World Bank Engagement at the State Level

The Cases of Brazil, India, Nigeria, and Russia

Evaluation Summary
THE WORLD BANK GROUP

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Inside—

Acknowledgments
Foreword
Executive Summary
Chairperson’s Comments: Informal Subcommittee on Development Effectiveness (CODE)
Abbreviations
Table of Contents to the Complete Volume
World Bank Engagement at the State Level

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—Evaluation Summary—
Acknowledgments

This report was prepared by the Independent Evaluation Group Country Evaluation and Regional Relations evaluation team: Konstantin Atanesyan (Task Team Leader, Senior Evaluation Officer), Basil Kavalsky (consultant), and Sarwat Jahan (consultant). It is based on the results of field visits to all four countries and interviews with key local (federal and state) counterparts and Bank teams.

The study draws extensively on four country background papers prepared by Joao Oliveira (Brazil), Tapas Sen (India), Olufemi Taiwo (Nigeria), and Galina Kurlyandskaya (Russia).

Ravi Kanbur (Cornell University), Steven Webb (Adviser, LCSPS), and Thomas O'Brien (Manager, SARDE) were the peer reviewers. Sarwat Jahan and Tim De Vaan provided data and research assistance. Cecilia Tan and Corky de Asis provided administrative support and William Hurlbut provided editorial support. Caroline McEuen edited the report for publication.

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Note: Vinod Thomas, Director-General, Evaluation, was recused from management oversight of the evaluation owing to his prior association with the Brazilian program as country director.
The Women in Movement Project sponsors an AIDS prevention clinic, Brazil. Photo by Alejandro Lipscyc, courtesy of the World Bank Photo Library.
This report summarizes the past 10 years (1998–2008) of World Bank engagement at the state level in selected large federal countries: Brazil, India, Nigeria, and Russia. This pilot cross-country study combines elements of a country assistance evaluation and a thematic review, looking at the evolution of four country strategies as well as the Bank’s state-level operations. The evaluation limited its review to selected cases of lending and analytic work where the state governments were the principal partners of the Bank and the primary party responsible for development outcomes.

Evaluating state-level engagement posed several strategic and operational questions, among them the selection of states, the scope, and the modalities of engagement. Two ideas—often at odds with one another—featured in most approaches to selection of states for direct engagement. One was to support better-performing, reformist states (the lead or focus states approach), while the other was to support the poorest states as a more direct route to reducing poverty.

The initial area of engagement was typically fiscal reform, where the Bank generally helped to enhance the capacity of state governments for public financial management. In some states Bank involvement extended to multisector engagement that usually involved a mix of analytic work, development policy lending, and investment lending, the aim being to derive synergies from the mix. The instruments deployed by the Bank evolved over the review period and included state-level development policy loans, multisector results-based investment lending, and reimbursable technical assistance. There was considerable successful innovation in the development of the instruments used, yet little knowledge sharing among countries.

The report identifies lessons and good practice examples that warrant further examination and wider dissemination. First, the study confirms the desirability of continued selective lending in a few focus states. The Bank’s engagement with progressive, reformist states has added value and has been highly appreciated, but to enhance the poverty impact of state-level interventions, greater weight should be given to the needs of the poorest states by balancing states’ propensity to reform and the concentration of poverty within them. Experience shows that it has been possible to achieve results in some of the poorer, low-capacity states through persistent work with committed state counterparts and partnerships with other donors. Second, continued focus on public finance management appears sound, irrespective of whether engagement is confined to this area or serves as an entry point for broader engagement. Third, there is considerable scope for greater impact from knowledge transfer and expanded knowledge services.

Cheryl W Gray
Director, IEG-World Bank
Gathering for a meeting in India. Photo by Curt Carnemark, courtesy of the World Bank Photo Library.
Beginning in the late 1990s, the World Bank significantly expanded its engagement at the state level in Brazil, India, Nigeria, and Russia. This pilot cross-country study reviews selected cases of World Bank lending and analytic work at the state level in those four large, federated countries. In each case, state governments were the Bank's principal development partners. The study looks at the evolution of the four country strategies, and the Bank's mode of engagement at the state level, to glean lessons from that experience for both the Bank and its federal and state partners.

State-level engagement posed several strategic and operational questions, among them which states to engage, the scope of engagement, and the modalities of engagement. The Bank set out its approach to selecting states in country strategy documents. Two tendencies—often at odds—featured in most approaches. One was to support better-performing, reformist states (the lead or focus states approach). The other was to support the poorest states as a more direct route to reducing poverty.

