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MEXICO

SECOND PROGRAM FOR THE FINANCING OF RURAL SECTOR PRODUCTION RESTRUCTURING AND INVESTMENT PROJECTS

(ME-L1190)

CONDITIONAL CREDIT LINE FOR INVESTMENT PROJECTS

(ME-X1021)

LOAN PROPOSAL

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ABBREVIATIONS

BANSEFI	Banco del Ahorro Nacional and Servicios Financieros, Sociedad Nacional de Crédito, Institución de Banca de Desarrollo
CCLIP	Conditional credit line for investment projects
CNBV	Comisión Nacional Bancaria y de Valores [National Banking and Securities Commission]
FEFA	Fondo Especial para Financiamientos Agropecuarios [Special Fund for Agricultural Financing]
FIRA	Fideicomisos Instituidos en Relación con la Agricultura [Agricultural Trust Funds]
FUNDEF	Fundación de Estudios Financieros [Foundation for Financial Studies]
ICAS	Institutional Capacity Assessment System
IFC	International Finance Corporation
IMF	International Monetary Fund
INEGI	Instituto Nacional de Estadística y Geografía [National Institute of Statistics and Geography]
LIBOR	London Interbank Offered Rate
MSMEs	Micro, small, and medium-sized enterprises
NAICS	North American Industry Classification System
OECD	Organization for Economic Cooperation and Development
SAGARPA	Department of Agriculture, Rural Development, Fisheries, and Food
SFP	Civil Service Department
SHCP	Department of Finance
SMEs	Small and medium-sized enterprises
TFP	Total factor productivity

Project Summary

Mexico

Second Program for the Financing of Rural Sector Production Restructuring and Investment Projects (ME-L1190)

Conditional Credit Line for Investment Projects (ME-X1021)

<table>
<tr><th colspan="5">Financial Terms and Conditions</th></tr>
<tr><td colspan="3" rowspan="2">Borrower: Banco del Ahorro Nacional y Servicios Financieros, Sociedad Nacional de Crédito, Institución de Banca de Desarrollo (BANSEFI)</td><th colspan="2">Flexible Financing Facility[(a)]</th></tr>
<tr><td>Amortization period:</td><td>25 years</td></tr>
<tr><td colspan="3">Guarantor: United Mexican States</td><td>Original weighted average life:</td><td>15.25 years</td></tr>
<tr><td colspan="3" rowspan="2">Executing agency: Fideicomisos Instituidos en Relación con la Agricultura [Agricultural Trust Funds] (FIRA)</td><td>Disbursement period:</td><td>48 months</td></tr>
<tr><td>Grace period:</td><td>5.5 years</td></tr>
<tr><th>Source</th><th>Amount (US$)</th><th>%</th><td>Inspection and supervision fee:</td><td>[(b)]</td></tr>
<tr><td rowspan="2">IDB (Ordinary Capital):</td><td rowspan="2">50 million</td><td rowspan="2">100</td><td>Interest rate:</td><td>LIBOR-based</td></tr>
<tr><td>Credit fee:</td><td>[(b)]</td></tr>
<tr><td>Total IDB:</td><td>50 million</td><td>100</td><td>Approval currency:</td><td>U.S. dollars from the Ordinary Capital</td></tr>
<tr><th colspan="5">Project at a Glance</th></tr>
<tr><td colspan="5">Project objective/description: The objective of the second program under the conditional credit line for investment projects (CCLIP) ME-X1021 is to help raise productivity in Mexico’s rural areas by financing production restructuring, investment, and enterprise- and export-development projects. Accordingly, medium- and long-term credit resources will be channeled to the rural sector through FIRA’s network of financial intermediaries to enable enterprises—particularly micro, small, and medium-sized enterprises—in the rural agribusiness, commerce, and related services sectors to carry out their production restructuring, investment, and enterprise- and export-development projects.

The CCLIP’s objective is to promote private investment in production restructuring, investment, and enterprise- and export-development projects that boost productivity or promote more efficient use of natural resources, primarily in Mexico’s rural sector, through long-term financing that facilitates a greater supply of credit for such investments under favorable conditions.</td></tr>
<tr><td colspan="5">Special contractual condition precedent to the first disbursement of loan proceeds under the second program: the borrower will provide evidence, to the Bank’s satisfaction, of: (i) the formal appointment of program coordinators at BANSEFI and FIRA; (ii) the entry into effect of the Operating Regulations agreed upon with the Bank; and (iii) the presentation of the contract between BANSEFI and the executing agency setting forth the conditions for transferring financial resources and their obligations under the loan contract and Operating Regulations (see paragraph 3.8).</td></tr>
<tr><td colspan="5">Exceptions to Bank policies: None.</td></tr>
<tr><th colspan="5">Strategic Alignment</th></tr>
<tr><td>Challenges:[(c)]</td><td>SI ☐</td><td>PI ☑</td><td colspan="2">EI ☐</td></tr>
<tr><td>Crosscutting themes:[(d)]</td><td>GD ☐</td><td>CC ☐</td><td colspan="2">IC ☐</td></tr>
</table>

(a) Under the terms of the Flexible Financing Facility (document FN-655-1), the borrower has the option of requesting changes to the amortization schedule, as well as currency and interest rate conversions. The Bank will take operational and risk management considerations into account when reviewing such requests.

(b) 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 policies.

(c) SI (Social Inclusion and Equality); PI (Productivity and Innovation); and EI (Economic Integration).

(d) GD (Gender Equality and Diversity); CC (Climate Change and Environmental Sustainability); and IC (Institutional Capacity and Rule of Law).

I. DESCRIPTION AND RESULTS MONITORING

A. Background, problems, and rationale

1. Background

1.1 With the aim of promoting private investment in production restructuring, investment, and business development projects that raise productivity or promote more efficient use of natural resources, the Inter-American Development Bank approved a US$300 million conditional credit line for investment projects (CCLIP) (ME-X1021) with Banco del Ahorro Nacional y Servicios Financieros, Sociedad Nacional de Crédito, Institución de Banca de Desarrollo (BANSEFI) in 2014. The proposed program would be the second approved under that line.

1.2 **Macroeconomic context.** In the wake of the 2009 economic crisis, the Mexican government implemented a series of reforms to boost economic growth and reduce poverty. Between 2010 and 2015, Mexico's real GDP grew at an average annual rate of 2.8%,[1] and the country made very significant strides in the areas of macroeconomic stability, monetary policy, and fiscal transparency. Despite the depreciation of the peso, inflation reached an all-time low in 2015, closing that year at 2.1%, buoyed by the telecommunications reform and lower prices of energy products. This has helped deliver real purchasing power gains for families, enabling domestic demand to be the economy's main driver of growth that year in an unfavorable external context, characterized by the drop in oil prices[2] and weak external demand for Mexican manufactured goods. Despite these gains, international assessments[3] agree that Mexico faces the challenge of laying the foundations for strong and sustained economic growth in the medium and long term. Between 1995 and 2014, Mexico's per capita GDP grew 0.9%, below the rate observed for countries such as Chile (3.1%), Colombia (2.3%), and Brazil (1.7%); the average for Latin America and the Caribbean (1.6%) and the countries of the Organization for Economic Cooperation and Development (OECD) (1.3%); and far behind countries like Ireland (3.7%) and Korea (4%). Against this backdrop, the National Development Plan 2013-2018 calls for supplementing the macroeconomic stability policies in effect with others that promote increased productivity and productive development.

1.3 **Economic growth and productivity.** Numerous diagnostic assessments[4] show that the greatest challenge to the sustained growth of Mexico's economy is reversing its low productivity. Between 1991 and 2011, the economy's total factor

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1 World Bank, World Development Indicators, 2016.

2 Tax revenues decreased in 2015 in response to the drop in international oil prices—down 3.7 percentage points of GDP below their 2013 level. Toward the end of 2015, the average price of Mexican oil blend was only 28.2% of its level at end-2013. While this decrease was largely offset by an increase in nonoil revenue equal to three percentage points of GDP (due to the tax reform and the reduction in the gasoline subsidy), the government announced that it would cut public expenditure by roughly 2% per year in real terms through 2018.

3 OECD Perspectives: Mexico Key Policies for Sustainable Development, 2011; International Monetary Fund (IMF), Mexico: 2015 Article IV Consultation, 2015.

