normal benefits, coverage and rules once the crisis has passed.

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6 ILO, Trends econometric models, October 2011.
7 With Decree 6.917 the extreme poverty threshold went from R$60 to R$70 monthly per capita income and the one for poverty from R$120 to R$140.
8 As is the case in Guatemala, for example, where the CCT program expanded excessively and it is now under restructuring.
Turning Rio Around

Interview with Rio de Janeiro Municipal Finance Secretary Eduarda La Roque

By Mauro Azeredo

When Mayor Eduardo Paes announced that Eduarda La Roque was his choice for the key Finance Secretariat, in early 2009, many were taken by surprise. La Roque, a young star in the financial sector, had a stellar professional and academic profile, but no experience with the public sector.

But in just a few months – in spite of the international economic crisis – she had lead the effort to turn around Rio’s finances from a deficit to a sizeable sustainable surplus, enabling investments and helping prepare the grounds for the city’s successful bid for the 2016 Olympic Games.

Her strategic handling of the city’s historically chaotic finances and fiscal administration culminated with the achievement two investment grade assessments by Fitch and Moody’s, reaching Brazil’s own sovereign ratings – the only subnational entity to have done this.

Secretary La Roque spoke to the Brazil’s Economic Team from her office in Rio de Janeiro.

Brazil Economic Team: The city of Rio recently became the only subnational unit with risk rating equal to the sovereign rate. What was the strategy to make this possible?

Eduarda La Roque: The main task at the beginning of the administration of Mayor Eduardo Paes was to increase the investment capacity of the city with no increase in tax rates or burdening future generations with debt. Given the significant shortcomings in various areas of municipal responsibility, especially health and urban infrastructure, the amounts invested up to 2008 had been extremely low.

With this primary objective, we identified three main fronts: the efficient management of personnel costs and debt collection, the modernization of revenue collection, and a policy of attracting private investment.

In terms of control of personnel costs, the philosophy has been to control benefits that could be incorporated into wages and promote meritocracy and bonus payments for achieving goals. In the area of debt, the main highlight was the DPL loan from the World Bank, the first to any city worldwide. The US$ 1 billion amount (received in two installments in 2010 and 2011) was used to repay part of our Federal debt, reducing rates. This operation has already allowed us to save R$ 560 million (US$ 330 million) since the signing and the total current value of the benefit should reach R$ 2.0 billion.

In terms of increased revenue, we can highlight initiatives such as the Nota Carioca (electronic invoice), the Fiscal Intelligence System (crossing referencing of several databases) and greater efficiency in the management of non-tax revenues. When we compare the budget for 2012 (R$ 20.5 billion) and 2009 (R$ 11.8 billion), there is an 87% nominal increase, without hikes in the main ISS and IPTU taxes on services and real estate.

In the third axis, we sought out the private sector as a partner to leverage development, with well-planned tax incentive programs, improvement of the business environment with less bureaucracy, and the development of public-private partnerships, for which we also have the Bank’s technical assistance.

This fiscal adjustment allowed us to close 2011 with almost R$ 4.0 billion in investments in the municipal budget, without considering partner investments through PPPs. Thus, we believe that the outstanding credit rating granted us by both agencies that evaluate us (Fitch and Moody’s) reflects the sustainability of our finances, whose highlight is the ability to invest in a sustainable manner. The city of Rio de Janeiro is currently the only subnational entity with a credit note equal to the Union and that of companies like Banco do Brasil, BNDES and Petrobras.

“Risk management was a natural development of the expected overestimation of the municipal budget”

BET: What Rio did could be replicated by other cities? In your view, what would be the greatest difficulties for this to happen?

Eduarda La Roque: I believe that the actions taken in the management side are replicable in other cities, considering, of course, their characteristics (e.g. the structure and size of the budget allocation). That is, it is possible for the public sector to contribute by properly planning the allocation of its resources at the same time it on the productivity gains that will positively impact their budget constraints. From this perspective, it is essential for the government to manage very carefully the incentive system that impacts its revenues, expenses and the behavior of economic agents under its responsibility. Note that the system of incentives to which I refer is not limited to taxation, but the set of rules that govern the relationship between economic actors – government among them. Rules that induce desirable behaviors and are therefore essential for the objectives of the public sector to be achieved.