Concerning the scope of engagement, the initial and principal area of engagement was typically fiscal reform—fiscal sustainability, medium-term fiscal frameworks, strengthening the public financial management capacity of state governments, and fiscal federalism. In some states, Bank involvement extended beyond fiscal reform to multisector engagement focused on the growth and poverty reduction agenda. The modalities of engagement and the instruments deployed by the Bank evolved over the review period and included state-level development policy loans, multisector results-based investment lending, and reimbursable technical assistance. There was considerable successful innovation in this area, yet little knowledge sharing among countries.

The following findings are worth highlighting:

- First, the study confirms the desirability of continued selective Bank lending in a few states. But the poverty impact of those interventions could be enhanced by balancing the propensity of states to reform and the concentration of poverty within them, giving greater weight to the needs of the poorest states.
- Second, continued focus on public finance management as the core area appears sound, irrespective of whether engagement is confined to this area or it serves as an entry point for broader engagement.
- Third, there is considerable scope to gain greater impact from analytic work, knowledge transfer, and expanded knowledge sharing—not so much in concepts and theories as in the practical experience of what works and what does not.

**Evolution of Bank Strategy**

**Why State-Level Engagement?**

Over the past decade, the World Bank significantly expanded its engagement at the state level in four large federations: Brazil, India, Nigeria, and Russia, mainly through lending, but also through policy dialogue, technical advice, and
analytic work. Both demand and supply factors contributed to this expansion.

On the demand side, federal governments focused on fiscal stabilization following the financial crises of the late 1990s. They saw the potential for the Bank to provide state governments with incentives for reform through financing, while encouraging discipline through agreed policy measures and provision of technical support for implementation. Federal governments had limited scope to differentiate among states based on factors such as commitment to reform. They saw in the Bank's capacity to do this a means of assisting states willing to take the lead, with the possibility of a demonstration effect for other states.

State governments were also eager to borrow from the Bank because its loans, denominated in foreign currency, generally came at lower rates than those provided by the federal government or the domestic market. Bank loans, while often financially modest at the federal level, could be a major source of financing at the state level. State governments welcomed the Bank's focus on their economy as well as the associated dialogue, advice, and analytic work. In addition, with the increasing concern about meeting or achieving outcomes with regard to the Millennium Development Goals, both federal and state governments saw the Bank as having a comparative advantage in supporting better service delivery in the relevant social and economic sectors at the state level.

On the supply side, with the combination of fiscal stabilization and improvement in the fiscal situation of the four countries during the commodity boom of 2000–07, there was limited appetite to borrow from the Bank for federal programs (this trend was more pronounced in Brazil and Russia; Nigeria, an International Development Association [IDA] borrower, was an exception; in India, federal-level borrowing increased slightly in 2004–07). A level of Bank engagement commensurate with the size and importance of these countries almost mandated the shift to the state level, where demand remained buoyant. The increasing focus of the Bank on poverty reduction after 1995 was also an important factor. There is a distance between federal-level programs and results on the ground in such large countries. The majority of the public expenditure categories most closely associated with poverty reduction in the short and long terms are usually state responsibilities in these countries. Therefore, increasing the Bank's impact on poverty reduction meant increasing the focus on and activities at the state level. In addition, many Bank country and sector staff found work at the state level in these countries more rewarding, given the clients' greater interest in the Bank's financial and knowledge resources.

<table>
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<tr>
<th>Countries/operations</th>
<th>Number of loans</th>
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<th>Amount (US$ billions)</th>
<th>Percentage of state lending</th>
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<td>Total</td>
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<td>Nigeria</td>
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**Which States?**

The shift to the state level presented the Bank with a number of operational issues. Among them was which states the Bank should engage. The four countries have large numbers of states—26 states and a Federal District in Brazil, 28 states and 7 Union Territories in India, 36 states and a Federal Capital Territory in Nigeria, and 83 regions ("subjects of the federation"—republics, oblasts, krais, and okrugs) in Russia. Working in all of them would obviously be beyond the Bank’s budgetary and human resource capacities.

The Bank defined the strategic approach to the selection of states in its Country Assistance Strategies (CASs). Some attempts were made to develop quantified criteria for selective engagement, but the Bank generally preferred to keep the criteria broad to allow for flexibility. It is clear from all the countries reviewed that there was tension between the Bank’s interest in identifying progressive, reforming states that could serve as demonstrations to others and its interest in supporting poverty reduction by assisting the poorest states. In addition to these two key criteria—effectiveness of assistance and need (poverty)—another equally important criterion was the political economy, unique in each country and including (but not limited to) relations between the federal center and the states; capacity and political affiliation of the state-level leadership; level of trust and the relationship of the Bank teams with the clients; and local politics and electoral cycles.