4 Levy, S., Good Intentions, Bad Outcomes: Social Policy, Informality, and Economic Growth in Mexico, 2008; IMF, Financial Sector Assessment Program (FSAP), 2012; IMF, Article IV Consultation, 2015; World Economic Forum (WEF), The Global Competitiveness Report 2014-2015.

productivity (TFP) decreased 0.35% per year.[5] In this same period, countries like Chile and Peru saw TFP growth of 20% and 4%, respectively.[6] Recent studies show that, between 1991 and 2011, Mexico's economic growth was largely due to an increase in the factors of production, although the contribution of TFP to growth was negative (-0.39%).[7] A longer term look also confirms this trend: between 1960 and 2005, aggregate productivity in Mexico declined by about 40% with respect to the United States, while in Chile it increased 18%, and in countries such as Brazil and Panama it remained virtually unchanged. This is the main reason Mexico's gap in GDP per capita has widened with respect to the more advanced economies,[8] despite having experienced a rapid gain in labor and capital factors, and why its development path has been deficient in the last three decades.[9] The lag in productivity primarily affects micro, small, and medium-sized enterprises (MSMEs); their productivity decreased 6.5% in the period 1999-2009, while that of large companies increased by 6%.[10] This is quite significant given the prominence of MSMEs in the country's economic structure, where they account for 99.8% of enterprises, 72% of private sector employment, and 52% of GDP.[11]

1.4 The rural domain[12] has not been impervious to the productivity problems besetting the country as a whole. The growth of rural productive activities is influenced by the behavior of the primary sector's real value of production[13] and the processed food, beverage, and tobacco industries. As depicted in the table *Total Factor Productivity and Contribution to Growth of the Mexican Economy*, during the period 1991-2014, the average annual growth of these industries was 1.8%, -2.36%, and -3%, respectively, below the -3.01% reported for the economy as a whole. One of the main reasons underlying the differences in performance both between and within sectors is in fact attributable to productivity differentials.[14]

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5 If the period 1991-2014 is considered, Mexico's TFP decreased 0.33% per year. National Institute of Statistics and Geography (INEGI), 2016.

6 IDB, The Age of Productivity, 2010.

7 Torre Cepeda, L. and L. Colunga Ramos, *Patterns of Total Factor Productivity Growth in Mexico: 1991-2011*, Banco de México, 2015.

8 See Daude, C. and E. Fernández-Arias, On the Role of Productivity and Factor Accumulation in Economic Development in Latin America and the Caribbean, IDB-WP-155, 2010.

9 Hanson, G., Why Isn't Mexico Rich?, Journal of Economic Literature, American Economic Association, Vol. 48(4), pages 987-1004, 2010.

10 McKinsey Global Institute, A Tale of Two Mexicos: Growth and Prosperity in a Two-speed Economy, 2014.

11 OECD Studies on SMEs and Entrepreneurship: Mexico, Key Issues and Policies, OECD, 2013.

12 The rural domain refers to the geographical space, the economic uses of which include agricultural, forestry, and sylviculture activities, as well as the group of productive endeavors pursued by the secondary (industrial) and tertiary (services) sectors associated with those activities, whether or not they are based in rural areas.

13 Primary GDP includes farming, livestock raising, forestry, fishing, and hunting.

14 Meza, F., S. Pratap, and C. Urrutia, Crédito, eficiencia y productividad en la industria manufacturera en México: 2003-2010 [Credit, Efficiency, and Productivity in Mexico's Manufacturing Industry], Fundación de Estudios Financieros [Foundation for Financial Studies] (FUNDEF), 2011; Villalpando, M., Bank Credit and Productivity: Evidence from Mexican Firms, Banco de México, 2015.

1.5 **Productivity, investment, and access to finance.** Among the causes that limit productivity growth in Mexico's economy is the productive sector's low access to finance.[15,16] The importance of access to finance and financial system development as determining factors in growth of productivity has been widely documented in the literature.[17] This is produced by: (i) promoting the allocation of savings for potentially more productive investment, thereby improving the allocation of factors in the economy; and (ii) facilitating finance for companies to invest in technology, and in innovation, capital, and market access projects.[18]

1.6 With specific regard to rural areas, the National Development Plan 2013-2018 points to an acute shortage of credit for investment projects in equipment that facilitate the integration of new technologies, which hinders their productivity and sustainable development.[19] Recent studies reveal that this shortage is widespread in the sector and has significant consequences in terms of the number of investments made. These studies also suggest that eliminating such restrictions would increase the number of rural economic units that would invest, as well as the size of their investments.[20]

1.7 **Public policy and the development banking sector in Mexico.** Aware of the challenges of low productivity in rural areas, the government has promoted public policies to overcome them. Those policies are consistent with the National Development Plan 2013-2018, the Productivity and Competitiveness Act, and the work of the National Committee on Productivity, which together have identified support for the productive sector by increasing access to finance and building business capacity to be critical elements for boosting a country's productivity. Specifically, given the rural sector's limited access to credit to finance production restructuring, investment, and enterprise- and export-development project that would enable it to underpin its levels of productivity, the National Development Plan and the Sector Program for Agricultural and Fisheries Development (PSDAP) 2013-2018 calls on the national development banking sector to promote financing for these projects in the sector, in coordination with the sector departments and other relevant public stakeholders (Objective 4.2, Strategy 4.2.4; and Objective 1, Strategy 1.4, respectively).

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15 Government of Mexico, National Program of Development Finance 2013-2018.

16 Other factors constraining TFP growth in Mexico include: high levels of informality; low level of investment in human capital, innovation, and technology development; and excessive regulatory burden on companies. Government of Mexico, Program to Democratize Productivity 2013-2018. See also Hanson, G., Why Isn't Mexico Rich?, Journal of Economic Literature 48(4), 2010; Hernández, E., El crecimiento económico y la productividad en México, 1980-2011 [Economic Growth and Productivity in Mexico, 1980-2011], Economía Informa 391, pages 96-102, 2015.

17 See, for example, Beck et al., Finance and the Sources of Growth, Journal of Financial Economics 58(12), pages 261-300, 2000; Arizala et al., Financial Development and TFP Growth: Cross-country and Industry-level Evidence, Applied Financial Economics 23(6), pages 443-448, 2013; and IDB, Support to SMEs and Financial Access/Supervision Sector Framework Document, 2014.

18 See, for example, Aghion et al., Volatility and Growth: Credit Constraints and the Composition of Investment, Journal of Monetary Economics 57(3), pages 246-265, 2010.

19 See National Development Plan 2013-2018, Federal Executive Branch, Mexico, 2013, page 82.

20 See Love, I. and S. Sánchez, Credit Constraints and Investment Behavior in Mexico's Rural Economy, The World Bank, Policy Research Working Paper No. 5014, August 2009; and Mora Rivera, J., J. González, and E. Mendoza Flores, Determinantes de la Inversión en la Agricultura Mexicana [Determinants of Investment in Mexican Agriculture], Centro de Estudios Económicos, El Colegio de México, May, 2011.

2. Problems and rationale

1.8 **Problems and purpose of the second program under the CCLIP.** The low levels of productivity of economic units operating in rural Mexico pose a significant challenge to the sector's sustained growth. As mentioned previously, this is due in large part to low levels of financial intermediation, making it difficult to appropriately allocate productive resources to their most efficient and cost-effective uses. The proposed program will support the government in its efforts to tackle the low levels of long-term financing affecting the financial sector—especially their impact on private investment in rural areas.

1.9 **Low levels of financial intermediation.** Mexico's financial system is hampered by its limited financial depth. Credit to the private sector as a percentage of GDP was only 31% at end-2014, compared to 53% in Colombia, 69% in Brazil, and 109% in Chile.[21] With regard to total bank credit that year, credit to companies amounted to only 6.5% of total lending, of which large companies accounted for 78%, and small companies only 22%.[22] It is no surprise, then, that companies identify access to finance as one of the most challenging aspects of doing business in Mexico.[23] According to a recent study,[24] 52.4% of companies surveyed reported that the conditions of access to, and the cost of, credit hinder their companies' ability to conduct business.

1.10 In addition to being in scarce supply, financing for the productive sector is short term. In fact, the average maturity of most such credit is relatively short due to the fact that bank deposits are concentrated in very short-term instruments.[25] As of December 2015, nearly 69% of bank deposits were payable on demand,[26] limiting the banking system's ability[27] to offer enough credit with terms consistent with the cash flows of many producers' and enterprises' investment projects.[28]

1.11 **Problems facing MSMEs.** MSMEs' access to finance is especially limited. Only one third of these enterprises access financing, and when they do it is primarily short-term finance. In fact, the percentage of MSMEs that have access to investment financing (16.5%) is well below the regional (30%) and global (25%)

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[21] World Bank, World Development Indicators, 2016.

