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**MEXICO**

**SUBNATIONAL CREDIT LINE PROGRAM FOR PUBLIC INFRASTRUCTURE, PUBLIC SERVICES, INSTITUTION-STRENGTHENING, AND SUSTAINABLE DEVELOPMENT PROJECTS IN STATES AND MUNICIPIOS**

**(ME-L1059)**

**SECOND PROGRAM UNDER THE CONDITIONAL CREDIT LINE FOR INVESTMENT PROJECTS (CCLIP – ME-X1002)**

**Loan Proposal**

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ELECTRONIC LINKS	
<b>REQUIRED</b>	
1. Annual work plan for the first disbursement and the first 18 months of implementation	<a href="#">IDB Docs No. 35181325</a>
2. Monitoring and evaluation plan	<a href="#">IDB Docs No. 35342492</a>
3. Procurement plan – Itemized	<a href="#">IDB Docs No. 35181323</a>
<b>OPTIONAL</b>	
1. Comprehensive sustainable development program for the State of Yucatán	<a href="#">IDB Docs No. 35181179</a>
2. First operation under the CCLIP, loan proposal approved in 2008	<a href="#">IDB Docs No. 35171428</a>
3. Summary of the institutional assessment of BANOBRAS for CCLIP I (ICAS results)	<a href="#">IDB Docs No. 1382273</a>
4. Risk evaluation matrix	<a href="#">IDB Docs No. 35177247</a>
5. Draft Operating Regulations of the second operation under the CCLIP	<a href="#">IDB Docs No. 35171424</a>
6. Project profile. Strategic planning component	<a href="#">IDB Docs No. 35171448</a>
7. PADES – Proposed implementation arrangement for the Yucatán program	<a href="#">IDB Docs No. 35171470</a>
8. Project profile. Urban component	<a href="#">IDB Docs No. 35171433</a>
9. Project profile. Transport component	<a href="#">IDB Docs No. 35171473</a>
10. Project profile. Climate change component	<a href="#">IDB Docs. No. 35171475</a>
11. Project profile. Digital agenda component	<a href="#">IDB Docs No. 35171471</a>
12. Considerations for adjustments to the current integrated financial management system (IFMS) – LGCG	<a href="#">IDB Docs No. 35171464</a>
13. Javier Gala Palacios – Support for the public investment system of the state of Yucatán – Consultant’s report	<a href="#">IDB Docs No. 2047166</a>
14. Jorge Vidal Lopez – Support for the public investment system in the state of Yucatán – Environmental consulting engagement – Consultant’s report	<a href="#">IDB Docs No. 2057369</a>
15. Salvador Delgado Garza – Final report of the technical mission to support implementation of a results-based budgeting system in the state of Yucatán – Consultant’s report	<a href="#">IDB Docs No. 2035967</a>
16. Mario Loterszpil – Support for the public investment system in the state of Yucatán – Summary report	<a href="#">IDB Docs No. 2073118</a>
17. Environmental and social strategy (ESS)	<a href="#">IDB Docs No. 35170824</a>
18. Report Component 1– Identification and formulation of a development strategy for the state of Yucatán. Report to support the design of a program to integrate medium-term strategic planning with budget and financial management	<a href="#">IDB Docs No. 35342316</a>
19. Report Component 2 – Silvia Salvato – Financial management. Analysis of own revenue in state and municipal finances. Formulation of a medium-term fiscal plan. Basis for formulating a strategic institutional plan	<a href="#">IDB Docs No. 35537735</a>
20. Report Component 3 – Improving the quality and relevance of public investment. Report on a mechanism for planning, prioritization, and registration of public investment projects	In process (July 2011)
21. Digital agenda component – Mission report – Antonio Seco – SIAFY: Diagnostic assessment of the state’s current IFMS and presentation and discussion of the strategy to meet the short- and medium-term objectives of the consulting engagement (draft)	<a href="#">IDB Docs No. 35171480</a>
22. Digital agenda component: Preliminary report – Broadband network. Ricardo Martínez Garza Fernández, and Salma Jalife Villalón	<a href="#">IDB Docs No. 35171481</a>
23. Urban component – Mérida project: Profile, financial analysis, institutional analysis, social analysis, economic and cost-benefit analysis. Results matrix. Fund regulations	<a href="#">IDB Docs No. 35174507</a>
24. Urban component – Progreso project: Institutional analysis, social analysis, cost-benefit, economic report, financial evaluation, profile	<a href="#">IDB Docs No. 35174644</a>

25. Urban component – Environmental analysis (ESMR) – Manuel Felipe Olivera	<a href="#">IDB Docs No. 35177010</a>
26. Urban component – Urban development analysis	Progreso: <a href="#">IDB Docs No. 35174504</a> Mérida: <a href="#">IDB Docs No. 35174205</a>
27. Urban component – Economic evaluation	Progreso: <a href="#">IDB DocsNo.35174252</a> Mérida: <a href="#">IDB Docs No.35174260</a>
28. Urban component – Itemized budget	Mérida: <a href="#">IDB Docs No. 35174312</a> Progreso: <a href="#">IDB Docs No. 35174311</a>
29. Climate change component – Forest project presentation	<a href="#">IDB Docs No. 35172646</a>
30. Climate change component – Hog farm project presentation	<a href="#">IDB Docs No. 35172644</a>
31. Climate change component – Carbon feasibility study of the hog farm and forest projects	<a href="#">IDB Docs No. 35174562</a>
32. Climate change component – Fondo Maya presentation	<a href="#">IDB Docs No. 35172645</a>
33. Climate change component – Yucatán government prefeasibility study on hog farms (draft)	<a href="#">IDB Docs No. 35174558</a>
34. Transport component – Ulises Navarro – Sector diagnostic assessment and support for the design of a comprehensive urban transport program for Mérida and its metropolitan area	<a href="#">IDB Docs No. 35019538</a>
35. Transport component – Economic evaluation of Mérida’s PIMUS comprehensive sustainable urban mobility project. InfraFund.	In process
36. Transport component – Detailed design for implementation of Mérida’s PIMUS comprehensive sustainable urban mobility project	In process
37. Transport component –Environmental impact analysis of the transport project	In process
38. Transport component – Financial, legal, and organizational structure of the transport component. Includes an estimate of the costs and benefits, the legal supports required, and the execution structure for the component (section on institutional arrangements).	In process
39. Transport component – Awareness campaign strategy. Report containing an evaluation of needs, communication targets, awareness campaign strategy	In process
40. Fiscal component – INDETEC studies on the potential of the state of Yucatán for collecting own revenue and legal/regulatory diagnostic study of the regulatory framework governing own revenue of the state of Yucatán	<a href="#">IDB Docs No. 35180369</a>
41. Cost-benefit analysis methodology	<a href="#">IDB Docs No. 35342343</a>
42. Evaluation report, Program for Investment and Financial and Institutional Strengthening of States and Municipios (FORTEM) (1744/OC-ME). 2006.	<a href="#">IDB Docs No. 35790161</a>
43. Six-monthly report, Municipal Development and Management Program (1489/OC-UR). December 2010.	<a href="#">IDB Docs No. 35858708</a>
44. Component 1. Final report, “Design support for a statistical, geographic, and evaluation information plan of the State of Yucatán.”	<a href="#">IDB Docs No. 35951848</a>
45. Environmental classification and safeguards	<a href="#">IDB Docs No. 35220159</a>