BET: What are the next fiscal and financial goals of the Rio?
Our main goal is to keep the mandatory tax spending (personnel and debt) under efficient management, allowing us to implement the City’s investment priorities, and allowing a profound transformation in the lives of the citizens of Rio in the coming years.

We also are committed to ensuring that the Municipality will remain within the framework of all existing debt limits in our legislation, and we believe that maintaining the credit ratings equal to those conferred on the Union is an achievement that needs to be maintained.

BET: Could the international financial crisis disrupt Rio’s plans?

Eduarda La Roque: The crisis, if it worsens, could impact private investment. From the standpoint of public investment, the many different funding sources available to us, including the fiscal space available for our own investments in the municipal budget, ensures that the resources for the planned investments will be available can be made and, just as importantly, maintained. Additional investments, which may not have been planned, will be assessed against the current priorities and the expected evolution of both the financing capacity and tax revenues.

BET: How to reconcile fiscal responsibility with investment and growth in a Brazilian city?

Eduarda La Roque: The main issue is that the public sector must know what is its space and role, in order to occupy it as best as possible, including through the careful management of its system of incentives. In this sense, the concern with development / economic growth that guides the Municipal Finance Secretariat is an important change in attitude. The idea is to connect the Secretariat more actively to the question of development. Thus, availing himself of his own inducing capacity, the Secretariat no longer has a mere revenue role to leverage this growth, working seamlessly with other areas of municipal administration, always keeping in mind the cost-benefit concept.

In linking this development focus with the concept of fiscal responsibility it is essential to mention the engagement of the Municipality of Rio de Janeiro, in collaboration with the World Bank, in the preparation of its Medium Term Expenditure Framework. The MTEF is a medium-term budget that reconciles, in a clear and detailed manner, fiscal resources with the spending priorities in the medium term. Thus, development of the MTEF is a process that involves a series of detailed discussions between different actors in public administration, gradually put together until its final form is approved by the Mayor. It is important to note that the MTEF adds itself to what was already being implemented by the City under its Strategic Plan, and it contributes to the institutionalization of the processes of resource allocation and transparency.

BET: The World Cup and the Olympics can be a risk to fiscal sustainability in Rio? What is being done to prevent this?

Eduarda La Roque: Ever since the City won the right to host the Olympic and the Special Olympic Games in 2016, the philosophy and implementation of the process have been towards Games serve the City (and not vice versa), catalyzing the necessary resources to improve living conditions more broadly.

The key strategy is to preserve the Municipal Treasury as much as possible from the financial burden of the construction of the new spaces for competitions under municipal responsibility (notably, the Olympic Village and Olympic Park). These complement the sports infrastructure network already built by the municipality for the 2007 Pan American Games. The goal is to have them preferably built and operated by private partners in exchange for public non-financial counterparts (notably, real estate donations and construction permits).

Thus, the direct costs for the Municipal Treasury (including new debt) will be directed primarily to investments with long-term benefit, such as transport, sanitation and slum upgrading.

It should be noted also that the matrix of responsibilities for the 2014 World Cup and the 2016 Olympic and Special Games defines the specific duties of the City, State and Union, both in terms of sports spaces and urban infrastructure. The physical organization and the financial burden of these events, thus, do not fall exclusively on the municipality. Examples of important initiatives under the responsibility of other entities are the Maracanã sports complex, the expansion of the subway network (both in progress by the State Government), the Deodoro sports complex and the airports (under federal administration).

BET: One of your trademarks in the private sector was risk management. Were you able to transpose it to the public sector?

Eduarda La Roque: The issue of risk management has emerged as a natural response in the context of an expected "overestimation" of the budget at the beginning of the administration of Mayor Eduardo Paes, because revenue projections for 2009 had been (by legal imposition) made before the worsening of the global financial crisis in 2008. Faced with this problem, it was up to the new administration to closely follow the new revenue estimates that included the new set of information - so that we could assess how well they agreed with what was budgeted in 2008. In this context, for the first time in Rio we developed a mapping of possible revenue scenarios, with their probabilities, the so-called 'Risk Map'. With it, we could estimate the probable annual budget revenue values line by line, depending on the amounts already collected and the new projections, revised monthly.
The Impact of the IOF Tax on Capital Flows