[22] However, between 2009 and 2014, the share of credit to companies and MSMEs as a percentage of total bank credit increased from 5% to 6.5% and from 15.8% to 22%, respectively, during that period. See Reporte sobre las condiciones de competencia en el otorgamiento de crédito a las pequeñas y medianas empresas [Report on Competitiveness in Credit Granted to Small and Medium-sized Enterprises], Banco de México, April 2015, Table 11, page 27.

[23] World Economic Forum, Global Competitiveness Report 2015-2016.

[24] Banco de México, Encuesta sobre la evolución trimestral del financiamiento a las empresas, 2015 [Quarterly Changes in Finance to Companies, 2015].

[25] According to project team estimates, the average loan maturity in the system is about two and a half years, based on Banco de México's Reporte sobre las condiciones de competencia en el otorgamiento de crédito a las PyME [Report on Competitive Conditions in Granting Credit to SMEs], April 2015, Table 11, page 31.

[26] Project team estimates based on data from the National Banking and Securities Commission (CNBV), 2016.

[27] The transformation of maturities is a task inherent to the financial system, but the extreme concentration in very short-term deposits severely hinders this transformation.

[28] For example, an International Finance Corporation (IFC) survey of 86 financial institutions found that specialized finance companies and small banks, which represent a relevant niche for serving MSME projects requiring a long repayment term, expressed the need to access funding with terms that are well matched with the loan maturities required for such projects. See: Market Study of Sustainable Energy Finance in Mexico, Final Report, IFC, October 2012, page 28.

average.[29] Their limited access to medium- and long-term finance severely constrains their ability to invest in projects to boost their productivity.[30] In addition to facilitating the availability of working capital to procure inputs, timely financing on acceptable terms makes it possible to invest in the new technologies, equipment, and infrastructure that productive units need to expand productive capacity, reduce operating costs, and enhance profitability. The factors responsible for the limited access to finance for this business segment include: (i) the absence of a credit history; (ii) lower levels of capitalization and ability to post collateral; and (iii) the high fixed costs of intermediation and prudential regulation, which discourage financial institutions from serving this segment.[31, 32]

1.12 **Financial intermediation and companies linked to the rural sector.** In addition to the aforementioned factors, rural areas must contend with the inherent information asymmetry in these markets, high transaction costs,[33] the lesser availability of collateral, and the limited technical, administrative and business management capacities of producers and companies, with the latter restricting their ability to structure technically sound, bankable investment projects. Given the seriousness of these problems in rural areas, intermediation levels are particularly low and repayment periods are relatively short. Evidence of these problems, especially with regard to investment credit, is found in the report of the Interagency Group on Rural Development in Mexico, which states, “The problem is revealed in the fact that only 2% of the Mex$1.8 billion (roughly US$144 million) placed in the first quarter of 2010 went to the agriculture sector, and 86% of this amount was for short-term financing.”[34]

1.13 Evidence of these problems has also been reported in the agroindustrial sector.[35, 36] According to data from the Economic Census, there were 153,578 companies in

29 World Bank, Enterprise Surveys, 2010.

30 The impact evaluations for programs that alleviated financing restrictions on this business segment revealed productivity-related benefits. In Colombia, Eslava et al. (2012) showed that the beneficiary companies of Bancóldex credit resources had achieved growth in production, employment, and productivity of more than 34%, 19%, and 22%, respectively. Arraíz et al. (2010) evaluated the Fondo Nacional de Garantías de Colombia [National Guarantee Fund of Colombia] and found that the intervention had a positive impact on the size of the participating companies, both in terms of employment and the percentage of production exported. In an evaluation of the Programa de Capital Semilla [Seed Capital Program] in Chile, Bonilla and Cancino (2011) found that the participating companies had experienced an increase in sales volume and the number of employees. Machado et al. (2010) found that the companies participating in the “BNDES Card program” in Brazil had experienced a 10% increase in the number of employees.

31 IDB, Support to SMEs and Financial Access/Supervision Sector Framework Document, 2014.

32 Through loan 2993/OC-ME and operation ME-L1186, the IDB is supporting Mexico in its regulatory reform process to improve the institutional framework of support for productivity, Mexico’s business environment, and Mexican MSMEs’ access to finance.

33 Transaction costs tend to be higher than in other sectors due to: (i) greater climate risk, marketing risk, and concentration risk by activity and geographic area, as well as a lack of tools for managing these risks; (ii) greater limitations in terms of collateral and its enforcement, due to a lack of capital or the nature of land ownership; and (iii) geographic dispersion and small scales.

34 Análisis de los Problemas de Desarrollo del Medio Rural de México, Informe de la Reunión de Expertos [Report of the Meeting of Experts: Analysis of Development Problems in Rural Mexico], Economic Commission for Latin America and the Caribbean (ECLAC)–Food and Agriculture Organization of the United Nations (FAO)–Inter-American Institute for Cooperation on Agriculture (IICA), July 2010, page 13.

35 Refers to companies operating in the food manufacturing industry (North American Industry Classification System – NAICS, subsector 311) and in the beverage and tobacco industry (NAICS, subsector 312).

36 Meza, F., S. Pratap, and C. Urrutia, Crédito, eficiencia and productividad en la industria manufacturera en México: 2003-2010, [Credit, Efficiency, and Productivity in Mexico’s Manufacturing Sector] FUNDEF, 2011.

this sector in 2014, 99% (153,024) of which were MSMEs. Only 16% of these MSMEs reported having access to finance[37] (compared to 46% of MSMEs in the garment industry, 50% in the petrochemical industry, and 78% in the machine tool industry), and 70% used own resources to finance investment.[38] For companies in the agroindustrial sector, the collateral required to secure a loan is up to 250% of the loan value, compared to smaller requirements for the machine tool (172%), garment (174%), and furniture industries (176%).[39] The sector's scarce access to finance, among other factors, limits its ability to raise productivity levels. Estimates based on World Bank data indicate that the sector experienced a 5% loss in productivity in 2010, while countries such Brazil and Peru had productivity gains of 16% and 8%, respectively.[40] These data are not insignificant considering that the agroindustrial sector accounts for 40% of companies and 20% of manufacturing sector jobs.[41] It also acts as a driving force of Mexico's agricultural sector—which employs 6 million workers—and indirectly impacts the 24 million people residing in rural areas, 65% of whom live in poverty.

1.14 Agroindustry's potential as a driver of Mexico's agricultural sector is attributable to value chains—the mechanism used to organize productive activities.[42] In fact, one of the major international trends associated with agribusinesses is the formation of these chains, seeking to establish a closer linkage between primary production and markets.[43] Because companies in a value chain depend on one another, not only is solid performance by the links made up of agricultural commodity providers (agricultural sector) important, but also that of the industrial, marketing, and services links of the agricultural value chain. It is therefore essential that the companies participating in these links of the chain have access to finance. Nonetheless, just as the lack of access to finance impacts the performance of the chain's primary links,[44] it also poses a barrier to the performance of companies (particularly MSMEs) making up the links further down the chain. In fact, studies focused on agricultural value chains in Mexico show that the lack of access to medium- and long-term finance of companies participating in the rural manufacturing, marketing, and related services links poses a significant obstacle to

37 INEGI, Economic Census, 2014.

38 World Bank, Enterprise Surveys, 2010.

39 Ibid.

40 Ibid.

41 INEGI, Economic Census, 2014.

42 The value chain includes a combination of activities that range from the design of a product or service through its delivery or supply to the end-consumer. (Calatayud, A. and J.A. Ketterer, "Integrated Value Chain Risk Management," Technical Note IDB-TN-922, IDB, 2016).