In Brazil, the shift toward states was proposed in a mid-1990s CAS, directing lending to creditworthy reforming states. The next CAS, prepared at the turn of the millennium, continued this approach, using criteria established by the federal Fiscal Responsibility Law (FRL) and stressing the intention of providing assistance to the states of the Northeast region with highest poverty levels. Lending to states became more multisectoral, and significant innovations were introduced, such as state-level sectorwide lending (multisector SWAp) and state-level development policy loans (DPLs). Both instruments were applied in states that had turned the corner fiscally, despite significant disparity in their income levels. The 2008 Country Partnership Strategy (CPS) (World Bank Group 2008) focused on a technical assistance program of modest size with the federal government and a major demand-driven lending program with states, conditioned on perceived commitment, ownership of reforms, and fiscal responsibility. The Bank engaged with some of the more prosperous and reformist states. Although initially the Bank attempted to expand investment lending, this proved cumbersome given the two-tier approvals required by the state and federal governments. As a result of joint consultations with state and federal counterparts, by 2008 the composition of state-level lending shifted toward cross-sectoral operations in support of economic policies and public sector reforms (DPLs and multisector SWAps).

In India, the Bank shifted its focus to the state level in the mid-1990s. At the time, states were facing financial problems, and both the federal and state authorities were keen to tap into the Bank’s resources and take advantage of technical assistance. The Bank opted for major involvement in progressive reforming states (the focus states approach). The 2004 CAS (World Bank Group 2004) signaled a change of strategy, noting that the focus on reforming states was leading to neglect of the lagging states. Therefore, the CAS proposed the provision of technical assistance to the lagging states and an effort to shift lending to them as well. This proved to be difficult. As the 2009 CAS completion report noted, while lending at the state level remained a large share of the overall program, the share of lagging states in the program actually declined.

In Nigeria, the Bank reactivated and intensified its lending activities after return to civilian rule in 1999. During that period, Bank strategy passed through two phases: a period of interim strategies (fiscal 2000–05) following re-engagement; and the fiscal 2005–09 CPS (AfDB, DFID, USAID, and World Bank Group 2009), when the Bank adopted a medium-term focus. Engagement at the state level in Nigeria was largely driven by the social and poverty reduction agendas, with focus...
on improving infrastructure and providing support for agricultural and rural development.

During the CPS period of fiscal 2005–09, the Bank's strategy formally moved to focus on well-performing states (lead states), seeking to leverage state efforts and resources by granting them access to a performance package. Five states were selected based on the government-led State Economic Empowerment and Development Strategy (SEEDS) benchmarking process.

in Russia, the mid-1990s CAS emphasized regional investment projects (despite recognition that they were expensive to prepare and supervise). The next CAS (World Bank Group 1999) outlined a phased shift in lending, away from investment projects in infrastructure and energy in favor of increased emphasis on systemic aspects of institutional development. A subsequent strategy in the early 2000s continued the strategy shift, emphasizing support for reforms at the regional level, particularly to strengthen public sector management. The 2005 CAS Progress Report (World Bank Group 2005) stated that work at the regional level was to be carried out in a multisectoral manner and would concentrate on a small number of regions in agreement with the federal government. The 2007 CPS (World Bank Group 2007) added a finishing touch: the plan for gradual shift to the new modalities of cooperation and instruments, such as the subnational facility that allows the Bank Group to provide funds without a sovereign guarantee to states and municipalities and provision of technical assistance on reimbursable basis (fee for service).

The Scope of Engagement

The second issue for the Bank was the scope of its engagement. In Brazil, India, and Nigeria, the Bank had carried out numerous state-specific projects as part of its support for nationwide sectoral programs. The decision about which states to engage—for example, in support for agriculture and rural development in India or education in Brazil—was sometimes a matter of strategic choice, but more often a matter of historical engagement or the availability of analytic work, based in turn on opportunistic involvement of the Bank in particular states. In the new context, the Bank was steering toward a new model of engagement. This tended to have two elements: support for fiscal reform and broader multisector engagement at the state level.