By Fábio Bittar

Discussion on Capital Controls

As the global economy began recovering from 2008 financial crisis, capital started flowing back to emerging market economies. Capital flows enable countries with limited savings to attract financing for productive investments, foster risk diversification, promote intertemporal trade, and contribute to the development of financial markets. In this sense, the benefits of free flow of capital across borders are similar to the benefits from free trade and restrictions on capital mobility mean foregoing, at least in part, benefits owing to the distortions and misallocation that controls give rise to. Moreover, the recent surge in capital flows has created some new challenges to emerging economies. A large share of capital flows is perceived as temporary, reflecting interest rate differentials, which may be at least partially reversed when policy interest rates in advanced economies return to more normal levels. Certain types of capital inflows, particularly as opposed to equity flows, increase countries’ vulnerability to financial crisis. Equity flows, on the other hand, allow for greater risk sharing between borrower and creditor. Massive inflows can also lead to strong exchange rate appreciation, which could significantly complicate economic management and harm domestic production competitiveness.

Concerns that foreign investors may be subject to herd behavior, and excessive optimism, have grown stronger and may lead to collateral damage, including bubbles and asset booms and busts.

Last year, the IMF and the Brazilian government held a joint conference on the management of capital flows. One of the main conclusions of this meeting was that we still have a long way to go in order to better understand the costs and benefits of capital flows. While benefits are relatively straightforward, costs seem to be heavily dependent on the institutional framework of each country: things like the exchange rate regime, the degree of dollarization of the economy, and the credibility of the central bank.

With this in mind, members of the International Monetary Fund (IMF) suggested that under some circumstances capital controls could be an additional tool to handle sudden surges in inflows. More specifically, IMF staff suggested that when the economy is operating near potential, if the level of reserves is adequate, if the exchange rate is not undervalued, and if flows are likely to be transitory, then the use of capital controls in addition to both prudential and macroprudential policy is justified. Nevertheless, any country’s policies to control the inflow of capital should take into account potential adverse multilateral consequences, especially in moments of economic recovery. Furthermore, evidence on the effectiveness of those policies is somewhat limited. If anything, the evidence appears to be stronger for capital controls to have an effect over the composition of inflows rather than on their aggregate volume.

Developments in Brazil

Capital inflows to Brazil have increased significantly in recent years and have become an important source of financing for the recurrent current account deficits reported since early 2008. In 2011, the current account registered a record deficit for the Real Plan period (US$ 52.6 billion), heavily impacted by income transfers which amounted to a net outflow of US$ 47 billion. Nonetheless, financial and capital account surpluses were more than enough to offset the deficit and the overall balance reached US$ 58.6 billion in the same year.

Foreign direct investments (FDI) were the main source of capital inflows and also reached a historical record, amounting to US$ 66.6 billion.

Notwithstanding, heavy capital inflows resulted in the appreciation of the Brazilian exchange rate and consequent loss of competitiveness by Brazilian exports. The Real appreciated 11% between the end of 2009 and July 2011. Beginning in October 2009, the Government of Brazil (GoB) started introducing capital controls in order to moderate the continued appreciation of the Real. It began by raising the tax on financial transactions (IOF) to 2% for foreign portfolio investments (FPI), both for fixed and variable income. In October 2010, the IOF was raised to 6% for fixed income and also for future market operations. Finally, in 2011, the GoB introduced a 6% IOF for foreign loans maturing within 720 days. These measures had a direct impact on foreign portfolio investments, which dropped to US$17.4 billion in 2011 after accumulating a US$67.8 billion surplus in the previous year (Figure 1). It is important to note that the 12-month figure starts dropping already in the beginning of 2011, before the European fiscal crisis worsened and during a high confidence period, which began in the second half of 2009 as the Brazilian economy started recovering from the 2008’s financial crisis. Moreover, foreign investments in variable income responded sooner to the introduction of the IOF (Figure 2). The continued increase in fixed income assets after the introduction of the IOF can be explained by high domestic interests. As developed...
economies sustain interest rates at a record low, the higher predictability and lower risk of fixed income investment seems to compensate for the lower profit-ability caused by the IOF. The stronger resilience of fixed income motivated the increase on the IOF rate to 6% in October 2010.