43 FIRA, Mapeo de Redes de Agronegocios [Mapping of Agribusiness Networks], Boletín Informativo 21, 2014.

44 At end-2014, the amount of financing for the primary sector was, in real terms, virtually identical to the corresponding level in 2000. According to the Encuesta Nacional Agropecuaria [National Agricultural Survey], only 10.4% of production units had accessed credit in 2014, revealing a financing gap of more than 1.3 million rural economic units. Private sector participation in this financing has been low. At end-2012, the private sector provided 37% of such financing, compared to 45% in 2000, with the development banking sector covering the remainder. For more details on the situation of the primary sector's access to finance in Mexico, see: Department of Agriculture, Rural Development, Fisheries, and Food (SAGARPA), Diagnóstico del sector rural y pesquero, 2012 [Diagnostic Assessment of the Rural and Fisheries Sector, 2012]; and INEGI, National Agricultural Survey, 2012 and 2014. The IDB is supporting the increased access of Mexico's primary sector to finance through CCLIP 3302/OC-ME with Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero (Financiera Nacional) for US$1 billion. The objective is to help raise primary sector productivity through improved access of rural economic units to financing.

their ability to invest in the infrastructure and technology necessary to boost their productivity.[45] Aware of these obstacles,[46] the Mexican government has implemented a variety of programs to strengthen the performance of agricultural value chains that facilitate access to finance for agricultural producers, as well as for the manufacturing, marketing, and related services links of the value chain, as a way to increase investment and boost the productivity of these companies.

1.15 **Sector strategy in Mexico.** Aware of the strategic importance of the agricultural sector and agroindustrial value chains, the Mexican government, through the National Development Plan, has proposed the need to promote their productivity and competitiveness, with a view to ensuring the country's food security and impacting regional development and poverty. As part of this effort, the National Development Plan and the 2013 financial reform[47] seek to strengthen the role of development banks in leveraging growth and to encourage their participation in the agricultural and agroindustrial sector, where their intervention is needed to correct market failures and other factors that constrain credit.[48] In this context, FIRA[49] has been playing an important role in channeling resources to the sector. Its mission is to provide comprehensive financing to the agricultural and agroindustrial sector with the aim of boosting its productivity and raising the quality of life of the population employed by the sector from the regional development, environmental sustainability, and gender equity perspectives. As a second-tier public financial intermediary, FIRA provides financing to the sector through registered financial intermediaries authorized for this purpose. During the period 2007-2014, its portfolio witnessed cumulative growth in real terms of 39%, serving 9% of the sector's total productive units and 40% of producers with the ability to pay (those with income above the poverty line). In 2015, the total amount of financing supported by FIRA reached Mex$118,308,500,000 (approximately US$6.5 billion), up 20.1%, in real terms over 2014, and representing 102% of the planned annual target (Mex$116,100,000,000, approximately US$6.4 billion).

1.16 **FIRA's role in medium- and long-term financing for the agroindustrial, marketing, and related agricultural services sectors.** The activities eligible for

[45] Financing Agricultural Value Chains in Latin America: Barriers and Opportunities in Mexico, Peru, and Honduras, Washington, D.C., Multilateral Investment Fund, 2014; FIRA, Mapeo de Redes de Agronegocios [Mapping of Agribusiness Networks] Boletín Informativo 21, 2014.

[46] For example, Nacional Financiera, S.N.C.'s value chain program promotes access to and strengthening of value chains through a factoring service that reduces liquidity constraints for small suppliers (those with less collateral and credit history). The program's technology infrastructure is designed to facilitate coordination, provide training to participating enterprises, and be able to refinance second-tier financial institutions. FIRA, in turn, provides financing and technical assistance to the suppliers of the agroindustrial sector's anchor companies, and is also mapping agricultural value chains with a view to designing comprehensive financing products to meet the needs of the various participants in these chains. The Bank will support FIRA with nonreimbursable technical-cooperation resources (ATN/OC-15556-RG) to map two additional value chains; this information will be used to design an integrated risk management strategy and structure comprehensive financing products for each chain. For more information on the comprehensive value chain risk management strategies promoted by the IDB, see Calatayud, A. and J. A. Ketterer, "Integrated Value Chain Risk Management," Technical Note IDB-TN-922, IDB, 2016.

[47] See Financial Reform, Department of Finance.

[48] IDB, Public Development Banks: Towards a New Paradigm?, Capital Markets and Financial Institutions Division, Institutions for Development Sector, 2013.

[49] FIRA comprises four federal government trust funds: the Guarantee and Development Fund for Agriculture, Livestock Raising, and Poultry Farming (FONDO); the Special Fund for Agricultural Financing (FEFA); the Special Technical Assistance and Agricultural Credit Guarantee Fund (FEGA); the Guarantee and Development Fund for Fisheries Activities (FOPESCA).

financing with FIRA resources include agroindustry, marketing, and the production and delivery of goods, inputs, and services. Agroindustrial activities include the handling, processing, packaging, preservation, transformation, or storage of domestic products derived from the agricultural, forestry, or fisheries sectors. Marketing activities refer to the wholesale trade of domestic products derived from the agricultural, forestry, and fisheries sectors and eligible agroindustrial activities. Lastly, such activities also include the production and delivery of capital goods, and inputs and services associated with agricultural, agroindustrial, and marketing activities. According to FIRA data as of December 2015, long-term (more than 30 months) investment loans to companies in the agroindustrial, marketing, and services sectors represented 48% of the long-term corporate portfolio,[50] amounting to Mex$9.367 billion. Lending to this segment has increased four percentage points over the previous year. Investments financed with these loans fall into three categories: (i) acquisition of machinery and processing, transport, and storage equipment; (ii) repair and/or upgrading of industrial plants, warehouses, or depots; and (iii) modernization of power plants. FIRA has channeled these resources through banking financial intermediaries, including 20 commercial banks, Nacional Financiera, and 67 nonbank financial intermediaries.[51]

1.17 **CCLIP ME-X1021.** The proposed operation would be the second approved under this CCLIP, which was approved in 2014 for BANSEFI, in the amount of US$300 million (ME-X1021). The CCLIP's objective is to promote private investment in production restructuring, investment, and enterprise- and export-development projects that boost productivity or promote more efficient use of natural resources, primarily in Mexico's rural sector, through long-term financing to help increase the supply of credit for such investments under favorable conditions. The objective of the first operation under the CCLIP (First Program for the Financing of Rural Sector Production Restructuring and Investment Projects, 3335/OC-ME-1, for US$50 million), also approved in 2014, was to promote more efficient use of natural resources by producers and agroindustrial enterprises alike. The proceeds of that operation have been fully disbursed[52] and FIRA's performance as the executing agency has been satisfactory.

1.18 **Bank experience and coordination with other programs.** The Bank has amassed experience in Mexico's financial sector through the multiple and diverse operations it has carried out with a variety of public financial institutions. It has structured two financing operations aimed at combating the marginalization of rural production (loans 2656/OC-ME and 2838/SX-ME) with Financiera Nacional, a first-

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50 The remaining 52% is comprised of loans to companies operating in the primary sector.

51 FIRA, portfolio data, 2016.

52 An advance payment was made for the entire amount of the operation, and 80% of the resources have been justified to date. Based on the projects justified under the irrigation improvement component, 494 projects were financed—106 more than the original project target (338) for this subcomponent. Government support from SAGARPA decreased from the initial estimate of 43% of the total amount of each project down to 21% (due primarily to fiscal cuts the government was forced to make given the drop in its revenues), making more efficient use of this resource. This decrease in the share of public resources for each project was partially offset by an increase in the beneficiaries' capital contributions and an increased share of credit granted to the beneficiaries with program resources. If two objectives of any public program are to maximize the efficient use of concessional resources and to increase the leverage of the private investment, the program's irrigation improvement program has fully complied with both. The impact evaluation of the irrigation improvement subcomponent is about to get under way. Regarding the energy efficiency component, FIRA has already developed the instruments required to structure the demand for financing for this type of project. Accordingly, a portfolio of energy efficiency projects in the agroindustrial sector is expected soon.

tier public financial institution. The Bank has also structured an operation with that institution (loan 3302/OC-ME) to help boost primary sector productivity through improved access to finance by eligible rural economic units. The proposed operation complements loan 3302/OC-ME, in that it helps increase the supply of financing for enterprises (particularly MSMEs) in the agroindustry, commerce, and services sectors linked to the primary sector via agroindustrial value chains. The IDB, in turn, already has a working relationship with BANSEFI and FIRA, having structured and disbursed the first operation 3335/OC-ME (3335/OC-ME-1) under the same CCLIP as this operation. The proposed program complements the first operation under the CCLIP in that, while the focus of the first operation was on promoting more efficient use of natural resources by both agroindustrial producers and enterprises, the objective pursued by FIRA in the second operation is to boost the productivity of rural productive units, especially enterprises linked to the agroindustrial, marketing, and related services sectors. The Bank has also executed technical cooperation operations with FIRA aimed at improving the financing of companies linked to the agroindustrial sector (ATN/OC-12718-RG, ATN/FI-13401-RG, ATN/TC-14513-ME, and ATN/TC-14889-ME). The experience gained in this regard will be important in terms of developing the proposed program. Lastly, the Bank is also supporting Mexico in regulatory reforms to improve the institutional framework of support for productivity, Mexico's business environment, and Mexican MSMEs' access to finance. This has been accomplished through programs 2993/OC-ME and ME-L1186 (Programs to Boost Productivity in Mexico I and II), the latter of which is in preparation. The areas targeted by these programs include: increased competition in the banking sector; strengthening of prudential regulation; reform of development banking; strengthening of the capital market; improved contract enforcement and bankruptcy proceedings; and regulatory improvement and simplification of processes for businesses.