## ABBREVIATIONS

BANOBRAS	Banco Nacional de Obras y Servicios Públicos, S.N.C.
CCLIP	Conditional credit line for investment projects
ESMR	Environmental and social management report
FORTEM	Programa de Inversiones y de Fortalecimiento Institucional y Financiero a Estados y Municipios [Program for Investment and Financial and Institutional Strengthening of States and Municipios]
ICB	International competitive bidding
IFMS	Integrated financial management system
INDETEC	Instituto para el Desarrollo Técnico de las Haciendas [Institute for the Technical Development of Public Finances]
InfraFund	Infrastructure Fund
ISP	Institutional strategic plan
LFPRH	Ley Federal de Presupuesto y Responsabilidad Hacendaria [Federal Budget and Fiscal Responsibility Law]
LGCG	Ley General de Contabilidad Gubernamental [General Act in respect of Government Accounting]
NCB	National competitive bidding
PIMUS	Proyecto Integral de Movilidad Urbana Sustentable [Comprehensive Sustainable Urban Mobility Project], Mérida
PRODEV	Program to Implement the External Pillar of the Medium-term Action Plan for Development Effectiveness
PSPs	Public service and infrastructure providers
SHCP	Department of Finance
SIAFyP	Sistema Integrado de Administración Financiera y Presupuestaria [integrated financial and budget management system]
SNGs	Subnational governments

## PROJECT SUMMARY

### MEXICO

#### SUBNATIONAL CREDIT LINE PROGRAM FOR PUBLIC INFRASTRUCTURE, PUBLIC SERVICES, INSTITUTION-STRENGTHENING, AND SUSTAINABLE DEVELOPMENT PROJECTS IN STATES AND MUNICIPIOS (ME-L1059)

#### SECOND PROGRAM UNDER THE CONDITIONAL CREDIT LINE FOR INVESTMENT PROJECTS (CCLIP – ME-X1002)

Financial Terms and Conditions			
<b>Borrower and executing agency:</b> Banco Nacional de Obras y Servicios Públicos, S.N.C. (BANOBRAS) <b>Guarantor:</b> United Mexican States		Amortization period of the second program:	25 years
		Grace period of the second program:	5 years
		Disbursement period:	5 years
<b>Source</b>	<b>Amount</b>	Inspection and supervision fee:	*
IDB (Ordinary Capital)	Up to US\$310 million	Interest rate:	LIBOR
Total:	Up to US\$310 million	Credit fee:	*
		Currency:	U.S. dollars from the Single Currency Facility
		Conversion to Mexican pesos:	Local Currency Facility
Project at a Glance			
<b>Objective and description:</b> The program objective is to contribute to improving public infrastructure and public services and to strengthening the institutional capacity of the subborrowers. The program will pay special attention to supporting the strengthening of subnational governments in planning, fiscal management, investment management, and other areas in a framework of fiscal and financial sustainability.			
<b>Special contractual conditions:</b> As a condition precedent to the first disbursement, the borrower will obtain the Bank's no objection to the Operating Regulations for the second program under the CCLIP (see paragraph 3.1).			
<b>Exceptions to Bank policies:</b> None.			
<b>Special considerations:</b> Pursuant to the approved provisions for the CCLIP, procurement policies are waived for disbursements under the portfolio originated by BANOBRAS (see paragraph 3.6).			
<b>Project consistent with country strategy:</b> Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>			
<b>Project qualifies as:</b> SEQ <input type="checkbox"/> PTI <input checked="" type="checkbox"/> Sector <input type="checkbox"/> Geographic <input checked="" type="checkbox"/> Headcount <input type="checkbox"/>			
<b>Procurement:</b> Policy GN-2349-9 will be applied for works and goods, and policy GN-2350-9 for consulting services.			

\* The credit fee and inspection and supervision fee will be established periodically by the Board of Executive Directors as part of its review of the Bank's lending charges, in accordance with the applicable provisions of the Bank's policy on lending rate methodology for Ordinary Capital loans. In no case will the credit fee exceed 0.75% or the inspection and supervision fee exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

## I. DESCRIPTION AND RESULTS MONITORING

### A. Background, challenges, and rationale

- 1.1 This program is the second operation under the conditional credit line for investment projects (CCLIP – ME-X1002), approved on 12 November 2008 for US\$1.2 billion, to be executed over a period of up to 10 years. The first operation (ME-L1017, 2053/OC-ME) for US\$350 million, approved simultaneously with the credit line, is being executed satisfactorily. That operation has financed: (i) projects with water and sanitation companies; (ii) municipal projects; and (iii) projects with public service providers. As of 24 May 2011, US\$281 million (80%) had been disbursed under that first operation. There are commitments against the CCLIP with the Bank's no objection on the order of an additional US\$149 million (122% of the total).<sup>1</sup> The conditions for approval of a new operation under the CCLIP were fulfilled once 50% of total disbursements and/or 75% of total commitments were exceeded.
- 1.2 **Macroeconomic and fiscal framework.**<sup>2</sup> Mexico began a series of economic reforms in the mid-1990s that led to steady although moderate growth over the period 1996-2008 (3.6% of real annual GDP), with relatively low inflation. This result can be attributed to implementation of a monetary policy based on inflation targets, a flexible exchange rate, and prudent fiscal policy. The fiscal policy emphasized public debt reduction (particularly the external debt) to support fiscal sustainability and financial stability, with favorable results for controlling inflation (see Table 1.1).

**Table 1.1**  
**Main macroeconomic indicators 2005-2011 (% GDP)**

	2005	2006	2007	2008	2009	2010a	2011b
Real GDP (change %)	3.2	4.9	3.3	1.5	-6.1	5.5	4.0
Inflation rate (end-of-period)	3.3	4.1	3.8	6.5	3.6	4.4	3.0
Current account balance (% GDP)	-0.5	-0.5	-0.8	-1.5	-0.6	0.5	-1.5
Fiscal balance (% GDP)*	-0.1	0.1	0.0	-0.1	-2.3	-2.8	-2.5
Net public sector debt/GDP	35.2	32.4	31.4	35.8	38.8	39.1	39.0
Net international reserves**	68.7	67.7	78.0	85.4	90.8	113.0	120.8

Source: SHCP and International Monetary Fund.

\* The change in the series in 2009 reflects changes in methodological definitions and accounting principles.

\*\* In billions of U.S. dollars; a preliminary; b projected.

- 1.3 In recent years, the government has continued the process of fiscal reforms to strengthen public finances, buttress macroeconomic and financial stability, improve the quality and efficiency of spending, and bring about greater transparency in the use of public resources. The reforms included: (i) passage of the Federal Budget

<sup>1</sup> BANOBRAS has also informed the Bank that in March it approved a subloan on the order of US\$200 million to the State of Yucatán.

<sup>2</sup> The macroeconomic and fiscal framework has been adapted from work done recently by the project team of the Program to Strengthen Public Finance (loan ME-L1090), approved in 2010.

and Fiscal Responsibility Law (LFPRH) which established the Oil Income Stabilization Fund; (ii) a fiscal reform that included the establishment of new taxes and tax administration measures; (iii) introduction of results-based budgeting; (iv) a performance evaluation system; and (v) the Accounting Harmonization Law to better control public spending. The impact of these reforms is reflected in improved fiscal accounts in the years preceding the 2009 crisis (see Table 1.2).