Fiscal Reform

The Bank expanded its involvement in fiscal reform in selected states. With the focus on stabilization

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**Figure 1: Distribution of Projects by State**

**A. Brazil**

- Bahia: 13%
- Sao Paulo: 8%
- Minas Gerais: 10%
- Pernambuco: 8%
- Goias: 12%
- Others: 49%

**B. India**

- Uttar Pradesh: 17%
- Andhra Pradesh: 15%
- Tamil Nadu: 8%
- Rajasthan: 8%
- Karnataka: 14%
- Others: 38%
and the need to reduce growing state deficits or enhance state public expenditure management capacity, the Bank engaged in two areas.

The first of these was fiscal federalism. Fiscal relations between the federal and state governments are politically highly sensitive, since this is often at the core of balancing regional interests. From a strictly economic perspective, the resources available to the state governments need to be balanced with their expenditure responsibilities. For many taxes it is more efficient to centralize collections. This disconnect generally creates an imbalance between the revenues collected by the states and their development mandate. In Brazil this imbalance is relatively modest, but in Nigeria it is very large. This means that the federal government is

Box 2: The Fiscal Adjustment Program in Brazil

As part of their 1997 debt restructuring agreement, states signed a Fiscal Adjustment Program (PAF) and committed to meet negotiated targets on financial debt/net real revenue ratio, a minimum primary surplus, maximum wage bill expenditure, minimum own-revenue collection, structural reforms and/or assets divestiture, and level of investment expenditures. The PAF is a three-year rolling fiscal program, annually monitored by the federal government, and revised as needed, up to the 30 years during which the state is under the obligations of the debt restructuring agreement. Of 26 states and the Federal District, only 2 states (Tocantins and Amapá), which had no significant outstanding debt, did not sign the agreement.

The PAFs have been a powerful instrument for fiscal and structural reforms at the state level and for supporting macroeconomic stabilization policies. Since the PAFs were signed, states have shown significant improvement in most of the relevant indicators. There has been a reduction of debt ratios, increasing revenue collections, and primary surpluses as a ratio of state net revenue. For some states, the proceeds from privatization were a significant contributor to amortization of debt. The program has shown mixed results with respect to structural reforms of the states, such as the social security system.

Although specifically designed to resolve the states' debt crisis of the 1980s, PAFs have been critically important, paving the way for the adoption of the Fiscal Responsibility Law (FRL) in 2000, which brought a more strategic approach for a sustainable fiscal policy in the Brazilian federation.

Source: IEG consultant reports and mission interviews.
required to transfer resources to the state, generally based on various formulas that take account of population, per capita income, and the state government’s own tax effort. In the countries reviewed, federal transfers have not been very effective in reducing disparities in expenditure capacity between states.

A second key issue in fiscal federalism concerns discretionary transfers from the center to the states, usually intended to provide an incentive to states to undertake high-priority programs. The government of India has used such schemes a great deal. For the Bank, the political sensitivities make fiscal federalism a difficult area for intervention unless there is an explicit request from the federal government. The Bank has undertaken substantial analytic work in this area. Russia, where new fiscal relations were being defined in the past decade, is a very good example.

A second and far larger part of Bank engagement in fiscal reform is its direct support to public finance management at the state level, including enhancements in tax capacity, modernizing the tax structure, developing a sustainable fiscal policy and medium-term expenditure framework, and improving budget and expenditure management. The Bank’s engagement model generally started with a trigger mechanism that required states to show commitment to fiscal reform.

This requirement was highly formalized in Brazil where the federal government requires strict adherence to the FRL. In India and Nigeria the requirements were less formalized, but generally related to timely budgeting and reporting. In Russia, criteria were established for participation in the fiscal reform projects supported by the Bank. Once the triggers were met, the Bank was able to further support fiscal reform through an engagement model that combined analytic work with multisector lending and focused technical assistance in the areas of fiscal and governance reform.

Elements of this model are present in each country. In Lagos, Nigeria, for example, intensive analytic work at the state level was combined with investment lending and technical assistance, but the Bank is only now considering the possibility of using multisector lending in support of its approach. In Andhra Pradesh and Orissa in India, the Bank carried out analytic work and subsequently used multisector loans to support fiscal reform, but technical advice, except that embedded in the analytic work and lending activities, has not been a focus of the approach. The Bank’s involvement with tax policy has been relatively light, the a focus of its efforts has been on budgeting and public expenditure management systems, and increasingly on the governance issues associated with transparency and accountability for efficient service delivery.

Multisector Engagement

In addition to fiscal engagement, the Bank has also undertaken a broader state-level multisector engagement, which has focused on the growth and poverty reduction agenda. This has involved a mix of analytic work, adjustment lending, and investment lending. The Bank produced an explicit strategy for its activities in a particular state in only a few cases. Such strategies were usually covered in broad-brush fashion in the CAS.