In December 2011 the Brazilian government withdrew the 2% IOF tax over variable income portfolio investments in response to the worsening global scenario, which caused the Brazilian Stock Exchange – BM&F Bovespa to report a 9% loss in the second half of 2011. The measure had a positive effect and the IBOVESPA index increased 13.8% in the first two months of 2012. However, this cannot be attributed solely to the IOF withdrawal: improvements in the external scenario increased inflows to emerging countries and there has been a general appreciation of emerging markets’ currencies relative to the US dollar. Brazil led this trend, with the Real appreciating more than 8% from the end of 2011 until March 1st. On a recent move, the Brazilian government has extended the 6% IOF tax to foreign loans maturing within 5 years (the previous measure was set to 2 years approximately). The government’s intention is to limit exposure of domestic banks and firms to exchange rate risk and to halt the continued appreciation of the Real.

Suspicions and hypothesis

FDI inflows have increased steadily in the last years. Much of the increase can be explained by better growth perspectives for the Brazilian economy. Fast growing emerging countries have become increasingly attractive for foreign investments. A prudent macroeconomic policy and consumption growth due to effective poverty reduction classified into either intercompany loans or equity capital. The first refers to loans from multinationals to their subsidiaries in Brazil and also to loans from subsidiaries in Brazil to their headquarters abroad. The second relates to the acquisition of a minimum of 10% of a company’s equity capital with voting rights in Brazil and also includes Brazilian subsidiaries’ participation in their headquarters’ equity capital.

The first hypothesis would be that multinational companies are using resources from their subsidiaries to perform portfolio investments. The subsidiaries would allocate their capital into portfolio investments and, in exchange, they would receive loans from headquarters in order to cope with their investment’s needs. The Instituto de Pesquisas Economicas Aplicadas – IPEA, suggested a second hypothesis through equity capital. As the requirement for FDI stands at a minimum participation of 10%, it would be feasible for investors to sell their shares once their capital is in the country, especially for those investing close to the minimum required. This would compromise the long term nature of the investment and enable investors to use those resources in the purchase of portfolio investments.

Suggested Evidence

In this context, we now turn to the data and try to assess whether the evidence indeed suggests that investors have made use of productive investments to continue...
bringing portfolio inflows and escape the IOF taxation.

Our first approach is to look at the evolution of FDI and FPI since the beginning of 2008. The three-month moving average for FDI seems to increase significantly between the end of 2010 and beginning of 2011 (Figure 4). The timing of the change is also consistent with the introduction of the 6% IOF for fixed income assets, which was followed by a drop in portfolio investments. The graph clearly shows an inversion in the volume of the two kinds of flows, with FDI volume increasing and replacing the loss in foreign portfolio investments. However, it is important to note that FDI was running below pre-crisis level and the increase in the three-month moving average might as well indicate a recovery in FDI due to better perspectives for the Brazilian economy. More than that, investors’ sentiment towards Brazil might have improved as the country reported a robust performance in 2010 after a mild recession in the previous year. Even though the Brazilian economy contracted 0.3% in 2009, this result could be interpreted as positive news when compared to developed economies and even to previous crisis experiences, when the country’s economy suffered much more with challenging external scenarios.

We now look at foreign direct investments through different perspectives.

The first comparison deals with equity capital inflows, classifying it according to the volume of inflows. A significant increase in the lower categories would be consistent with the idea that investors are bringing the minimum required capital in order to convert it into portfolio flows afterwards. Three out of four categories under US$100 million reported higher growth in 2011 (Table 1). Overall, inflows under the US$100 million threshold increased 41.5% y-o-y in 2011, compared to a 14.8% growth in the previous year. Nonetheless, we can also observe a significant increase for transactions with higher volume of inflows. Transactions above US$ 100 million amounted to 52% of the total increase in equity capital inflows in 2011. Therefore, considering that higher investments in equity capital also represent a stronger commitment to the performed operation, it is hard to argue that the recent surge in equity flows of FDI resulted mainly from disguised portfolio investments. Indeed, the data indicates a significant increase in transactions that are more likely to stem from de facto productive investments.

A third possible approach to address this issue focuses on possible changes in volatility of FDI flows, which would be expected if FPI flows were being “disguised” as FDI. IPEA released a study where it estimated the volatility of FDI flows prior and after the introduction of the 6% IOF for fixed income portfolio investments.