**Table 1.2**  
**Fiscal balance, nonfinancial public sector, 2005-2011 (% GDP)**

	2005	2006	2007	2008	2009	2010a	2011b
Tax revenue*	8.6	9.0	9.3	10.0	9.4	10.0	10.7
Oil revenue	7.9	8.3	7.9	8.7	7.9	7.3	6.7
Primary expenditure	18.9	19.3	20.0	21.8	23.9	22.1	21.7
Traditional fiscal balance**	-0.1	0.1	0.0	-0.1	-2.3	-2.8	-2.5
Fiscal balance under the new fiscal rules***	—	—	0.0	-0.1	-0.2	-0.8	-0.5

Source: International Monetary Fund.

\* Excludes the special gasoline tax (special taxes on production and services, IEPS) and social security contributions.

\*\* The change in the series in 2009 reflects changes in definitions and accounting.

\*\*\* The LFPRH establishes that investments by Petróleos Mexicanos (PEMEX) will not be considered in evaluating the fiscal balance target; a preliminary; b projected.

- 1.4 The fiscal reform process continued in 2009, when the direct impact of the international economic and financial crisis was felt in a sharp drop in economic activity (-6.1%). The flexible exchange rate and timely intervention by Banco de Mexico to guarantee liquidity were able to mitigate the flight of capital. A nominal adjustment in the exchange rate of 25% between September 2008 and the first half of 2009 helped to cushion the impact on the real sector of the drop in foreign demand. Fiscal policy was used as the main instrument for counteracting the impact of the crisis on the economy through the application of countercyclical policies and the use of nonrecurring revenue, mainly the sums accrued in the Oil Income Stabilization Fund.
- 1.5 Toward the end of 2009, with a view to strengthening the sustainability of fiscal policy and financial sustainability, and given the signs of recovery in the domestic economy, the authorities adopted a set of additional fiscal measures that included an increase in the value added tax (VAT) from 15% to 16%. This set of measures is expected to produce an increase in revenue of about 1.3% of GDP during 2010.
- 1.6 **Fiscal decentralization in Mexico.** The structure of intergovernmental fiscal relations in Mexico is complex, reflecting a prolonged process of negotiating and formulating agreements between the various levels of government. At present, the subnational governments (SNGs) rely heavily on transfer payments (conditional transfers [*aportaciones*] and revenue-sharing transfers [*participaciones*]) by the federal government, which amount to 34% of federal government spending.<sup>3</sup>

<sup>3</sup> These conditional transfers and revenue-sharing transfers are the two main instruments used by the federal government for financial transfers to states and municipios, and account for 90% of all state income.

- 1.7 The management challenges and fiscal difficulties currently facing Mexico's states include: (i) weakness in their development planning systems owing to a disconnect with budget and investment programming; (ii) low levels of tax revenue collection—average own income out of total income is about 10%, but the potential is estimated at between 15% and 20%; (iii) limited effectiveness and high rigidity of public spending, with current expenditures amounting to nearly 90% of the total; (iv) scant capacity to identify, evaluate, design, and implement investment projects; and (v) disparities in budget accounting from state to state, which makes it difficult to consolidate subnational public finances and make them more transparent. This has a negative impact on fiscal and administrative management, including the quantity and quality of basic services and infrastructure. Also, the states' heavy reliance on federal government transfer payments creates periodic fiscal pressure by the subnational governments on the federal government with potentially adverse macroeconomic consequences.<sup>4</sup>
- 1.8 The government has recently adopted a series of measures to reform and modernize intergovernmental relations and to strengthen the country's subnational entities. They include constitutional and legal mandates for the adoption of results-based budgeting by the subnational governments and the harmonization of fiscal accounting. In addition, the government has strengthened the states' tax bases by transferring responsibility to them for collecting the gasoline tax, and spurred local fiscal effort through new formulas for fiscal transfers that now include indicators for tax collection by the states.
- 1.9 In this framework, the Department of Finance (SHCP) requested Bank support to develop capacity for planning, fiscal management, administration, investment execution, and public service management in the country's subnational entities. In part of 2009 and 2010, the initiative has included the states of Yucatán, Michoacán, Baja California, Tabasco, Campeche, and the Federal District. As a starting point for the Bank's work and with the support of the SHCP, memorandums of understanding were signed between the Bank and the states. Subsequently, nonreimbursable technical-cooperation funding was approved for each of these subnational entities from the Fund to Support Implementation of Results-based Budgeting (PRODEV), for a total of US\$5 million, to improve the allocation and quality of subnational public spending. The Bank has also satisfactorily executed two technical-cooperation projects in the states of Yucatán (ATN/KM-11439-ME) and Tabasco (ATN/KM-11349-ME), each for US\$100,000, to support the establishment of an investment unit in the former, and to strengthen the existing investment unit in the latter. Other actions under way include a technical-cooperation project for Banco Nacional de Obras y Servicios Públicos, S.N.C. (BANOBRAS) to support preinvestments in infrastructure projects in states and municipios (InfraFund) for US\$1.5 million (ATN/OC-11354-ME); two operations

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<sup>4</sup> For a comprehensive diagnostic assessment of SNGs in Mexico, see the document of the Department of Finance (SHCP) at: <http://www.shcp.gob.mx/UnidadCEF/Paginas/DiagnosticoIntegral.aspx>. For a detailed diagnostic assessment, conducted by the Bank, of the institutional management capacity of the six federal agencies prioritized by the SHCP, see: IDB Docs [No. 35243925](#); [No. 35243889](#); [No. 35243930](#); [No. 35243966](#); [No. 35244032](#); and [No. 35243836](#).

for preparation of state action plans against climate change in Yucatán and Tabasco for US\$200,000 each (ATN/MC-11463-ME and ATN/MC-11384-ME) under the Sustainable Energy and Climate Change Initiative (SECCI); and a MIF project to promote public-private partnerships in Mexican states for US\$300,000. Execution of these operations is helping to build the capacity of the states to successfully execute their investment projects. The proposed operation also takes account of the experience of program ME-L1047 (2043/OC-ME) to support results-based budgeting, which is currently in execution.