At its most developed, as in Andhra Pradesh in India and in Ceará in Brazil, the Bank programs combined investment lending in most of the core economic and social sectors with multisector lending. The objective was to derive synergies from the combination of activities. In Andhra Pradesh, for example, the Bank was explicit in its view that the difficult measures required for fiscal reform needed to be matched by increased investment in agriculture, rural development, health, and education to provide a politically acceptable package of reforms.

The selection of states for this broader engagement focused more on fiscal reform than on the broader poverty issue. The Bank spent a great deal of time in these countries supporting relatively high-income, high-capacity states (such as Minas Gerais in Brazil, St. Petersburg in Russia,
Box 3: The Bank Program in Andhra Pradesh

Andhra Pradesh is considered a middle-income state in India. In the late 1990s, Andhra Pradesh became one of the first Indian states to promote reform and fiscal adjustment and to reach out for Bank assistance. At the time, the Bank's strategy in India was to target the reforming states. Andhra Pradesh was selected as the initial focus state. The culmination of the Bank- Andhra Pradesh partnership was the Andhra Pradesh Economic Restructuring Project (APERP, 1998), a massive multisectoral loan underpinned by an agreed multiyear fiscal framework with a total loan/credit value of $540 million. This was essentially a DPL that had to be constructed as an investment loan, since Bank policy did not approve of subnational DPLs at that time.

After Bank policy on subnational DPLs changed, Andhra Pradesh received three DPLs (fiscal 2002, 2004, and 2007). The Bank's first state-level policy-based loan (S-PBL) to Andhra Pradesh addressed not only the need for fiscal adjustment, but also public expenditure management reform and restructuring of public enterprises, including privatization. The later DPLs added three specific sectoral foci: power, health, and education. The Bank's S-PBL program was controversial in India because it conflicted with populist measures such as free power and irrigation water for farmers. Despite the initial setback in the power and irrigation sectors, the S-PBLs not only ushered in fiscal correction but also helped Andhra Pradesh to become the frontrunner in a number of reform areas, with significant demonstration effect on other states: introducing a single-window clearance system for new investments; e-procurement on a wide scale, and so on.

Andhra Pradesh has also implemented a number of investment projects (in the rural poverty, forestry, water, and power sectors) over fiscal 1998-2008. The Bank has also supported significant nonlending activities in Andhra Pradesh. It started with the "Andhra Pradesh: Agenda for Economic Reforms" (World Bank 1997) report, which underpinned the subsequent lending program. In addition there have been several Andhra Pradesh Policy Notes covering issues such as fiscal and debt management and analysis of Andhra Pradesh's growth potential and public enterprise reform.

The portfolio of Andhra Pradesh has changed with the Bank's shift in strategy away from focus states to lagging states. While Bank's commitments to Andhra Pradesh had reached $1.5 billion by 2000, after the strategy shift in fiscal 2004, the Andhra Pradesh portfolio gradually fell. In June 2004 it comprised 10 percent of the total lending volume ($1.2 billion) and fell to 5 percent ($0.74 billion) in June 2008. At the time of the 2008 CAS, only one project planned for the state was considered firm (Andhra Pradesh Water Sector Improvement).


and Karnataka in India). While this support added value, it came at the expense of Bank efforts in poorer states that lack capacity.

**Modalities of Engagement**

_How to engage_ was also a concern for the Bank during the period, and there was considerable evolution in the approach. The first bridge to be crossed was the use of adjustment (development policy) lending at the state level (the first such adjustment loan was made in March 2000 to the state of Uttar Pradesh in India). Until that point the Bank had struggled to find an instrument to attach to its policy dialogue and strategic approach at the state level. The multisector restructuring loan in Andhra Pradesh, an investment loan undertaken in 1998, was a way to accomplish this, but it was an enormously costly operation to prepare and supervise.

Adjustment lending rapidly became the instrument of choice to support fiscal reform and statewide strategies in Brazil and India, but in Brazil there was a sense that it was less effective in reaching out to the line ministries in key sectors. The Bank's Brazil country team developed the innovative approach of a multisector SWAp, a results-based instrument with target indicators defined for each sector and disbursements associated with achievement of the targets. This had very positive outcomes: it brought to the fore the linkages required to achieve results, such as the need for improved water supply in order to reduce infant mortality. Another important innovation was the pioneering of reimbursable technical assistance at the state level in Russia. Bank budgets rarely allow the level of analytic work demanded by intensive engagement in three-to-five states, and an
Box 4: Multisector SWAp

SWAp's traditionally have been associated with a single sector. From this perspective, the SWAp's in Brazil are innovative because they were adapted to integrate several sectors and they were delivered at the state level. Ceará was the first state to implement a multisector SWAp. This loan aimed to strengthen social inclusion while preserving fiscal sustainability. It had a unique design, because it was an Adaptable Program Loan making use of a results-based SWAp loan modality.