The argument behind this approach is based on the fact that portfolio investments are characterized by higher volatility due to their speculative nature aimed at short-term financial gains. Using a time series approach for heterocedastic series, they model the mean and the variance for FDI flows. IPEA finds evidence that the volatility of FDI increases from December 2010 and this happens at the same time that we observe an increase in the volume of FDI. Then they run the same analysis for the different categories of FDI (intercompany loans and equity flows) using gross figures. Their conclusion is that the increase in FDI resulted from both higher volumes of equity capital and intercompany loans. Regarding volatility, IPEA points out that the higher volatility in FDI results mainly from equity capital inflows. Inflows of intercompany loans and outflows of intercompany and equity

### Table 1: FDI – Equity Capital by Volume

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<tr>
<td>Transactions lower than or equal to US$10 million</td>
<td>5,868.00</td>
<td>6,536.00</td>
<td>11.4%</td>
<td>8,767.00</td>
<td>34.1%</td>
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<tr>
<td>Transactions between US$10 million and US$20 million</td>
<td>2,337.00</td>
<td>3,024.00</td>
<td>25.4%</td>
<td>3,807.00</td>
<td>25.9%</td>
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<td>Transactions between US$20 million and US$50 million</td>
<td>4,809.00</td>
<td>5,442.00</td>
<td>13.2%</td>
<td>7,918.00</td>
<td>45.5%</td>
</tr>
<tr>
<td>Transactions between US$50 million and US$100 million</td>
<td>4,077.00</td>
<td>4,623.00</td>
<td>13.4%</td>
<td>7,284.00</td>
<td>57.6%</td>
</tr>
<tr>
<td>Transactions between US$100 million and US$500 million</td>
<td>7,303.00</td>
<td>11,086.00</td>
<td>51.8%</td>
<td>15,311.00</td>
<td>38.1%</td>
</tr>
<tr>
<td>Transactions between US$500 million and US$1 billion</td>
<td>5,525.00</td>
<td>4,947.00</td>
<td>-10.5%</td>
<td>7,450.00</td>
<td>51.4%</td>
</tr>
<tr>
<td>Transactions higher than US$1 billion</td>
<td>1,760.00</td>
<td>18,925.00</td>
<td>861.6%</td>
<td>18,955.00</td>
<td>12.0%</td>
</tr>
<tr>
<td>Total</td>
<td>31,679.00</td>
<td>52,583.00</td>
<td>66.0%</td>
<td>69,530.00</td>
<td>32.2%</td>
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capital are at a high historical level but volatilities have been higher during the worst period of the crisis in 2009.

On a different approach, IPEA estimated the standard deviation for FDI. We are now using a similar method using data until January 2012 and extending it to the components of productive investments.

Figure 5 confirms again that there was a substantial increase in FDI after the IOF tax on fixed income portfolio investments was raised to 6%. The new evidence comes from the red line, which shows the standard deviation for FDI in a 12-month period. The standard deviation is used here as a measure for volatility. We can observe that not just the volume of productive investments inflows increased, but also its volatility. Moreover, the standard deviation becomes considerably larger than the one observed during the 2008 crisis. It is also interesting to notice that in December 2011 the standard deviation drops to nearly the same level observed prior to October 2010. The timing coincides with the withdrawal of the 2% IOF over variable income portfolio investments.

We then use the same analysis for the components of FDI. Equity capital reports very similar results (Figure 6), suggesting that this was the channel most affected by the implementation of capital controls. Nonetheless, it is important to remember that equity capital responds for nearly 84% of total FDI and, therefore, both measures should follow similar paths.

Figure 6: 12-month average FDI – Equity Capital and standard deviation

The analysis for intercompany loans shows that this component reported higher volatility after the adoption of the 6% IOF. However, we can observe two curious behaviors (Figure 7). The first one relates to the level of volatility. The standard deviation increased after October 2010, but the magnitude of the increase wasn’t as impressive, barely overcoming volatility observed in previous years. Moreover, we can observe that volatility started dropping already during the second quarter of 2011. Under the hypothesis that multinationals are using their subsidiaries to perform portfolio investments, the worsening of the global economy, which led to more risk averse investors, and the inversion of the monetary policy cycle during the second half of that year could have contributed to a reduction in FPI and, indirectly, to decline in intercompany loans volatility.