- 1.10 **Infrastructure for the delivery of public services.** Mexico has significant unmet needs in terms of infrastructure for delivering public services. Estimates current rank Mexico's infrastructure sixty-fourth out of 125 countries, and seventh in Latin America.<sup>5</sup> As noted in the previous section, the federal government's tax revenue collection is low (approximately 17% of GDP) compared to the countries of the Organization for Economic Cooperation and Development (OECD), where levels are above 30% of GDP. This imposes restrictions on public investment, which was less than 3% of GDP in 2009 and 2010, equivalent to less than 16% of federal public spending.
- 1.11 This situation is even more pronounced in the case of the states. Most of the subnational entities have sharp deficits in infrastructure and public services, which has a negative impact on opportunities for local economic and social development. In 2009 and 2010, state spending on investments was around 1% of GDP, equivalent to about 11% of total spending. In light of this situation, the states need to make a significant and sustained improvement in their investment funding.<sup>6</sup>
- 1.12 Although information is scant, the municipios appear to make higher capital expenditures as a percentage of their budgets, even though the figures in absolute terms are small. Midway through the 2000-2010 decade, municipios' total capital expenditures were Mex\$44.9 billion (close to US\$3.8 billion)—or about US\$50 per capita, which is very low in proportion to the unmet needs for access to local public services.
- 1.13 The government has made a top priority of improving the quality and competitiveness of infrastructure and basic services. To this end, it plans to significantly increase spending on infrastructure. As detailed in the 2007-2012 National Development Plan (PND), narrowing the gap in infrastructure investment relative to comparable countries will require mobilizing resources from the private sector as well as SNGs.
- 1.14 The 2007-2012 National Infrastructure Program (PNI) provides for investments of Mex\$2.5 trillion over six years, almost a 50% increase in real terms from the previous five years. The PNI emphasizes the need to increase infrastructure financing and recognizes the central role of improving the quality of project design

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<sup>5</sup> World Economic Forum: <http://www.weforum.org/reports>.

<sup>6</sup> Sources: Estimates by the IDB team based on data from the International Monetary Fund (World Economic Outlook Database, April 2010); Mexico's SHCP (published financial reports); and Mexico's National Statistics and Censuses Bureau (statistics on state and municipal public finances).

to ensure not only efficient use of public resources but also high economic and social returns. Therefore, timely allocation of resources is necessary to improve project design, strengthen SNG managerial capacity, and raise subnational investment levels.

- 1.15 **Developments in the subnational debt market.** Subnational debt markets have developed in recent years, supported by regulatory innovations to strengthen market discipline, resulting in steady increase in access to financing. According to SHCP figures, between 1993 and 2009, the SNGs' total debt (including states and municipios) rose from Mex\$16.618 billion to Mex\$252.153 billion (by more than 30% in real terms). By the end of 2009, the debt level of the SNGs was 44.2% of guaranteeable income,<sup>7</sup> with more than 60% concentrated in a small group of subnational entities.<sup>8</sup> Nevertheless, Mexico's SNGs have relatively low levels of debt. Since 1994, their debt has not exceeded 2% of GDP.<sup>9</sup> Total municipal debt, in turn, represented only 11.6% of the SNGs' debt at the end of 2009.<sup>10</sup> Although municipal debt has increased in recent years, from Mex\$4 billion in 2000 to Mex\$29.4 billion at the end of 2009, over 40% of this total was concentrated in municipios in the states of Jalisco, México, Nuevo León, and Sonora.
- 1.16 **Challenges for increased capital expenditure by SNGs.** Most Mexican states and nearly all of the municipios must overcome significant institutional challenges before they can increase their investments in public services and basic infrastructure. These include strengthening: (i) their finances, particularly in terms of increasing their own resources, improving the quality of expenditures, and harmonizing accounting systems; (ii) their capacity to design and execute projects; and (iii) the regulatory framework. All of these institution-strengthening efforts presume significant investments in training, reengineering processes, and information technology infrastructure. The technical and capacity limitations in developing projects, combined with geographic dispersion that increases transaction and construction costs, serve to exclude most SNGs from access to credit. This limits their capacity to finance projects geared toward improving public services and institution strengthening.
- 1.17 **BANOBRA's mission.** BANOBRA is a national credit institution established in 1933 to finance infrastructure and public service projects, to support institution-strengthening in federal, state, and municipal governments, and to contribute to the country's sustainable development. To fulfill its mission, BANOBRA offers

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<sup>7</sup> Includes revenue-sharing transfers, 25% of the Fondos de Aportaciones para la Infraestructura Social [Conditional Transfer Funds for Social Infrastructure] (FAIS) and the Fondo de Aportaciones para el Fortalecimiento de las Entidades Federativas [Conditional Transfer Fund for Strengthening of Federative Entities] (FAFEF), and own income (<http://www.shcp.gob.mx/UNIDADCEF/Paginas/Deuda.aspx>).

<sup>8</sup> In particular, the subnational entities' share in the composition of the debt is concentrated in the Federal District (Mex\$47.5 billion, 1.9% of local GDP) and the states of México (Mex\$33 billion, 2.9% of local GDP), Nuevo León (Mex\$27 billion, 3% of local GDP), Jalisco (Mex\$20.1 billion, 2.7% of local GDP), Chihuahua (Mex\$13.1 billion, 2.4% of local GDP), and some with smaller populations such as Chiapas (Mex\$9.2 billion, 4.8% of local GDP).

<sup>9</sup> In France this figure was 6.4%, in Spain 9.2%, and in the United States 16% in 2008.

<sup>10</sup> This figure includes the direct debt with and without backing by the state governments.

technical assistance, financing, and guarantees to SNGs, including the Federal District, government-controlled public entities, and concessionaires of public services. The priority sectors for investment include: (i) water and sanitation; (ii) roads, highways, bridges, and urban development works; (iii) land acquisition and improvement; (iv) urban facilities and image; (v) power generation and conservation; (vi) land records and public property and business records; and (vii) collection, disposal, and treatment of waste and industrial residues.

- 1.18 **Strategic partnership.** The relationship with BANOBRAS is of central importance to the Bank. It enables the two institutions to leverage their individual strengths and more effectively coordinate programs to improve public services through institution-strengthening and financing for SNG projects with socioeconomic returns. The CCLIP allows synergy by establishing a framework to create value for SNGs through a combination of technical assistance to improve subnational management capacity and structure operations, long-term financing, and support for diversification of sources of payment. As explained above, the challenges faced by SNGs and their need for increased access to financing are critical for their development. The Bank therefore has made subnational operations a priority, including technical assistance. As the SNGs assume greater responsibility for providing public services and infrastructure financing, the Bank's activities directed toward these entities will become more important. Therefore BANOBRAS—the only channel through which the Bank can serve SNGs in Mexico—is a strategic partner.
- 1.19 **Institutional capacity.** BANOBRAS has successfully executed 25 Bank-financed projects and is currently executing the CCLIP under which the proposed operation will receive financing. The Bank conducted an institutional capacity and risk assessment of BANOBRAS that indicated satisfactory development results and low risk. BANOBRAS has demonstrated a high level of institutionalization, with solid systems and documented, audited processes, and fully meets the criteria for executing agencies.
- 1.20 **Previous programs.** The Program for Investment and Financial and Institutional Strengthening of States and Municipios (FORTEM), executed in three operations by BANOBRAS (1214/OC-ME, 1283/OC-ME, and 1744/OC-ME), supported Mexico's decentralization process by improving SNGs' management capacities and financing technical assistance and investment projects with socioeconomic returns. The program had a significant impact, spending close to US\$900 million since 2000 and producing experiences that have been taken into account in the design of this second program under the CCLIP ([IDB Docs No. 35790161](#)). This operation also benefits from the experience of subnational programs to strengthen management and public investment capacity in other countries, such as the Municipal Development and Management Program in Uruguay (loan 1489/OC-UR), specifically in terms of accounting modernization, cadastral modernization, tax revenue collection, and strengthening of public investment systems (average internal rate of return: 21.6%) (see the 2010 program status report, [IDB Docs No. 35858708](#)).