1.19 **Lessons learned.** The lessons learned from working with development banks in Mexico and in other countries point to the need for entities specializing in rural credit services and related sectors, with advantages in acquiring and processing private information, as well as the possibility of combining different financial and technical assistance services that support the sector's profitability and mitigate its risks. The experience of working with development banks in the region shows that these institutions are more effective in their role when: (i) they are given a clear mission and mandate; (ii) they are geared towards second-tier arrangements; (iii) they complement the role of commercial banks; and (iv) they operate in the framework of clear, high quality rules, and according to international standards that ensure strong and transparent corporate governance. These experiences and good practices have been incorporated into the design of the proposed operation by selecting FIRA as the operation's executing agency. FIRA's mission is to provide integral financing to the agricultural/agroindustrial sector, and has a long track record of working in that sector. FIRA has received a satisfactory evaluation from the IDB (see paragraph 2.5) and has also satisfactorily performed its role as the executing agency of the first operation under the CCLIP. One important lesson learned from the first operation under the CCLIP and other operations with development banks in the countries of the region concerns the fact that the availability of financing resources for long-term investments is unlikely to be resolved in the short term, as it depends on structural factors such as the public sector's preference for liquidity, the economic agents' expectations regarding the macroeconomic environment, and financial intermediaries' perceptions of risk. Like its predecessor, the proposed program is a provisional source of long-term financing while the aforementioned structural factors are corrected in a context of sustained macrofinancial stability that, over time, has a favorable impact on the preferences and expectations of economic agents and financial institutions, respectively.

1.20 **Strategic alignment.** The operation is consistent with the Update to the Institutional Strategy 2010-2020 (document AB-3008) and is aligned with the development challenge of "productivity and innovation" by improving access to finance for projects with the potential to raise MSME productivity in Mexico. The program will contribute to the Corporate Results Framework 2016-2019 (document GN-2727-4), inasmuch as it will increase the number of MSMEs financed. It is also aligned with the Country Strategy with Mexico 2013-2018 (document GN-2749) which, under the general objective of raising productivity, includes increasing the level of finance to the real economy through interventions to support development banks' programs to promote financing. Additionally, the operation is aligned with the objective of promoting the development of the rural sector. The operation is included in the Operational Program Report 2016 (document GN-2849). Lastly, it is consistent with the Support to SMEs and Financial Access/Supervision Sector Framework Document (document GN-2768-3), the Agriculture and Natural Resources Management Sector Framework Document (document GN-2709-2), and the Food Security Sector Framework Document (document GN-2825-3).

B. Objectives, components, and costs

1.21 **Objective.** The objective of the second program under CCLIP ME-X1021 is to help raise productivity in Mexico's rural areas by financing production restructuring, investment, and enterprise- and export-development projects. Accordingly, medium- and long-term credit resources will be channeled through FIRA's network of financial intermediaries to enable enterprises, particularly MSMEs, in the rural agroindustrial, commerce, and related services sectors to carry out their production restructuring, investment, and enterprise- and export-development projects.[53]

1.22 **Beneficiaries.** The eligible beneficiaries are companies of all sizes operating in the industrial, commerce, and services sectors that address the needs of the agricultural, livestock raising, forestry, and fisheries sectors, as well as those of the rural sector as a whole, that request long-term financing (loans of at least 30 months) to make investments to help raise their productivity. According to the recent composition of FIRA's investment loan portfolio and client profile for eligible projects, most of the beneficiary enterprises are expected to be MSMEs. In fact, these enterprises were the beneficiaries of 68% of the loans granted by FIRA in 2015.

1.23 **Estimate of demand.** For rural agroindustrial, marketing, and related services companies, the estimated range of unmet demand for credit is approximately US$17.626 billion (see Demand Analysis). Accordingly, the resources provided under the CCLIP in this second operation will help cover 0.28% of those needs.

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[53] In addition to the impact evaluations that have shown the benefit of increasing companies' access to finance through public policy programs (see footnote 18), a 2014 evaluation conducted by the IDB's Office of Evaluation and Oversight (OVE) on IDB support programs to companies in Brazil found that, once financing constraints were eased, these companies' experienced an increase in their exports and staffing level.

Consequently, there is ample scope to implement the intervention financed by the program.

1.24 **Components and eligibility.** Based on this estimate of demand, the program will have a single credit component for US$50 million to fund investment and technology adoption projects. Eligible projects will be those submitted by rural agroindustrial, marketing, and services enterprises with the aim of investing in, e.g., machinery and processing, transport, and storage equipment; repairs or upgrading of plants, warehouses and depots; the modernization of power plants; the treatment of wastewater; and other investments geared toward raising the productivity of the beneficiaries. The maximum amount of financing will be established in the Operating Regulations.

1.25 Funding provided through the proposed program will be complemented with technical assistance resources and guarantee facilities managed by FIRA to overcome the barriers in the demand for credit mentioned in paragraphs 1.11 and 1.12. FIRA, with its 1,134 employees, 110 regional offices, five technology development centers, 2,114 trained technicians, and 261 certified offices, and its Special Program for Agrifood Productivity and Competitiveness[54] is already supporting rural companies and producers in identifying, structuring, financing, and managing investment programs similar to those it seeks to promote in this program. It also has a guarantee fund (FONAGA)[55] to help alleviate collateral constraints on companies interested in financing projects that promote increased productivity and competitiveness.

1.26 Given the challenge posed in financing value chains, the IDB, through a nonreimbursable regional technical-cooperation operation (RG-T2714, ATN/OC-15556-RG), expects to support FIRA in designing the risk management strategies necessary to ensure the feasibility of financing for the two value chains it identified as priorities. Needless to say, the companies comprising the value chains that are ultimately supported by the above-mentioned technical-cooperation operation, and that need financing, may benefit from funding provided under the proposed program to finance production restructuring, investment, and enterprise- and export-development projects on acceptable terms.

C. Key outcome indicators

1.27 The program's outcome will be an increase in beneficiary companies' productive investments, particularly MSMEs, in the rural agroindustrial, marketing, and services sectors. This will be achieved by providing finance to the companies to make these investments. In accordance with the program objective, the expected impact is an increase in the productivity of the companies that have received financing through the program, as well as a boost to the productivity of Mexico's rural areas (see Annex II).

1.28 Based on information provided by FIRA, the Cost/Benefit Analysis identified the various income and expenditure flows generated in typical ventures implemented with loans financed through the program. Once the remaining flows were discounted at the usual rate for Bank projects (12%), net present value remained

[54] See Special Program for Agrifood Productivity and Competitiveness.

[55] Garantías para el desarrollo sostenible de los sectores agropecuario, forestal, pesquero y rural [guarantees for the sustainable development of the agricultural, forestry, fisheries, and rural sectors]. Available at the FONAGA Internet page.

positive for a wide range of variations in the relevant parameters. The description of the typical beneficiaries was drawn from FIRA administrative data, based on existing clients and taking into account their expected demand, which results in a particular composition (indicated in the economic analysis). The information is extrapolated from real FIRA portfolio cases and requires very few assumptions—which have a minor impact, as the sensitivity analyses show. Specifically, for example, the expected productivity gains were computed by FIRA technicians and, once verified, were found to be clearly in line with the calculations of independent studies. Furthermore, as shown, most of the economic outcome does not crucially stem from these gains, but rather the expansion of production (although it should be clear that there are productivity gains). Other sensitivity analyses were conducted in addition to this one, which identify the most significant components and show that the program is robust to negative, noncatastrophic scenarios.