Concluding Remarks

Evidence on volatility indicates that suspicions over FPI having been “disguised” as foreign direct investments could be consistent with existing data. Nonetheless, by looking at the composition of equity flows we observe that large transactions corresponded to more than half of the total increase in 2011, suggesting that there has also been a considerable “real” increase in productive investments in the last year.

Going forward, it is not hard to imagine that the Brazilian government may adopt further measures on capital controls in order to sustain the exchange rate at a reasonable level and protect domestic production. The Central Bank has indicated it will continue decreasing the policy rate, which could provide some relief regarding exchange rate pressures stemming from carry-trade operations, at least as long as inflation continues on a declining trend.
**Early Child Education: Making Programs Work for Brazil’s Most Important Generation**

By David Evans and Katrina Kosec

An exhaustive analysis of literature and data on early child education in Brazil, coupled with consultations with key policymakers in municipalities and states across the country, revealed a series of seven facts and seven implications about early child education in Brazil.

**The Facts**

Early child education (ECE) can have lasting positive impacts on children, with benefits far exceeding the costs. But quality is crucial. Evidence from the United States, Argentina, Chile, and elsewhere has shown long-term positive impacts of early child education. That evidence is now complemented by data from Brazil showing positive impacts of early child education – particularly pre-school – on short-run cognitive development, medium-run test scores, and long-run educational attainment and income. But simply enrolling children in ECE is no guarantee of success. Evidence from Brazil shows that children who attend low-quality pre-schools perform the same on literacy tests two years later as do children who attend no pre-school at all, whereas children in high-quality pre-schools perform much better.

**ECE matters most for the poorest children.** ECE is likely to have the greatest positive impacts on children coming from poorer and less-educated families where there is less cognitive stimulation at home. In Brazil, a study of adults in the Northeast and Southeast regions demonstrated that pre-school had bigger impacts on children with illiterate parents than on children with literate parents. Internationally, the strongest evidence for the value of ECE comes from high-quality programs closely targeting the most vulnerable children.

**There are stark disparities in ECE coverage across states, with some requiring massive expansions in the coming years to achieve intended universal pre-school coverage by 2016.** Achieving universal enrollment in pre-school will require almost 1.6 million new spaces. Reaching even thirty percent of children enrolled in creches would require over 1.3 million new spaces. Behind these massive numbers lies great variation across states (Figure 1). Six states have pre-school enrollment rates of under 60%, meaning that universal coverage would require close to doubling enrollment over five years. Likewise, six states have creche rates of under 10%, requiring a massive expansion to even reach the most vulnerable children.

Poor children and rural children are being left behind in early child education. Brazil’s poorest children are by far the least likely to be enrolled in creche or pre-school, and those poor children that are enrolled are much more likely to rely on public schools than their richer peers. The richest children are three times as likely to be in creche as the poorest children and 24% more likely to be in pre-school (Figure 2). Not only are wealthier families much more likely to provide their children with early child education: they are much more likely to use the private system. More than 85% of the poorest children who are in ECE use public institutions, whereas only around 10% of the wealthiest children do. Because private institutions tend to have higher quality, this gap further intensifies inequality of opportunity.

Quality in ECE centers in Brazil has improved over time but is still weak, particularly in activities to stimulate cognitive development. In certain key indicators,
such as physical infrastructure and caregiver-child ratios, ECE centers have improved over the past decade. Good infrastructure is an essential but far from sufficient condition for a high-quality ECE experience. A recent study of creches and pre-schools in six capital cities around Brazil found that ECE centers were strongest on interactions between caregivers and children, and weakest on activities and on a consistent program structure that lends itself to cognitive, social, and emotional development. Overall, using a scale that has been applied in several countries, 50% of creches and 30% of preschools rated inadequate, and none rated excellent. Quality outside capital municipalities is likely to be even lower.

Municipalities with higher income and more income inequality are less likely to expand investment in early child education. A study of Brazil's over 5,000 municipalities during 1995-2008 demonstrates two key points about municipal characteristics and ECE investment. First, public creches and pre-schools do not benefit all citizens equally. They disproportionately benefit poorer citizens, since they are the most likely to use these public services. Rich families tend to enroll their children in private ECE, and therefore are less invested in the public education system. Second, the distribution of income in a municipality hugely affects public ECE investment. Given extra revenue, poor and equal municipalities are more likely to expand public ECE than are richer and more unequal municipalities.