- 1.21 **Rationale and beneficiaries of the second program under the CCLIP.** The proposed program will provide medium- and long-term financing for eligible projects presented by SNGs and/or public service and infrastructure providers (PSPs) that currently face difficulties in preparing strategic projects and/or accessing long-term financing. The funding will be supplemented with technical assistance for structuring projects with socioeconomic returns. The SNGs will benefit from the support of BANOBRAS and the Bank in structuring portfolios of projects eligible for financing backed by long-term resources. Concretely, this arrangement is being used to support the structuring of operations in various SNGs with technical assistance resources and with preparation and implementation times consistent with the cycles of the SNG administrations (six years for states and three for municipios). With this arrangement, the socioeconomic return of operations with SNGs/PSPs tends to be significantly higher than the financial cost of the loans, which pools the costs of the Bank and of BANOBRAS. Beneficiary SNGs of this program include the State of Yucatán,<sup>11</sup> for which BANOBRAS approved US\$200 million in financing under the CCLIP in March 2011; and the states of Baja California and Michoacán, where PRODEV technical cooperation operations (ATN/OC-11970-ME and ATN/OC-11971-ME) are supporting project preparation.<sup>12</sup>
- 1.22 **The Bank's strategy.** The second program under the CCLIP is consistent with the Bank's country strategy with Mexico (document GN-2595-1). The proposed operation, by providing technical assistance and financing for investments to strengthen SNG capacity, increase subnational revenue, and improve investment quality, is aligned with the strategy priorities in the areas of decentralization, modernization of the State, and higher private sector productivity. The operation is in line with the 2008-2011 strategy, which emphasizes the Bank's focus on subnational issues, and is consistent with the National Infrastructure Program (PNI) and the measures taken by the SHCP to address the macroeconomic situation.

## **B. Program objectives and structure**

- 1.23 **Objective.** The program objective is to contribute to improving public infrastructure and public services and to strengthening the institutional capacity of the subborrowers. The program will pay special attention to supporting the strengthening of subnational governments in planning, fiscal management, investment management, and other areas in a framework of fiscal and financial sustainability.
- 1.24 **Program structure.** Consistent with the general objective of the CCLIP, the program will enable financing and technical assistance needs with different institutional risk profiles to be addressed gradually and in a flexible manner at the

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<sup>11</sup> See optional electronic link 1: "[Comprehensive sustainable development program for the State of Yucatán.](#)"

<sup>12</sup> In the case of the State of Yucatán, the internal rate of return for the comprehensive program is highly positive (return for the technical assistance component for fiscal management: 255%, calculated for the total loan; return for the investment component for urban development in Puerto Progreso: 39%, in Mérida: 15%; return for the urban transportation component in Mérida: 15% to 35%, estimated range). The total weighted rate of return is 112%.

subnational level, and will be implemented through subloan operations with SNGs or PSPs. As approved under the CCLIP, BANOBRAS may use the loan to provide guarantees.

- 1.25 SNGs and PSPs that meet the eligibility criteria of the BANOBRAS charter and its implementing regulations (see the program's Operating Regulations) may receive subloans financed by the program. The program may offer subloans to SNGs to finance sustainable development projects with two subprograms: (i) technical assistance to develop planning, fiscal management, and investment capacity; and (ii) financing for investments in basic services and infrastructure. In this case, the funds will be committed for the whole of each sustainable development project. Disbursements will be based on a multiyear schedule to be implemented gradually. The Bank will cooperate with BANOBRAS and with the states to identify the comprehensive projects, assess their feasibility, carry them through implementation, and support their execution.<sup>13</sup>

### C. Cost, currency, and financing

- 1.26 The estimated amount of financing for this second program will be up to US\$310 million, divided into an estimated 20% for technical assistance and 80% for investments (see Table 1.3). The program's Operating Regulations will establish the implementation and disbursement mechanisms in agreement with BANOBRAS. The document approving the original CCLIP states that each successive individual program can utilize the different investment project financing modalities provided for in the Bank's policies.

**Table 1.3**  
**Cost of the second program under the CCLIP (in US\$ millions)**

Investment component	IDB	Local contribution	Total	%
Technical assistance	22.0	-	22.0	20.0
Investment financing	288.0	-	288.0	80.0
Total, second program	310.0		310.0	100.0

- 1.27 **Currency and term.** The second operation under the CCLIP will be financed through the Single Currency Facility in U.S. dollars from the Ordinary Capital, and will provide for the use of the Local Currency Facility (document GN-2365-6). The credit line can be used over a term of 10 years. The second program will have a disbursement period of five years and an amortization period of 25 years.

### D. Key results indicators

- 1.28 The Results Matrix for the credit line has been designed to monitor the primary specific objectives of the successive programs: (i) expansion and diversification of the product range will be measured by the increase in structured operations or operations using sources other than revenue-sharing transfers as guarantees; (ii) the number of SNGs/PSPs with access to financing will be expanded by increasing the

<sup>13</sup> The resources are deemed committed upon signature of a financing agreement between BANOBRAS and an SNG or PSP.

number of state and municipal governments gaining access to financing and the number of SNGs/PSPs receiving technical assistance to improve their performance and prepare projects; and (iii) financing of projects with a social and economic impact will be achieved by targeting a significant portion of financing to SNGs with poverty indicators that are higher than the national average. The Results Matrix for the present operation is consistent with the CCLIP and assumes that BANOBRAS will finance state sustainable development projects. In the event that BANOBRAS decides to carry out an operation with an SNG, the expected outcomes of the program will include improvements in the capacity for planning, fiscal management, and investment management, as well as a menu of investment sectors, as indicated in the Results Matrix (see Annex II).

- 1.29 **Methodology for compiling outcomes.** Data collection and measurement of outcomes will be based on the monitoring systems already implemented at BANOBRAS (see the [monitoring and evaluation plan](#) for more details). The social and economic impact will be assessed based on specific sector indicators, and social and economic returns will be analyzed from a sample of projects financed.
- 1.30 **Expected outcomes.** Completion of the second program is expected to achieve the following outcomes: (i) strengthened planning capacity of SNGs; (ii) improved fiscal management of SNGs; and (iii) strengthened public investment management of SNGs. Additionally, at least one SNG investment plan, approved by BANOBRAS, will have been obtained with its respective outcome indicators by sector of intervention. In the context of institutional strategies, substantial progress will be made in consolidating the institutional partnership between BANOBRAS and the IDB. The Results Matrix (see Annex II) establishes outcome indicators for eligible sectors under this program.

## II. FINANCING STRUCTURE AND RISKS

### A. Borrower, guarantor, and executing agency

- 2.1 The borrower and executing agency will be Banco Nacional de Obras y Servicios Públicos, S.N.C. (BANOBRAS). The guarantor will be the United Mexican States.

### B. Risks and mitigants for the second program

- 2.2 **Fiduciary risk.** The operation is considered to have low fiduciary risk. BANOBRAS has recognized institutional capacity, as demonstrated in an evaluation conducted by the Bank. That evaluation found that all processes, systems, and procedures are properly documented and audited. BANOBRAS has a local AAA credit risk rating (Fitch) and is supervised by the Comisión Nacional Bancaria y de Valores [National Banking and Securities Commission] (CNBV), the Auditoria Superior de la Federación [the Federal Audit Office] (ASF), the Department of the Civil Service and its deconcentrated entities, and an external audit firm of recognized standing. During preparation of the CCLIP, the Bank conducted an institutional assessment using the Institutional Capacity Assessment System which indicated satisfactory development capacity and low risk.