The key innovative features of this loan were:

- **Multisectoral Model and Activities.** The loan had two components. The SWAp component supported time eligible expenditure programs across five key line sectors: health, education, water and sanitation, water source management, and environment. The technical assistance component primarily supported public sector management. Targeting six sectors assured that institutional reform synergies would take place across sectors.

- **Results-Based Disbursement.** The project emphasized the use of results-based disbursement. Disbursement depended on: (a) the borrower had reached specific disbursement-linked indicators mapped to each sector, (b) borrowers' primary surplus was above a certain threshold, (c) performance of Ceará on three other World Bank loans (water, education, and rural development), ensuring that these loans meet state physical as well as disbursement targets; and (d) the borrower had actually spent at least 70 percent of the amount budgeted for the specific sectors.

- **Disbursement to Treasury and Not to Sectors.** The Bank released its funds directly to the state treasury as a single tranche for reimbursement of expenditures under the various programs. It allowed the government to manage fiscal resources and allocations while forging a partnership between the central and the line operators.

The loan had varying degrees of success in achieving the desired outcomes in the targeted sectors. It was very successful in leveraging the Bank's support to ensure that sector expenditure levels, which had been about 25 percent of budgeted amounts before the start of the project, were up to 70 percent. The loan also helped to reinforce other traditional investment projects. Two of the three investment loans in Ceará were upgraded to satisfactory as a result of cross-conditionality. The downside of the modality of this loan is that it is complex and can be successfully implemented only if there is sufficient institutional capacity.

**Multisector SWAp's in Other Brazilian States: The Ceará SWAp model was sufficiently successful that a second SWAp was approved ($210 million, 2008). The model is also being replicated in Minas Gerais ($375 million, 2008), the Federal District ($130 million, 2009), and Paraná ($155 million, 2009). Each of these operations follows essentially the same SWAp structure, combining support to public sector management reforms with support for selected sector programs. In addition, each one links disbursements to the borrower's ability to meet specific performance targets over the course of the loan. The nature of the indicators varies in accordance with the institutional development of the state/sector. For example, the Minas Gerais SWAp relies to a greater degree than the others on outcome measures: appropriate "stretch goals" for one of Brazil's most developed states. In contrast, Ceará SWAp will use mainly output measures rather than outcome targets as disbursement indicators for the sector programs.**

The main findings of this review, which may be helpful in guiding the organization of future work at the state level, include:

**Findings**

Overall, the analysis leaves little doubt that the Bank's engagement at the state level did add value. There was a great deal of enthusiasm at both the federal and state levels in these countries regarding the Bank's contribution and a large number of specific achievements. Although state-level engagement often requires additional effort and can be resource-intensive, it is usually worth the cost.

On selection of states:
EXECUTIVE SUMMARY

Box 5: Client Views

Federal- and state-level clients broadly considered the Bank’s state-level engagement useful and timely. But views differed from country to country on specific aspects, such as modalities of engagement and mix of products.

In Brazil, for example, both federal and state authorities seemed to prefer DPLs and multisector SWAps. Among the advantages they noted were flexibility, disbursement speed; and, most important, the role of these loans in helping to establish and institutionalize policy coordination in the state government.

In Nigeria, federal authorities expressed strong reservations about adjustment lending in general, yet a few high-level state officials expressed interest in multisector SWAps, and possibly even state-level DPLs.

In all cases, the federal governments have the final say about whether the Bank will lend to a particular state, because they approve the operations and provide the sovereign guarantee required by the Bank. The states take full responsibility for the financial execution and implementation.

In all four cases, federal governments have been supportive of the Bank’s strategy of state-level engagement. Most federal governments value the discipline associated with Bank lending to the states. In Brazil, for example, the federal government appears to put considerable weight on Bank lending as a mechanism for reinforcing compliance with the FRL.

In all four countries, a detailed and structured process at the federal level for approving proposals for state borrowing is in place.

In Brazil and Russia, the federal governments have seen borrowing by states and regions as a way of maintaining substantial Bank engagement and presence in the country, despite the sizeable resource inflows and rising per capita income level of the past decade.

Source: IEG mission interviews.