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instruments

2.1 The second program under the CCLIP meets the eligibility criteria for individual loan operations under CCLIPs (document GN-2246-4): the operation falls under the sectors and components of the CCLIP; it is included in the country program; the program's executing agency is the same as the first operation under the CCLIP; and its performance continues to be satisfactory. Moreover, the performance of the first operation has been satisfactory, having fully disbursed the first operation and complied thus far with all contractual conditions. The second program will be financed with resources from the Bank's Ordinary Capital, in U.S. dollars. Under the criteria of the Flexible Financing Facility, the borrower may convert balances owed in U.S. dollars into Mexican pesos, if country market and regulatory conditions allow.

2.2 The proposed program, for US$50 million, is aligned with the intervention areas of BANSEFI and FIRA.

2.3 For the proposed program: (i) the speed of disbursements will be determined by FIRA's demand, as a function of demand from eligible financial institutions; and (ii) the disbursement period will be 48 months, starting on the effective date of the loan contract.

B. Environmental and social risks

2.4 The loan provides resources to fund second-tier credit operations. Therefore its environmental and social impacts and risks will occur at the subloan level and cannot be foreseen ex ante. According to Directive B.13 of the Environment and Safeguards Compliance Policy (document GN-2208-20 and Operational Policy OP-703), this operation does not require classification. For its execution, however, FIRA will have an environmental and social risk management system as part of its lending process, which was developed with IDB support through technical-cooperation resources (ATN/FI-13401-RG). In addition, the program will be governed by other environmental and social management requirements to be included in the program's Operating Regulations (see Environmental and Social Management Report).

C. Fiduciary risks

2.5 The report prepared using the Bank's Institutional Capacity Assessment System (see Annex III) found that both institutions have the capacity to perform financial management, and the fiduciary risk is low.

D. Other risks

2.6 The risk matrix provides details of the program's risk profile, based on the application of the project risk management tool. Although the demand for investment project financing may be a risk, it is considered to be medium given the relatively small size of the program with respect to potential demand. FIRA's ample institutional capacity and experience supporting enterprises in structuring eligible, technically sound, and bankable business projects helps to mitigate that risk. FIRA's Special Program for Agrifood Productivity and Competiveness supports rural enterprises and producers in identifying, structuring, financing, and managing investment projects that are similar to those promoted by this program. Regarding support to enterprises participating in value chains that may need financing, the nonreimbursable technical-assistance operation (RG-T2714, ATN/OC-15556-RG) mentioned above will strengthen FIRA's capacity to support these companies with the financial and risk management tools necessary to ensure the feasibility of financing for their investment needs.

2.7 The sustainability of the program's outcomes are strengthened because: (i) the increase in productivity and competitiveness of the sector in question (rural and related sectors) is included among the priorities set forth in Mexico's National Development Plan, with the aim of ensuring the country's food security and having an impact on regional development and poverty; (ii) the National Development Plan and 2013 financial reform emphasize and seek to strengthen the role of development banks as a driver of growth for the productive sector; and (iii) there is expected to be a demonstration effect due to the increased productivity of the companies participating in the program and the increase in access of underserved segments to system financing, which also promotes increasing the supply and demand for finance of the rural and related sectors.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

3.1 The borrower will be BANSEFI, and the executing agency will be FIRA, through the public development trust fund Fondo Especial para Financiamientos Agropecuarios [Special Fund for Agricultural Financing] (FEFA), which is part of FIRA.

3.2 The United Mexican States will be the guarantor of the loan contract to be signed between the borrower and the Bank.[56]

3.3 BANSEFI is an entity of the federal government, with legal status and its own assets. Its purpose is to support the institutional development of the community savings-and-loan sector and to promote the financial culture and savings among the members of this sector by offering appropriate products and services and

[56] The BANSEFI Act establishes that any obligations the institution acquires are guaranteed by the United Mexican States. Nonetheless, it will also sign a guarantee contract with the United Mexican States for its financial obligations.

coordinating support from the federal government and various agencies. In accordance with its implementing act, BANSEFI is authorized to grant financing to public development trust funds. As demonstrated in the institutional analysis and its execution of the first program under the CCLIP, BANSEFI has the administrative and operational capacity for intermediation and to successfully execute the proposed program. It is governed by the laws and regulations of the financial system and is subject to supervision and monitoring by the CNBV. BANSEFI is a solvent institution with good risk management practices (see Institutional Analysis).

3.4 FIRA consists of four development trust funds, with the Department of Finance as trustor and Banco de México as trustee. Proceeds from the BANSEFI loan will be disbursed to FEFA, which is one of the trust funds. The institutional analysis and the execution of the first program under the CCLIP show that FIRA has the experience and administrative and operational capacity needed to successfully execute the proposed program. Because FIRA acts as a second-tier bank, it is governed by the Federal Law on Semipublic Institutions and is subject to monitoring and supervision by the CNBV. Lastly, FIRA is a solvent entity with outstanding risk management practices (see Institutional Analysis).

3.5 The Bank will grant a loan to BANSEFI so that BANSEFI, in turn, can issue a loan to FIRA, which FIRA will use to provide medium- and long-term financing to its authorized financial institutions, which may then offer subloans under favorable terms to eligible beneficiaries in order to finance eligible investment projects (the subloans may be cofinanced).

3.6 For the proposed program, FIRA—as the executing agency—will be responsible for providing the Bank information on: (i) execution and supervision of the appropriate use of subloan proceeds; and (ii) the provision, as planned and on schedule, of the necessary human and technological resources for this execution and supervision.

3.7 The execution of the second program under the CCLIP will require that FIRA's qualification system for financial institutions be in place, and that the respective Operating Regulations be approved and put into effect. The second program includes the following features:

a. **Financial institution qualification system.** First-tier institutions regulated by the CNBV and nonbank financial institutions authorized and monitored by FIRA may participate as financial institutions. These institutions will: (i) evaluate the risk of subborrowers and decide whether to grant financing, in accordance the Operating Regulations and FIRA's regulations; and (ii) assume responsibility vis-à-vis FIRA for servicing and repaying the subloans regardless of whether the subborrowers comply in servicing their obligations.

b. **Operating Regulations.** The Operating Regulations: (i) will be consistent with BANSEFI, FIRA, and Bank policies, as well as with Mexico's financial laws and practices; (ii) reflect the main characteristics of the program; and (iii) may be modified with the Bank's no objection.

3.8 **As a special contractual condition precedent to the first disbursement of the loan for the second program, the borrower will provide evidence, to the Bank's satisfaction, of: (i) the formal appointment of program coordinators at**

BANSEFI and FIRA; (ii) the entry into effect of the Operating Regulations agreed upon with the Bank; and (iii) the presentation of the contract between BANSEFI and the executing agency setting forth the conditions for transferring financial resources and their obligations under the loan contract and Operating Regulations.

3.9 **Retroactive financing.** The Bank may use the loan proceeds to retroactively finance eligible expenditures made by FIRA prior to the date of approval by the Board of Executive Directors, up to US$10 million (20% of the loan amount), provided that requirements substantially similar to those established in the loan contract have been satisfied. These expenditures must have been made on or after 29 March 2016 (project profile approval date), but in no case more than 18 months prior to the loan approval date. This financing is justified because FIRA, which already has a line of credit for the investment projects of companies linked with the rural sector, has identified additional demand for credit for such projects. As shown in the Demand Analysis prepared for the program, demand of the agricultural and related sectors (industry, commerce, and services) for FIRA credit has increased.

3.10 The borrower will require the executing agency to pledge to submit the program's audited financial statements, within 180 calendar days following the close of the latter's fiscal year and during the original disbursement period and any extensions thereto. These are to be duly audited by an independent auditing firm hired and financed by the borrower or the executing agency and acceptable to the Bank. The last audited financial statements will be presented within 180 calendar days following the end of the original disbursement period or any extensions thereto. The statements will be prepared based on terms of reference previously agreed upon with the Bank and the Civil Service Department.

B. Summary of results monitoring arrangements

3.11 **Reports.** The program will be monitored by means of semiannual reports prepared by the executing agency and submitted to the Bank within 60 calendar days following the end of each six-month period. These reports will measure the progress of the outcome indicators (see Annex II) and fulfillment of the eligibility criteria at the project and program level.

3.12 **Evaluation.** The borrower and the Bank will conduct a midterm evaluation 24 months following the date of the first disbursement or when 50% of the loan has been disbursed, whichever occurs first. The evaluation will measure progress in fulfilling program objectives and outcomes, based on the results matrix, so as to identify any appropriate corrective action. The executing agency will provide all information needed for the Bank to prepare a project completion report, which will be prepared six months following the last disbursement. Monitoring meetings will be held periodically as well.