- 2.3 **Environmental and social risks.** Since the project team worked on preparing specific investment projects for this second operation under the CCLIP, the environmental and social strategy (ESS) consisted of a detailed evaluation of the impacts of these investments. However, since projects not originally envisaged may be financed, evaluations will be performed to identify high- and medium-risk projects and determine how the relevant social and environmental issues are to be managed. Program monitoring will include the following: (i) execution and monitoring of specific environmental and social management plans designed for preidentified works actually financed under the CCLIP; (ii) presentation to the Bank of the environmental impact statements on all new high- and medium-risk operations,<sup>14</sup> for consultation and agreement regarding the mechanisms to be used and action to be taken; (iii) application of all requirements for specific projects established in the Operating Regulations, including the list of activities ineligible for financing;<sup>15</sup> and (iv) obtaining an express commitment by the subborrowers to comply with Mexican environmental and social legislation and applicable Bank policies as part of the financing request. The Bank's regular supervision procedures will include a review of compliance with the environmental and social management requirements agreed upon for the program, including a midterm review.

### III. EXECUTION MECHANISM, MONITORING, AND SUPERVISION

#### A. Execution mechanism

- 3.1 BANOBRAS will execute this operation under its current organizational structure, and it has the appropriate technical personnel for that purpose. The Technical and Financial Assistance Subdivision will have primary responsibility for executing the program. The operational provisions governing program execution are defined in the Operating Regulations agreed to by the Bank and BANOBRAS for the first program under the CCLIP, which will be revised and updated for this second program. That document is consistent with the standards and policies of BANOBRAS and the Bank. **As a special condition precedent to the first disbursement, the borrower will obtain the Bank's no objection to the Operating Regulations for the second program under the CCLIP.**
- 3.2 **Eligibility criteria for SNGs and PSPs.** SNGs and PSPs that meet the eligibility criteria established in the BANOBRAS charter and applicable legislation. In the event that the Bank provides nonreimbursable technical assistance to an SNG to structure sustainable development projects, eligible SNGs will: (i) sign a memorandum of understanding with the Bank, with the SHCP's consent and notice to BANOBRAS, stating the Bank's intention to cooperate with the eligible SNG in the development of its capacity to manage and finance investments; (ii) have or be able to establish a portfolio of investment projects to be developed, consistent with the state's development plan; (iii) demonstrate that the state's debt is sustainable; and (iv) obtain authorization for the borrowing pursuant to state legislation.

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<sup>14</sup> Categories A and B in the project classifications established in Operational Policy OP-703.

<sup>15</sup> Annex I of the Operating Regulations.

**B. Disbursements and execution period**

- 3.3 Program funds will be committed during a term of 48 months from the effective date of the loan contract and should be disbursed over a period of not more than 60 months from the same date. Financing extended by BANOBRAS upon terms analogous to those described in this document will be recognized as of 14 May 2010 (approval date of the project profile), provided that this date is not more than 18 months prior to signature of the loan contract, in accordance with Bank operational policy OP-504. BANOBRAS can reimburse expenditures of up to US\$62 million of the Bank's financing for this operation incurred by subborrowers prior to approval of the corresponding subloans, in accordance with Bank policies. Reimbursable activities may include preinvestment expenditures, procurement of equipment or consulting engagements, and other activities to ensure project quality or advance the project prior to approval, or to enable the borrower or subborrowers to obtain a significant economic advantage. The recognition of expenditures is also justified by the overcommitment of BANOBRAS on the first operation under the CCLIP (see paragraph 1.1). The three disbursement mechanisms for the loan are summarized below.
- 3.4 **Option 1: Disbursements based on physical and financial progress.** This mechanism provides for disbursement of funds as the end borrowers request partial disbursements. Considering that the financing is for SNG and PSP investment plans, the execution mechanism should be responsive and flexible. Accordingly, the subborrowers will have access to up to 50% of the loan upon signature of a contract with BANOBRAS. The SNG will have access to the remaining amount as evidence of physical and financial progress of the project is presented, as prescribed in the respective loan contract between BANOBRAS and the SNG.
- 3.5 **Option 2: Advance disbursements.** This mechanism provides for disbursement of funds to BANOBRAS at the time it receives the borrower's financial commitment through signature of a loan contract. The funds, which are a disbursement of the loan, will be used exclusively to finance the specific project specified in the loan contract with the SNG. This mechanism will enable BANOBRAS to fix the level of funding received from the Bank, which is subject to variation due to the volatility of the derivatives (swaps) market. BANOBRAS will submit to the Bank expenditure reports and reports certifying the physical and financial progress of each project that will be used to justify the use of resources.
- 3.6 **Option 3: Disbursements under the originated portfolio.** This mechanism finances works and goods executed and provided by SNGs, when their value does not warrant the use of international competitive bidding (ICB) under Bank policies. In this case, in order to be able to serve the majority of SNGs that lack access to financing, as approved under the CCLIP, a waiver of procurement policies is anticipated for rediscounting the portfolio originated by BANOBRAS. This mechanism has allowed the Bank to take part in financing social infrastructure and basic services projects. Subloans to each municipio are limited to US\$5 million. The IDB will conduct ex post controls and verifications based on sampling. BANOBRAS utilized this modality, approved under the CCLIP, to finance a portfolio of small municipal projects on the order of US\$139 million. The

preliminary information on this modality is positive, providing access to lending and benefiting local governments in the development of low-cost works for urban renewal and improvement of services.

- 3.7 **Formalization of access to the CCLIP.** Access to the credit line to finance investment plans under Options 1 and 2 will be formalized through a loan contract between BANOBRAS and the SNG concerned, which will include an approved investment plan and a procurement plan.

### **C. Procurement**

- 3.8 The procurement procedures used in this operation match the different characteristics of BANOBRAS' subborrowers and the disbursement mechanisms designed for them. Goods and works will be procured in accordance with the Bank's policies in document GN-2349-9 (Policies for Procurement of Works and Goods Financed by the Inter-American Development Bank). International competitive bidding (ICB) will be mandatory for works estimated to cost over US\$15 million equivalent per contract, and for goods estimated to cost over US\$3 million equivalent per contract. National competitive bidding (NCB) will be mandatory for works estimated to cost over US\$500,000 equivalent per contract, and for goods estimated to cost over US\$100,000 equivalent per contract. Procurements under these thresholds will use price comparison. Mexico has standard procurement documents agreed to by the Bank, the Department of the Civil Service, and the World Bank, which will facilitate application of the Bank's policies and procedures.
- 3.9 Consultants for public subborrowers will be selected and contracted in accordance with the provisions of the Policies for the Selection and Contracting of Consultants Financed by the Inter-American Development Bank (document GN-2350-9). For the purpose of the policy on consultants, the shortlist for contracts estimated to cost less than US\$500,000 equivalent may consist entirely of national consultants.
- 3.10 For operations with private or public borrowers that are autonomous public service providers, goods and works will be procured in accordance with the Bank's policies set forth in document GN-2349-9. Private-sector subborrowers, regardless of the disbursement modality to be used, will use procurement procedures tailored to market practices for the private or business sector that are acceptable to the Bank. These procedures must result in competitive market prices for goods and services.
- 3.11 **Disbursements under the originated portfolio (Option 3).** In accordance with the Bank's procurement policies, procurements under loans of less than US\$5 million, financing of which is governed by the portfolio rediscount mechanism, can use NCB or other methods provided for in the policies, in accordance with the procedures established in local legislation. Local legislation can also be used, if justification is provided that the works being financed with this mechanism are small<sup>16</sup> and are aimed at financing for municipal social infrastructure and basic services. Such works are performed based on demand, making procurement planning unfeasible. Procurements and contracts financed under this mechanism

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<sup>16</sup> Works amounting to approximately US\$120,000 per contract.

will adhere to the principles of economy, efficiency, and transparency as stipulated in national legislation and the Bank's procurement policies.

