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Investing in rural people

President's memorandum

Extension of the time limit for signature of the financing agreement with the

State of Pernambuco of the Federative Republic of Brazil for the

Sustainable Rural Development Project in the Territories of the Zona da Mata and Agreste of Pernambuco

Note to Executive Board representatives

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For: Approval

Recommendation for approval

Given the importance of this project to supporting poor smallholder farmers in the State of Pernambuco, and taking into consideration the commitment of the State Government to the project, it is recommended that the Executive Board approve a 12-month extension – to 30 March 2021 – of the deadline for signing the financing agreement for the Sustainable Rural Development Project in the Territories of the Zona da Mata and Agreste of Pernambuco.

I. Background

1. The Sustainable Rural Development Project in the Territories of the Zona da Mata and Agreste of Pernambuco (PE-PRODUZ) was approved through the lapse-of-time (LOT) procedure by the Executive Board on 30 March 2018. The project cost of US\$40.0 million is financed by an IFAD loan of US\$20.0 million, a counterpart contribution of US\$16.0 million from the State of Pernambuco (the borrower) and a contribution of US\$4.0 million from the beneficiaries. The IFAD loan is guaranteed by the Federal Republic of Brazil.
2. PE-PRODUZ is designed to address capacity constraints at three levels: (i) community development; (ii) the strengthening of economic organizations of smallholder producers; and (iii) capacity-building among government and civil society entities.
3. **Key project objective.** The overall goal is to reduce rural poverty and promote sustainable development through a territorial approach and more effective access to public programmes.
4. **Deadline for signature.** The deadline for signature of the financing agreement is 30 March 2020. Following IFAD rules for projects approved before the Executive Board session of December 2018, IFAD's financing commitment will be automatically cancelled for financing agreements that have not been signed within 24 months of approval.
5. In a letter dated 28 November 2019, the Government of Pernambuco informed IFAD that the State's creditworthiness rating by the Federal Government still did not allow it to sign the financing agreement. In the same letter, the Government requested a 12-month extension for the signing of the agreement.

II. Status of loan signature

6. When the financing agreement was negotiated in January 2018, the State's credit rating by the Federal Government was favourable. Shortly after approval, the Federal Government modified the criteria for assessing the creditworthiness of the States. As a result, the State of Pernambuco dropped in its rating on the fiscal debt capacity (CAPAG) scale from B, which permits external borrowing, to C, which does not. As such, the conditions for signing the financing agreement became unfavourable.
7. Since early 2018, the Government of Pernambuco has been making major efforts to improve its fiscal situation. It has already partially achieved this, as evidenced by its reduced expenses and the reversal of the State accounts from a deficit in 2017 to a surplus in 2018. The State has yet to achieve certain targets under the Fiscal Responsibility Law, but it is at an advanced stage in the process of accessing the Fiscal Equilibrium Plan (FEP). The FEP has been designed specifically to support the transition of selected States from CAPAG C to B, provided the States introduce fiscal reforms according to targets closely monitored by the National Treasury. Pernambuco is one of the few States in Brazil that has met the criteria for accessing the FEP and is the first State in Brazil to qualify for it. Pernambuco is set to adopt the plan in early 2020 so as to achieve CAPAG B by the end of the year.

In addition, as part of its efforts to introduce fiscal reform measures, it has obtained a loan from the Inter-American Development Bank, which became effective in October 2019, for Modernization and Transparency Support to Fiscal Management (PROFISCO) for the State of Pernambuco. This loan was exempt from CAPAG as part of the fiscal reform introduced by the State.

8. PE-PRODUZ remains fully relevant and is a high-priority operation for the Government of Pernambuco. Moreover, the State of Pernambuco participates in many IFAD-supported knowledge management activities in the country in order to enhance its implementation readiness.

III. Recommendation

9. Based on the information and the rationale described above, it is recommended that the Executive Board approve a 12-month extension – to 30 March 2021 – of the deadline for signing the financing agreement for the PE-PRODUZ.