3.13 The evaluation plan—the financing for which is not included as part of the resources of this operation, but that will be implemented if the Bank identifies additional resources other than the program to finance it—calls for a quasi-experimental evaluation to be conducted using statistical paring and a difference-in-differences estimator in order to compare beneficiary enterprises to comparable nonbeneficiary enterprises (see Monitoring and Evaluation Plan).

3.14 **Information.** The borrower and the executing agency will compile and retain the information, indicators, and parameters it has, to prepare the project completion report and any ex post evaluation that these parties and/or the Bank wish to conduct.

Development Effectiveness Matrix			
Summary			
I. Strategic Alignment			
1. IDB Strategic Development Objectives	**Aligned**		
Development Challenges & Cross-cutting Themes	**-Productivity and Innovation**		
Regional Context Indicators			
Country Development Results Indicators	**-Micro / small / medium enterprises financed (#)**		
2. Country Strategy Development Objectives	**Aligned**		
Country Strategy Results Matrix	**GN-2749**	**Increase the level of finance to the real economy.**	
Country Program Results Matrix	**GN-2849**	**The intervention is included in the 2016 Operational Program.**	
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**
	8.4		**10**
3. Evidence-based Assessment & Solution	**7.5**	**33.33%**	**10**
3.1 Program Diagnosis	**2.4**		
3.2 Proposed Interventions or Solutions	**2.4**		
3.3 Results Matrix Quality	**2.7**		
4. Ex ante Economic Analysis	**8.5**	**33.33%**	**10**
4.1 The program has an ERR/NPV, a Cost-Effectiveness Analysis or a General Economic Analysis	**4.0**		
4.2 Identified and Quantified Benefits	**1.5**		
4.3 Identified and Quantified Costs	**1.5**		
4.4 Reasonable Assumptions	**0.0**		
4.5 Sensitivity Analysis	**1.5**		
5. Monitoring and Evaluation	**9.2**	**33.33%**	**10**
5.1 Monitoring Mechanisms	**2.5**		
5.2 Evaluation Plan	**6.7**		
III. Risks & Mitigation Monitoring Matrix			
Overall risks rate = magnitude of risks*likelihood	**Low**		
Identified risks have been rated for magnitude and likelihood	**Yes**		
Mitigation measures have been identified for major risks	**Yes**		
Mitigation measures have indicators for tracking their implementation	**Yes**		
Environmental & social risk classification	**B.13**		
IV. IDB´s Role - Additionality			
The project relies on the use of country systems			
Fiduciary (VPC/FMP Criteria)	**Yes**	**Financial Management: Accounting and Reporting, Internal Audit.**	
Non-Fiduciary			
The IDB's involvement promotes additional 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**	**Technical assistance was provided through RG-T2166 in order to support FIRA assessing the environmental and social risks in its lending operations and identify new business opportunities that could arise from a continuous process of environmental and social risk assessment.**	
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	**Yes**	**Currently there are few studies considered representative of the anticipated impact from this type of operation (ME-L1190) according to IDB's evaluability criteria. It is expected that the evaluation will provide information on the potential impact of financing of the beneficiaries in key variables, such as sales, investment, and employment.**	

Note: (*) Indicates contribution to the corresponding CRF's Country Development Results Indicator.

The project exists as part of a CCLIP (ME-X1021) and its specific objective is to contribute to raising productivity in Mexico's rural sector via financing for investment projects. The document describes the low levels of productivity in Mexico and how this is even more pronounced for MSMEs. This is particularly relevant for the rural sector that has experienced low growth that is also behind the growth of the Mexican economy. Productivity growth is limited by the absence of credit, which the project seeks to address. According to the Report on Global Competitiveness 2015-2016, companies identify a lack of credit as a major obstacle to business and this is not surprising given that only 6.5% of bank financing was destined to companies.

The project seeks to place US$50 million in the agroindustry in investment projects and projects of reconversion and productivity growth. The vertical logic is adequate and substantiated by a demand analysis that indicates there will be ample demand for the placed funds. The cost-benefit analysis is also adequate and monetizes the benefits perceived by the benefitting companies. The project's indicators capture the improvements in term, leveraging, and the percent of firms that are MSMEs. An impact evaluation will be carried out to measure improvements in productivity.

RESULTS MATRIX

Program objective:	The objective of the second program under CCLIP ME-X1021 is to help raise productivity in Mexico's rural areas by financing production restructuring, investment, and enterprise- and export-development projects. Accordingly, medium- and long-term credit resources will be channeled through FIRA's network of financial intermediaries to enable enterprises—particularly MSMEs—in the rural agribusiness, commerce, and related services sectors to carry out their production restructuring, investment, and enterprise- and export-development projects. The CCLIP's objective is to promote private investment in production restructuring, investment, and enterprise- and export-development projects that boost productivity or promote more efficient use of natural resources, primarily in Mexico's rural sector, through long-term financing that facilitates a greater supply of credit for such investments under favorable conditions.

Indicators	Unit	Baseline	2016	2017	2018	2019	End of program	Description
OUTPUTS								
COMPONENT: LINE OF FINANCING FOR PRODUCTIVE INVESTMENTS (TOTAL COST = US$50 MILLION)								
Number of enterprises linked to the rural agroindustrial, marketing, and related services sectors that secure loans to finance investments with program resources	Number of enterprises	1,104	132	19	16	7	1,278	This indicator measures the number of enterprises that secure loans with the program's resources. The baseline includes the number of rural-sector MSMEs that receive new loans in addition to the refinancing of existing loans (includes new borrowers). The support provided by the line delivers more resources than the system is capable of absorbing, given FIRA's capillarity and the considerable excess demand in Mexico. From 2016 to 2019, the number of enterprises expected to receive loans with the program's resources are 132, 19, 16, and 7, respectively, for a total of 174. This assumes an average loan amount of approximately US$287,316.00 per enterprise. The baseline has been calculated on the basis of the average number of refinancing operations and new borrowers over the last five years. **Source:** FIRA reports.

Indicators	Unit	Baseline	2016	2017	2018	2019	End of program	Description
EXPECTED OUTCOMES								
FINAL OUTCOME: INCREASE IN THE ENTERPRISES' PRODUCTIVE INVESTMENTS								
Indicator 1. Annual amount of productive investments leveraged through the program	US$ million	396.5	47.4	6.6	5.6	2.5	458.6	This indicator measures the investments of enterprises that secure loans with the program's resources. The baseline includes the investments of rural-sector MSMEs that receive new loans and refinance existing loans (includes new borrower). The support provided by the line delivers more resources than the system is capable of absorbing, given FIRA's capillarity and the considerable excess demand in Mexico. From 2016 to 2019, the investments expected to be made leveraging the program's resources are US$47.4 million, US$6.6 million, US$5.6 million, and US$2.5 million, respectively, for total investments of US$62.1 million. This assumes an average loan amount of approximately US$287,316.00 per enterprise, with 20% of own capital. The baseline has been calculated on the basis of the average number of refinancing operations and new borrowers over the last five years. **Source:** FIRA's program information system.
Indicator 2. Increase in the average term of loans granted with program resources compared to the average term of system loans	Number of months	25	30	30	30	30	30	This indicator shows the year-on-year change in the average term of loans granted with the program's resources compared to the average term of system loans. This indicator is expected to be higher than the average term of system loans for eligible investment projects. If the term is 25 months higher in the baseline year, it is expected to be 30 months higher than the system average by the end of the program. This will indicate the program's success in terms of offering better financing terms for rural ventures and enterprises. **Source:** FIRA's information system on the program

Indicators	Unit	Baseline	2016	2017	2018	2019	End of program	Description
Indicator 3. Percentage of enterprises that are MSMEs financed with program resources	Percentage of enterprises	97.4	99.2	100	100	100	97.7	This indicator shows the percentage of the total enterprises financed with program resources that are MSMEs. **Source:** FIRA's program information system
EXPECTED IMPACTS								
IMPACT 1: INCREASE IN THE PRODUCTIVITY[57] OF ENTERPRISES FINANCED BY THE PROGRAM								
Average work output: increase in sales per worker of enterprises that received program financing relative to comparators that did not	%	3.5					3.5	This indicator shows the increase in average work output using as a proxy the sales per worker of enterprises that received program financing relative to comparators that did not. The baseline already captures the effect of access to this financing (according to FIRA data on enterprises that have accessed its line of financing). The program (ME-L1190) provides funding in addition to the aforementioned line. For this reason, the target is equal to the baseline, which includes the impact of enterprises that do not receive financing. **Source:** FIRA, based on the ex post impact evaluation, as described in the monitoring and evaluation plan.
IMPACT 2: INCREASE IN TOTAL FACTOR PRODUCTIVITY (TFP) OF THE RURAL SECTOR								
Increase above the average variation in the TFP of enterprises that received financing relative to those that did not	%	2.1					2.1	TFP is calculated on the basis of FIRA technical analyses that include coefficients for the use of machinery, repairs, and the use of installed capacity. TFP will be measured using a regression model of the value of production in function of the value of remunerations, capital, and other inputs that can be identified in the Economic Censuses. The baseline already captures the effect of access to this financing (according to FIRA data on enterprises that have accessed its line of financing). Beyond the aforementioned line, the program (ME-L1190) also provides additional funding. Consequently, the target

[57] The value per worker, which is constructed in a way that incorporates the effect of changes in TFP, is also used as a proxy for TFP.