- 3.12 The advantage of identifying investments for this lending option lies in the fact that when the portfolio amount to be rediscounted with the Bank is identified, the information available to BANOBRAS as a lending institution is based on units of credit, not contracts for works. However, the use of the funds is verified by the BANOBRAS control desk within a maximum of 120 days following disbursement and after the close and completion of the work. The BANOBRAS control desk has a comprehensive warning system to monitor compliance with contractual obligations, which includes verification of the final use of resources.
- 3.13 As subloan operations are formalized, they will be incorporated into the procurement plans for Options 1 and 2. Private-sector rediscount operations cannot be incorporated. The IDB and BANOBRAS will conduct ex ante reviews of procurement by SNGs of goods, works, and consulting services over the ICB thresholds for Options 1 and 2. To this end, BANOBRAS has demonstrated that it has the procurement system and personnel required for this task. Lastly, it was agreed that for procurements under the ICB thresholds, the Bank will conduct ex post reviews based on sampling.

#### **D. Program monitoring and evaluation**

- 3.14 Monitoring and evaluation activities will be ongoing. In addition to semiannual progress reports to be presented by BANOBRAS, meetings will be held with the IDB to evaluate aspects including: (i) structured, approved, and committed operations; (ii) progress on disbursements; and (iii) SNG investments. A midterm review will also be conducted in the first 24 months of execution, or once 50% of the operation has been committed, to assess progress on execution and fulfillment of program objectives. The project team will coordinate the necessary activities with BANOBRAS to ensure the technical quality of infrastructure and management strengthening projects at SNGs/PSPs. To this end, the IDB will receive the project proposals, which will be reviewed by sector specialists to ensure they meet the specific technical criteria. The program evaluation will focus on determining: (i) the economic and social benefits of the subloans for SNGs (see, for example, [electronic link 41](#), "Cost-benefit analysis methodology," used to evaluate the sustainable development program in Yucatán); and (ii) the outcome indicators established in the Results Matrix ([see Annex II](#)). These activities will be conducted in accordance with a monitoring and evaluation plan agreed upon with BANOBRAS (see required [electronic link 3](#)). In the program Operating Regulations, paragraphs 12.1, 12.2, and 12.3 establish mechanisms for the collection of indicators, and Annexes V(a) and V(b) present the monitoring and development indicators based on typical investment areas.

Development Effectiveness Matrix			
Summary			
I. Strategic Alignment			
1. IDB Strategic Development Objectives	Aligned		
Lending Program	The intervention contributes to the lending program to support climate change initiatives.		
Regional Development Goals	The intervention contributes to support the institutions for growth and social welfare; as well as to protect the environment, responding to climate change, promoting renewable energy, and enhancing food security.		
Bank Output Contribution (as defined in Results Framework of IDB-9)	The intervention contributes to the Bank Output of Municipal or other sub-national governments supported.		
2. Country Strategy Development Objectives	Aligned		
Country Strategy Results Matrix	GN-2595-1	Improve the effectiveness and efficiency of public expenditure at the federal and subnational level.	
Country Program Results Matrix	GN-2617	The project is included in 2011 Country Program Document.	
Relevance of this project to country development challenges (If not aligned to country strategy or country program)			
II. Development Outcomes - Evaluability	Evaluable	Weight	Maximum Score
	6.1		10
3. Evidence-based Assessment & Solution	6.8	25%	10
4. Ex ante Economic Analysis	5.5	25%	10
5. Monitoring and Evaluation	4.4	25%	10
6. Risks & Mitigation Monitoring Matrix	7.5	25%	10
Overall risks rate = magnitude of risks*likelihood		Not available	
Environmental & social risk classification		Not Classified	
III. IDB's Role - Additionality			
The project relies on the use of country systems (VPC/PDP criteria)			
The project uses another country system different from the ones above for implementing the program			
The IDB's involvement promotes improvements of the intended beneficiaries and/or public sector entity in the following dimensions:			
Gender Equality			
Labor			
Environment			
Additional (to project preparation) technical assistance was provided to the public sector entity prior to approval to increase the likelihood of success of the project	Yes	Specific TC's were provided to support preparation of Yucatan's (proxy) project (ME-T1128); and additional subnational PRODEV TC's for Yucatan (ME-T1123), Baja California (ME-T1138) and Michoacan (ME-T1139). An INFRAFUND TC was approved for BANOBRAS for supporting pre-investment studies (ATN/OC-11354-ME); and specific technical assistance for State Climate Change Action Plans has been provided for the case of Yucatan (ATN/MC-11463-ME).	
The ex-post impact evaluation of the project will produce evidence to close knowledge gaps in the sector that were identified in the project document and/or in the evaluation plan.			

This is an investment loan funded by ordinary capital funds. The objective of the program is to improve public infrastructure, public services and strength institutional capacity of the subborrowers. In a framework of fiscal and financial sustainability, the program will particularly support subnational governments in areas such as strategic planning, fiscal management.

The program has a relatively clear diagnostic with identification of the deficiencies found, their magnitudes and their interrelationships. There are no alternative solutions considered as for this type of problem. The impact of the program, although defined, has no indicators. Outputs are correctly defined and all indicators are SMART. The problem is with some outcomes that are not specific and hence indicators are not SMART. General mechanisms for monitoring have been defined, a budget has been included for this activity, and there is reference to the sources of the data to be collected. The operation has a reflexive evaluation methodology. Nevertheless, there is no evaluation plan with the principal activities to be undertaken and the responsible party for each. There is an economic analysis for some of its components. The program has identified risks, as well as all the required mitigation measures.

**RESULTS MATRIX  
TABLE OF INDICATORS**

	Baseline	End of year 1	End of year 3	End of year 5	2 years after program end	Comments
<b>Objective:</b> The program objective is to contribute to improving public infrastructure and public services and to strengthening the institutional capacity of the subborrowers. The program will pay special attention to supporting the strengthening of subnational governments in planning, fiscal management, investment management, and other areas in a framework of fiscal and financial sustainability.						
<b>Subprogram I: Technical assistance for subnational governments (SNGs)</b>						
<b>Outputs:</b>  1. Institutional strategic plans (ISPs) associated with the results-based budget and the public investment program, incorporated into the budget.	0	0	3	3	3	These ISPs will be implemented at three (or more) state government agencies with the highest expenditures. The ISPs are expected to be incorporated into the results-based budget by year 3. The agencies with the highest expenditures are typically: health, education, and public works.  Source: Law on the State Expenditure Budget.

