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AID's Experience with Minas Gerais High ·y Maintenance Program

PD-AAF-143-A1

SUMMARY

The State of Minas Gerais is seriously delinquent in meeting financial obligations undertaken in connection with a $15 million A.I.D. Highway Maintenance Loan to the Minas Gerais State Highway Department (DER/MG). Moreover, DER/MG has failed to take a number of organizational steps wh· ·h are clearly essential to the success of the program. Becau·e this grave situation, USAID suspended disbursements under this loan in July 1967. Intensive efforts over the past 18 months to develop a program which would enable Minas Gerais to meet its commitments so far have not been successful. USAID recently ordered a special audit to determine the exact magnitude of non-performance and/is considering withdrawing from the program. Pending resolution of this situation, USAID has applied a moratorium on other loans to the State of Minas Gerais, including a major program in secondary education.

FINANCIAL SITUATION

In July, 1965, a loan of $15 million was made to the State of Minas Gerais to finance the purchase of equipment and technical services to develop the State's Highway Department. The loan is guaranteed by the Government of Brazil. Most of the maintenance equipment under the loan has been procured and delivered to Brazil. The loan agreement provides for a State and Federal Government contribution of $21.4 million in local currency to finance Brazilian-made equipment and certain supporting costs. Approximately 90 percent of the revenues that support the DER/MG come from the National Highway Fund (from Fuels tax earmarked for NHF) and matching funds from the Treasury of Minas Gerais State. In the DER/MG budget, the monies from the National Highway Fund have been earmarked exclusively for the maintenance operations, and the State matching fund is set aside for road construction and capital improvements.

Early in January 1967 it was evident that the DER/MG was in financial difficulty as their 1966 revenues from NHF were almost NCr$20,000,000 below the level anticipated for the year 1966. DER/MG's financial difficulty was aggravated by provision in the new Brazilian Constitution of March 15, 1967 which reduced the states' portion of the NHF from, 48% to 32%. To compensate for the loss of revenue, states were permitted to impose a state-wide circulation tax (ICM) on fuel and lubricants. However, before the ICM tax could go into effect, the President of Brazil, by Decree No. 319 of March 27, 1967, postponed collection of this ICM tax until January 1968.

This serious plight prompted a special USAID study of DER/MG's financial situation in mid 1967. This study revealed that the DER/MG was NCr$33 million in debt and that combined Federal/State contributions to the DER/MG during the first quarter of 1967 were only NCr$6.9 million, instead of the NCr$31.25 million foreseen in the 1967 budget. The USAID Deputy Director met with the Governor of Minas Gerais in May 1967 to work out a solution to these financial difficulties. The Governor guaranteed that sufficient funds would be made available. By the end of the second quarter, however, DER/MG's revenues totaled only NCr$16.5 million (NCr$10.7 million from NHF; NCr$5 million in State Treasury letters of credit and NCr$.8 in cash from the State Treasury). By July 1967 it was quite evident that such funds would not be forthcoming from the State and routine maintenance operations were cut back. In view of this poor financial performance, in July 1967 USAID suspended disbursements under this loan. The DER/MG subsequently received a NCr$5 million short term loan from the Bank of Brazil, but the situation with regard to state financing did not materially improve.

Negotiations with various state and federal officials continued during late 1967 and early 1968 with equally disappointing results. Another meeting with the Governor of Minas Gerais in February 1968 resulted in an agreement to apply receipts from the federal fuels tax (NCr$493 million estimate for Minas Gerais during 1968) and the proposed state vehicle registration tax (NCr$24 million) exclusively to the maintenance program, with additional required funds provided out of the state budget. However there were considerable delays in receipt of fuels tax revenues and consideration by the State legislature of the registration tax and thus the agreement was never fully implemented. As a result the DER/MG maintenance program continued to be severly handicapped by lack of funds. To compensate for the lack of revenue from these anticipated sources, in April the Governor agreed that the State would deposit NCr$1 million monthly, beginning May 1968, to help cover the deficit of the maintenance program. While these recent actions are somewhat encouraging, there is as yet no satisfactory eviddnce that the necessary funds are being deposited. On the basis of presently available evidence one can only conclude that Minas Gerais has not yet demonstrated the capacity to mobilize the funds necessary to successfully implement the maintenance program.

OPERATIONS REFORM

The DER/MG's performance in instituting a number of administrative and organizational changes, which form an integral part of the overall program, has also been discouraging. The following list indicates some of the more important measures which remain to be taken:

(a) Adoption of a cost accounting system, with an acceptable time-phased implementation;

(b) Implementation of a state-wide warehouse control system for fuels, materials, spare parts and components;

(c) Establishment of an equipment replacement schedule;

(d) Adoption of equipment standardization;

(e) Utilization of program on better use of equipment;

(f) Reformulation of in-service manual and organizational pattern.

CURRENT STATUS

In view of the serious financial and operational shortfalls, the USAID Mission recently ordered a comprehensive audit of DER/MG's operations and finances to determine the exact magnitude of non-compliance. USAID informed the DER/MG in July 1968 that it was considering the possibility of withdrawing from the Minas highway maintenance program. USAID pointed out that withdrawal would include placing the loans in default and accellerating repayment.

As a result of the substantial degree non-compliance on the part of Minas Gerais on this loan, USAID reluctantly decided to withhold further loans involving the State of Minas Gerais until its ability to meet its obligations had been re-established. The first casualty of the decision was a promising loan in support of the State's secondary education system.

COMMENT

The financial audit and analysis of operational procedures should be completed shortly. Hopefully, some means will be found to enable the State to meet its obligations under this loan. If not, the experience under this project puts into question Minas' ability to support foreign loans. Other major international lenders should be appraised of Minas' non-performance and the USAID Mission's present course of action, as they may wish to consider temporary deferral of projects involving the State until the situation is clarified.