**Much innovation in Early Child Education in Brazil is taking place at the municipal level, providing models within the country to improve both access to and quality of ECE services.** Many municipalities are investing in their ECE programs, developing specialized curricula, monitoring systems, improved training for caregivers, and more. With over 5,000 municipalities across Brazil, there is great opportunity for these municipalities to learn from each other, thus enhancing quality and efficiency. For example, the Municipality of Santarém (State of Pará) has developed the program Eco-Schools, and the Municipality of Rio de Janeiro has developed a curriculum to provide parent training to parents which spans education, health, and social assistance. These tools and others like them represent a potent educational resource for other municipalities.

**The Policy implications**

Brazil will need to be strategic in where it invests in ECE and use creative models to reach the children. A 2009 Constitutional amendment lowered the mandatory school starting age to four years old, and the nation has a stated goal of achieving universal coverage by 2016. Given the 1.6 million children out of preschool, roll-out will have to be strategic even in that time period. In areas of lower population density, ECE centers may need to be constructed on a smaller-than-typical scale, or home visits and other delivery modalities may need to be used in order to cost-effectively satisfy needs for ECE. For example, in the municipality of São Paulo, 0.4 square kilometers of territory would be sufficient to fill an average-sized São Paulo pre-school with 4-5 year olds. However, in more rural Barra do Turvo municipality, also in São Paulo state, over 320 square kilometers would be required to fill an average-sized São Paulo pre-school.

It would be important for municipalities to aim at better targeting new centers and spaces at the poorest children (whose parents are not able to self-finance ECE), opening new centers in areas that will achieve this purpose. In public creches, a full twenty percent of scarce spots are taken by children from the richest fifth of families in Brazil (see Figure 2: ECE access by income quintile.)
Teachers need specific guidance on the best stimulation activities to use in the classroom, to complement existing ECE curricular guidelines. Teachers at Brazilian ECE centers rate relatively high on interactions, suggesting that these teachers are motivated to engage with children. But Brazilian ECE centers rate very poorly on effective activities for stimulating children’s cognitive and social development. What teachers lack is strong guidance on effective activities. Building on the Ministry of Education’s 1988 three-volume curricular guide for ECE, a valuable next step will be to provide practical workbooks or guides with lesson plans containing specific activities in pre-reading, pre-mathematics, and other areas, to help educators not only understand what are good activities, but also how to implement them. Some municipalities – such as the Municipality of Rio de Janeiro – are developing their own curricular guides in the meantime, with specific guidance on program structure and specific activities.

The federal government could consider encouraging strong municipal monitoring systems which keep ECE institutions accountable for their results, as well as introducing a standard observational tool, and providing licensing guidelines for minimum quality standards which municipalities can adapt. The Ministry of Education has established minimum standards of infrastructure quality for creches and pre-schools. The next step will be to establish an additional level of licensing guidelines, which will apply to child-caregiver ratios and caregiver qualifications. Municipalities can greatly improve quality by introducing standardized observational tools, such as the ITERS-R and ECERS-R instruments – among others – that allow for regular, systematic monitoring of the quality of activities and program structure.

Brazil could facilitate knowledge sharing across ECE providers so that they can learn from one another’s success stories. Given the great array of experimentation and innovation at the municipal level, the Ministry of Education can encourage knowledge sharing on a number of levels. The National Network for Early Childhood focuses on improving national policy. Two initiatives for more direct sharing of information have also been launched. One is the Network for Cooperation and Peace for Children, which is a social networking site (à la Facebook) where policymakers, non-profit workers, educators, and other interested citizens actively share information. A second initiative launched by the National Forum for Early Child Development and the World Bank, called the Network for Cooperation in Early Child Development, seeks to provide a map of early child development services across Brazil as well as a social networking site more focused on sharing exactly the kinds of materials described above: information on innovative programs, experiences, and best practices.