- While it would be naïve to argue that political considerations do not enter into the state selection process, in practice decisions on the eligibility of states for selection are dominated by technocratic considerations. In the choice of which of the eligible states to support, both governments and the Bank have generally tried to avoid the perception of bias by including both pro-government and opposition-led states.

- The scope of engagement:
  - Continued focus on public finance management as the core area for state-level work appears sound, whether engagement is confined to this area or it serves as an entry point for broader engagement.
  - The lending programs and Bank budgets in some states are often larger than for many Bank clients. For states where the Bank plans or has a major engagement, a brief state strategy document could be a useful tool for defining the scope of engagement and developing a medium-term outlook.

- Modalities of engagement:
  - There is considerable scope for greater impact from knowledge transfer and expanded knowledge services. In particular, there is strong demand for better knowledge sharing, both within the Bank and across the countries concerned. This is not so much a matter of sharing of concepts and theories as it is of communicating practical experience regarding what is working and what is not.
• Widening the scope and increasing the amount of analytical work at the state level could be helpful in identifying high-impact, high-priority areas. There seems to be a potential for closer partnership between state governments and the Bank in this area.

References
Chairperson’s Comments:
Informal Subcommittee of the Committee on Development Effectiveness (CODE)

On September 21, 2009, the Informal Subcommittee of the Committee on Development Effectiveness (CODE) considered an Independent Evaluation Group (IEG) report entitled *World Bank Engagement at the State Level: The Cases of Brazil, India, Nigeria, and Russia*. Staff representatives from the four countries considered in the report were present at the meeting.

**Summary**
Members commended IEG for the well-written and informative report and welcomed management’s broad agreement with its findings. The Subcommittee held a rich discussion, where members noted the importance of this report as a basis for further considering the direction and potential of state-level engagement by the Bank. Some members remarked on the considerable innovation and creativity in this area, which was considered a critical aspect of a country’s development. Going forward, the need to bear in mind the poverty focus in engaging at the state level and to strengthen knowledge sharing within and across countries was noted. Members’ interventions focused on IEG’s findings related to the need for the Bank to have a strategic approach to state-level support, selection of states, modalities of engagement, and knowledge transfer, which are elaborated below. The comparative analyses of the experiences in the four countries covered by the report and staff elaboration of country experiences were appreciated.

**Recommendations and Next Steps**
The Subcommittee recommended the following to management:

- Consider this IEG report as a basis for further thinking toward a more comprehensive framework to guide the Bank’s engagement at the state level, and to continue adjusting its instruments to meet the needs of the states.
- Maintain a flexible approach to selection of states, to accommodate different country contexts while keeping in mind the poverty focus.
- Consider ways to strengthen systematic knowledge sharing and learning from ongoing work at the state level.

**Main Issues Discussed**

**Framework for Bank Engagement.** Some members noted the potential benefit of IEG’s suggestion to prepare brief state-level strategy documents for states with significant long-term Bank engagement. Management clarified that the strategic analysis and dialogue with client countries on the Bank’s engagement at the state level...
level takes place as part of the CAS process. It also expressed concerns about adding another layer of strategy paper, but noted that integrating separate strategies for the most important state clients within a CAS could be a useful way to approach this issue.

Selection of States. Members supported selectivity in engaging at the state level and discussed the approach to selecting states, i.e., whether the Bank should work with more progressive, reformist states or with poorer states in light of IEG's findings, taking into consideration the Bank's mandate to reduce poverty and the potential added value of focusing on lagging states. There was general consensus to preserve flexibility to accommodate different country contexts and political economies and enable the Bank to work with active state actors at the state and sub-state levels, while keeping in mind the poverty focus.

The importance of transparency in selecting states was emphasized. IEG noted the tension between the two approaches and reiterated that to enhance the poverty impact of state-level intervention, greater weight to the needs of the poorest states was merited since there was no clear evidence of the desired demonstration effect. IEG added that it is possible to achieve results through persistent work, even in the poorest and low-capacity states. Management commented on the country realities that have driven the selection of states, as in the case of India, where the Bank is making an effort to work more with lagging states. Reference was also made to the CPS in Nigeria that describes the principles of engagement at the state level; a key principle is the level of human development indicators.

Federal Government and States. Some questions were raised about ownership and involvement of the federal government with regard to Bank assistance to states and any tensions encountered between the federal and state levels. In addition, interest was expressed in the Bank's comparative advantage in working directly with states, the costs and benefits of working directly with states, and approaches to addressing foreign exchange risks at state levels. IEG and management stressed that Bank engagement at the state level is predicated on federal government support. Referring to the example of Brazil, management also noted that the federal government has encouraged Bank involvement at the state level as a way to incentivize states to carry out difficult reforms (such as reducing the fiscal deficit). It also indicated that the Treasury Department has offered assistance to Indian states interested in addressing exchange rate risks.