	Baseline	End of year 1	End of year 3	End of year 5	2 years after program end	Comments
2. Tax collection system based on information platform, implemented.	0	0	1	1	1	<p>The tax collection service will be implemented via a specialized agency or new mechanism to increase collection efficiency, based on computerization of the taxpayer registry and tax enforcement system. The new system is expected to be in operation by the end of year 3.</p> <p>Source: Six-monthly project report, based on the report of the state finance department.</p>
3. Public Investment Unit created.	0	1	1	1	1	<p>The Public Investment Unit is expected to be operational from late year 1 of project implementation, performing cost-benefit analysis of investment projects.</p> <p>Source: Report of the state planning department certifying the administrative act establishing the unit, sent to BANOBRAS.</p>

	Baseline	End of year 1	End of year 3	End of year 5	2 years after program end	Comments
<b>Outcomes:</b>						
1. Planning capacity of state governments strengthened.  <u>Indicator:</u> Percentage of investment projects for amounts over US\$1 million at the three state government agencies with highest expenditures that have one or more outcome indicators (states of Yucatán, Baja California, and Michoacán).	0%	5%	30%	50%	$\geq 50\%$	Source: Law on the State Expenditure Budget.
2. Fiscal management improved.  <u>Indicator:</u> Own revenue as a percentage of total revenue of the states.	<u>Yucatán:</u> 5%	5%	6.8%	6.8%	$\geq 6,8\%$	Source: Executed state revenue budget. State finance department.
	<u>Baja California:</u> 12%	12%	14.4%	14.4%	$\geq 14.4\%$	Average own revenue of the state governments in Mexico is 10% of their total revenue. The increase in average revenue collection is an estimated 25%.
	<u>Michoacán:</u> 7%	7%	8.8%	8.8%	$\geq 8.8\%$	
3. Public investment management of the states strengthened  <u>Indicator:</u> Percentage of investment projects in the states of Yucatán, Baja California, and Michoacán, over US\$5 million, that have a cost-benefit analysis.	0%	10%	50%	75%	$\geq 75\%$	Source: Report of the state investment units.

	Baseline	End of year 1	End of year 3	End of year 5	2 years after program end	Comments
<b>Subprogram II: Portfolio of SNG investments in services and works</b>						
<p><b>Outputs:</b></p> <p>State investment plans approved by BANOBRAS under the CCLIP.</p>	1	1	2	2	2	<p>Baseline: BANOBRAS approved the investment plan of the State of Yucatán in March 2011.</p> <p>BANOBRAS is expected to approve at least one more state investment plan by year 3 of program implementation. Source: Six-monthly project report, BANOBRAS.</p> <p>The program may finance projects in the following investment sectors, among others: (i) territorial and urban development; (ii) road infrastructure and transportation; (iii) environmental management and climate change; and (iv) digital agenda. Other sectors may be added according to the investment priorities of the participating states and by agreement with BANOBRAS and the Bank. The investment sectors listed in Annex V of the Operating Regulations will be ineligible.</p>

	Baseline	End of year 1	End of year 3	End of year 5	2 years after program end	Comments
<b>Final results – Outcomes by sector:</b> (i) Territorial and urban development.  <u>Indicator:</u> Average assessed value in each project beneficiary city in the investment's area of influence.	<u>Example of Yucatán:</u> Historic center of Mérida: US\$797/m <sup>2</sup> Puerto Progreso: US\$667/m <sup>2</sup>	US\$797/m <sup>2</sup>  US\$667/m <sup>2</sup>	US\$877/m <sup>2</sup>  US\$734/m <sup>2</sup>	$\geq$ US\$877/m <sup>2</sup>  $\geq$ US\$734/m <sup>2</sup>	$\geq$ US\$877/m <sup>2</sup>  $\geq$ US\$734/m <sup>2</sup>	The assessed value is expected to rise by at least 10% in real terms by the end of execution of the respective project. The baseline for the other beneficiary cities will be calculated once they have been identified, at the end of year 1. Source: Municipal property records of the beneficiary city. Initial report (baseline) and final report (outcomes) of the state agency responsible for urban development.
(ii) Road infrastructure and transportation.  <u>Indicator:</u> Variation in the average end-to-end travel time for the proposed road corridors in each project beneficiary city.	TBD	0%	0%	-20%	$\geq$ -20%	The baseline and final outcome will be measured by the subborrower via origin-destination surveys of users, with project financing, available at the end of year 1. Source: Initial report (baseline) and final report (outcomes) of the state agency responsible for the transportation system.

	Baseline	End of year 1	End of year 3	End of year 5	2 years after program end	Comments
<p>(iii) Environmental management and climate change.</p> <p><u>Indicator:</u> Reduction of at least 10% in CO<sub>2</sub> emissions by project end in the production areas/units targeted directly by the environmental management and climate change projects.</p>	TBD	0%	0%	10%	≥ 10%	<p>The baseline and final outcome will be quantified using standard methods for measuring carbon emissions as part of the design and final evaluation of the environmental management and climate change projects. These measurements will be the responsibility of the beneficiary, and will be available at the end of year 1. Source: Initial report (baseline) and final report (outcomes) of the state agency responsible for environmental issues. Examples of standard methods of measurement:</p> <ul style="list-style-type: none"> <li>• <b>Animal manure management.</b> Approved small-scale methodology: see link &lt;<a href="#">AMS.III-D: Methane recovery in animal manure management systems.</a>&gt;</li> <li>• <b>Reforestation/afforestation.</b> Consolidated reforestation methodology: see link &lt;<a href="#">AR-ACM0001. Afforestation and reforestation of degraded land.</a>&gt;</li> </ul>
<p>(iv) Digital agenda.</p> <p><u>Indicator:</u> Number of beneficiary subnational government entities (education, health, safety, etc.) providing digital public services based on their connection to information technology networks.</p>	<p><u>Yucatán:</u> 0</p> <p><u>Baja California:</u> TBD</p> <p><u>Michoacán:</u> TBD</p>	0	+1	+1	≥ 1	<p>The baseline will correspond to the number of public entities of the subborrower that provide digital public services, such as educational services using the Internet, citizen portals, telemedicine, citizen security monitoring, etc. The baseline will be available at the end of year 1. Source: Initial report (baseline) and final report (outcomes) of the state agency responsible for the digital agenda.</p>

\* To add projects in new investment sectors in the states, the beneficiary, BANOBRAS, and the Bank must agree on specific indicators (outputs/outcomes).

### **PROCUREMENT PLAN – SUMMARY**

Due to the nature of the **Program for the Sustainable Development of Mexico's States and Municipios (ME-L1059)**, a procurement plan cannot be prepared in advance. The beneficiaries of subloans will prepare and present an initial procurement plan covering at least the first 18 months of execution of each subloan,<sup>1</sup> as an eligibility requirement for Bank financing to BANOBRAS. The plans will be presented in accordance with the program Operating Regulations.

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<sup>1</sup> Running from the subloan's eligibility date.