Integrating health services into creches and pre-schools can provide opportunities to improve child welfare in cost-effective ways, and would be facilitated by establishing a cross-sectoral coordinating agency. Multi-sectoral programs allow parents to know about and access all of the services they need to help their children flourish in one place, rather than having to separately seek out services of which – in some cases – they may not even be aware. The most established example of cross-sectoral collaboration in early child development in Brazil is the Rio Grande do Sul program, Primeira Infância Melhor. Brazil has also developed the National Plan for Early Childhood, prepared collaboratively by the National Network for Early Childhood. But if the Government of Brazil is serious about cross-sectoral collaboration on ECD, it will need to establish a coordinating agency to oversee its implementation.

Using participatory budgeting to distribute educational resources has the potential to lead to more equitable outcomes and to target resources at the poorest children. Participatory budgeting (PB) allows citizens to vote on how to use a share of municipal revenue designated for their neighborhood, and to elect neighborhood representatives to make municipality-wide spending decisions. Additionally, policymakers must publicize budgets and expenditures to promote transparency. PB increases political participation of marginalized groups and can lead to more pro-poor expenditures, including public investment in ECE.
The BET imposed itself as a natural need for the Bank’s work in Brazil. Knowledge is a central dimension of the Bank’s work in middle income countries, but Brazil is an über MIC whose experiences and work continuously push the envelope for the rest of the Bank and other developing countries. The Quarterly and the BET sought to bring the leading edges of economic thought of the Bank on Brazil to the broader public.

The work we do here epitomizes the relationship with a sophisticated, highly demanding client – or clients, as there are numerous from the Federal to the states to the large municipalities – that has access to other leading sources of knowledge and funding. Whether through long term analytical contributions (such as the Low Carbon Study, or the Aging report), just-in-time non-lending technical assistance (as in the aftermath of the floods in 2011) or conferences (such as the Human Development series with Rio), the Bank’s knowledge operations were complemented and supported by the BET products.

Also, as a very decentralized country, with different demands from the federal, state and municipal levels, Brazil is a unique sounding board for middle income country innovation and service delivery, and the unifying factor is the knowledge agenda.

To be relevant, the Quarterly and the BET had to reach these high standards. I think that it achieved this. For this reason, this experience is now known beyond Brazil. MIC clients and their sophisticated development and academic communities are looking up to the Bank not only to provide the traditional diagnostics, but to help them devise own ways to fix development problems, export and adapt their solutions, and upgrade their own analytical capacity, bringing in more than leading edge knowledge and experience, but also impact evaluation, south-south links and the Bank’s seal of approval and convening power. All of these have featured in these pages.

From challenging the existence of a credit crunch in the country, to dissecting the financial future of Brazil’s largest city – passing through the pros and cons of hosting the Olympics, the impact of the food crisis in Brazil and the dark side of financial integration – the Quarterly tackled topics that were at the forefront of the development debate.

So the BET and the Quarterly are really about much more than just one country. They are important and integral pieces of the knowledge agenda I sought to develop in Brazil, with much broader ramifications.

I am sure that the two dimensions of these agenda – the knowledge generated in the Brazil context, and the strategy behind this knowledge generation, will be useful in many other contexts, and I will certainly encourage this type of knowledge products in my new capacity as World Bank Vice President for Africa.

Enjoy the reading!

Makhtar Diop

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**Editorial**

(continued from page 1)

**In the Loop**

Some of the quarter’s noteworthy events

**Events**

- Quality of Labor Seminar in IPEA—September 12
- Fiscal Consolidation, Human Development and Public Sector Management: The experience of the municipality of Rio de Janeiro—September 22
- Treatment as Prevention Debate—November 10
- Brazil’s Middle Class Brown Bag Lunch with Ricardo Paes de Barros (SAE)—November 18
- Bridging the Atlantic—Brazil/Africa Cooperation—December 13
- Exploring the economic and social impacts of mining in Brazil—February 29
- Gender and Development in Brazil—March 6
- International Workshop on Involuntary Resettlement—March 27

**Projects Approved**

- META Energy and Mineral Strengthening—$49.6 million
- Plau Green Growth and Inclusion—$350 million
- PE Opportunities and Equity Program—$500 million
- Amazon Region Protected Areas (ARPA)—$15.9 million (GEF grant)
- São Bernardo Water Management—$20.8 million
- Pernambuco Rural Project—$100 million