Scope and Modality of Support. Some members highlighted the potential for Bank support for fiscal federalism and governance and capacity building at the state level. A member sought more clarity on the outcomes of fiscal reforms and another encouraged conducting Public Expenditure Reviews at the state level. Others emphasized the importance of analytical work at the state level, including in lagging states. A few members suggested that the IFC model of state-level support be reviewed. Management described some of the ongoing analytical work at the state level such as the Doing Business reports in Russia and Nigeria, Public Expenditure Reviews in Nigeria, and Social Expenditure Reviews in Russia.

Demonstration Effect and Knowledge Sharing. A few members sought more clarity regarding the limited demonstration effect on lagging states, noting that the experience in Russia seems to have been more positive. Speakers stressed the importance of strengthening knowledge sharing across states and countries. For example, the potential for other countries to learn from Russia's experience with fee-based services was noted. A few members urged that the Bank should give the highest priority to demand for services where the recipient was willing to pay a fee, because this indicated the seriousness and the will to carry out reform and change. The possibility of a Global Expert Team to improve knowledge sharing among staff was suggested. Management elaborated on the demonstration effect in Nigeria and Russia. The Nigeria country team representative described their
efforts in reaching out to other regional departments to learn from their experience and about sharing of experience across states through the Governor's Forum in Nigeria. It was also noted that there have been institutional efforts to share experiences on provision of fee-based services. It was noted that Brazil is now considering fee-based services at the state level.

Giovanni Majnoni, Chairman
View down the boulevard with high-rise construction in the background, Russian Federation. Photo by Yuri Kozyrev, courtesy of the World Bank Photo Library.
Abbreviations

CAS: Country Assistance Strategy
CODE: Committee on Development Effectiveness
CPS: Country Partnership Strategy
DPL: Development policy lending/loan
FRL: Fiscal Responsibility Law
IDA: International Development Association
IEG: Independent Evaluation Group (World Bank Group)
IFC: International Finance Corporation
SEEDS: State Economic Empowerment and Development Strategy
SWAp: Sector wide approach

All dollar ($) amounts are in U.S. dollars.
Contents of the Complete Volume

Abbreviations
Acknowledgments
Foreword
Executive Summary
Chairperson's Comments: Informal Subcommittee of the Committee on Development Effectiveness (CODE)

1. Introduction
   Background
   Scope and Objective of the Evaluation
   Structure

   Brazil
   India
   Nigeria
   Russia
   Conclusions

3. The Scope of Bank Engagement
   Fiscal Reform
   Fiscal Federalism
   Fiscal Capacity at the State Level
   Multisector Engagement at the State Level
   State-Level Strategies

4. Modalities of State-Level Engagement
   Evolution of Instruments
   Multisector SWApS and State-Level DPLs
   Investment Lending at the State Level
   Capacity Building and AAA
   Implementation Arrangements and Staffing
   Partnership

5. Summary of Findings

Appendixes
   A: Portfolio Performance
   B: Key Fiscal Indicators and Legal Framework at the State Level
   C: The Global Financial Crisis and State-Level Lending
   D: Countries at a Glance
   E: Key State Social and Economic Indicators
   F: Distribution of Projects by States
G: Fiscal Responsibility Law—Brazil
H: Partnerships with Other Development Agencies
I: People Met

Endnotes

Bibliography

Boxes
3.1: Increasing Use of Earmarked Transfers in India and Russia
3.2: The Fiscal Adjustment Program in Brazil
3.3: Analytic Work on Fiscal Federalism in Russia
3.4: Improved Governance in the Fiscal Area in Orissa
3.5: Bank Program in Andhra Pradesh
4.1: Multisector SWAp
4.2: Minas Gerais—From Management Shock to Results-Oriented State
4.3: Bank Engagement in Bihar: An Example of Effective Partnership
4.4: Client Views

Figure
1.1: Distribution of Projects by State

Tables
1.1: Bank Lending to State/Provincial Governments (1998–2008)
2.1: Comparative Data on Population and Gross Domestic Product per Capita in States/Regions
2.2: Evolution of Bank Engagement in Brazil, Fiscal 1998–2009 CASs
2.5: Evolution of Bank Engagement in Russia, Fiscal 1998–2008
IEG PUBLICATIONS

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