Indicators	Unit	Baseline	2016	2017	2018	2019	End of program	Description
								is equal to the baseline, which includes the impact attributable to the enterprises that do not receive financing. **Source:** FIRA technical analyses, based on the ex post impact evaluation, as described in the monitoring and evaluation plan.

FIDUCIARY AGREEMENTS AND REQUIREMENTS

Country:	Mexico
Project:	ME-L1190
Name:	Second Program for the Financing of Rural Sector Production Restructuring and Investment Projects under conditional credit line for investment projects (CCLIP) ME-X1021
Borrower:	Banco del Ahorro Nacional y Servicios Financieros, S.N.C., Institución de Banca de Desarrollo (BANSEFI)
Executing agency:	Fideicomisos Instituidos en Relación con la Agricultura [Agricultural Trust Funds] (FIRA)
Prepared by:	Germán Zappani, Lead Financial Management Specialist; Rafael Flores, Senior Associate Financial Management Specialist; and Víctor Escala, Lead Procurement Specialist (FMP/CME)

I. EXECUTIVE SUMMARY

1.1 The objective of the second program under CCLIP ME-X1021 is to help raise productivity in Mexico's rural areas by financing productive restructuring, investment, and enterprise- and export-development projects. Accordingly, medium- and long-term credit resources will be channeled through FIRA's network of financial intermediaries to enable enterprises, particularly MSMEs, in the rural agribusiness, commerce, and related services sectors to carry out their production restructuring, investment, and enterprise- and export-development projects.

1.2 The CCLIP's objective is to promote private investment in production restructuring, investment, and enterprise- and export-development projects that boost productivity or promote more efficient use of natural resources, primarily in Mexico's rural sector, through long-term financing that facilitates a greater supply of credit for such investments under favorable conditions.

1.3 The borrower, originally founded in 1949 as the Patronato del Ahorro Nacional [National Savings Foundation] (PAHNAL), became BANSEFI in January 2002 with the mission of supporting institutional development of the community savings-and-loan sector and promoting the financial culture and savings among the members of this sector. Its implementing act sets forth the objectives of "promoting, managing, and financing projects to serve the needs of the coordinating agencies, the community savings-and-loan institutions, and the entities and groups of individuals described in the Community Savings and Loan Act, which enable it to fulfill its mission throughout the country and allow for the most efficient use of each region's resources." BANSEFI is also authorized to provide technological support and technical assistance, and to serve as the financial agent of the federal government, *inter alia*.

1.4 BANSEFI has also served as a financial agent for a number of IDB operations with the Mexican government, and is currently doing so for loan 3133/OC-ME, executed by the National Water Commission (CONAGUA), and loan 3335/OC-ME, executed by FIRA.

II. THE EXECUTING AGENCY'S FIDUCIARY CONTEXT

2.1 The program will be executed using a decentralized, global credit arrangement between BANSEFI and FIRA as the executing agency. FIRA will have a direct relationship with its financial intermediaries, as will these intermediaries, in turn, with the end borrowers. Based on the recent favorable experience with the execution of loan 3335/OC-ME, the decision was made not to update the Institutional Capacity Assessment System (ICAS) for the current operation, since the above-mentioned operation had been assessed in August 2014, which yielded total weighted scores of 99.26% for BANSEFI and 100% for FIRA, indicating highly developed fiduciary systems and low risk for the program's fiduciary execution. No weaknesses that could compromise proper project execution were identified. BANSEFI will submit to the Bank a detailed list of disbursements to FIRA, as the executing agency, so that the Bank may recognize these disbursements.

2.2 While FIRA's execution capacities have been satisfactory, the executing agency should, nonetheless, continue to receive training in the Bank's fiduciary requirements.

III. FIDUCIARY RISK EVALUATION AND MITIGATION MEASURES

3.1 As noted above, the ICAS applied in 2014 yielded a total weighted score of 99.26%, signaling a satisfactory degree of development in BANSEFI's fiduciary systems and a low level of risk in fiduciary execution. See the ICAS Report.

IV. CONSIDERATIONS FOR THE SPECIAL PROVISIONS OF THE LOAN CONTRACT

4.1 Conditions precedent to the first disbursement: As a special contractual condition precedent to the first disbursement of the first program, the borrower and the executing agency will provide evidence, to the Bank's satisfaction, of: (i) the formal appointment of the program coordinators at BANSEFI and FIRA; (ii) the entry into effect of the Operating Regulations agreed upon with the Bank; and (iii) the presentation of the contract between BANSEFI and the executing agency setting forth the conditions for transferring financial resources and their obligations under the loan contract and Operating Regulations.

4.2 The exchange rate for accounting purposes will be the rate in effect in the borrowing country on the date on which the borrower makes the expenditure in local currency or any other currency agreed on with the Bank.

4.3 **Submittal of the program's annual audited financial statements, approved in accordance with the agreed upon terms of reference.** The annual financial statements will be audited by Bank-eligible external auditors within a period of 180 days following the close of the fiscal year.

4.4 **Retroactive financing.** For the sake of continuity in financial and technical support, the Bank may use the loan proceeds to retroactively finance eligible expenditures made by FIRA prior to the date of the loan approval by the Board of Executive Directors, up to US$10 million (20% of the loan amount), provided that requirements substantially similar to those established in the loan contract were satisfied. These expenditures must have been made no earlier than 29 March 2016 (project profile approval date), but under no circumstances may expenditures be made more than 18 months before the loan approval date. This financing is justified because FIRA, which already has a line of credit to finance the investment projects of companies associated with the rural sector, has identified additional demand for credit for such projects. As evidenced in the program's Demand Analysis, the demand of the agricultural and related sectors (industry, commerce, and services) for FIRA credit has increased.

V. Agreements and Requirements for Procurement Execution

5.1 Given the nature of the program, which comprises a single credit component—i.e. understanding that FIRA, in its capacity as a financial intermediary, will subsequently onlend the resources to private-sector enterprises or autonomous business enterprises of the public sector—the subborrower may follow either the established practices of the private sector or business practices that are acceptable to the Bank. In the event FIRA engages in any direct contracting, then the Policies for the Selection and Contracting of Consultants Financed by the IDB (document GN-2350-9), or the Policies for the Procurement of Works and Goods Financed by the IDB (document GN-2349-9) both of 2011, will apply, as well as the table of threshold amounts and corresponding procurement modalities. If these policies are amended, the amended versions may apply, provided the executing agency agrees to this in writing.

5.2 Although FIRA has a dedicated procurement structure and experience in procurement, that experience is in selection and contracting processes governed by Mexican law and regulations. To prepare FIRA for procurement processes within the framework of the Bank's procurement policies, at least one training event will be held that is specifically related to the nature of the procurement processes it will carry out.

1. Threshold amounts (US$)

Table 1. Threshold amounts (US$ thousand)

Works			Goods[1]			Consulting	
International competitive bidding	National competitive bidding	Shopping	International competitive bidding	National competitive bidding	Shopping	International advertising consultants	Shortlist 100% National
> 15,000,000	< 15,000,000 and > 500,000	< 500,000	≥ 3,000,000	< 3,000,000 and > 100,000	< 100,000	> 200,000	< 500,000

[1] Includes nonconsulting services.

5.3 **Records and files.** Files must be available for any procurement review that the Bank deems appropriate.

VI. FINANCIAL MANAGEMENT AGREEMENTS AND REQUIREMENTS

1. Programming and budget

6.1 BANSEFI's resources are directly budgeted by BANSEFI and are independent of the federal budget published by the Department of Finance (SHCP). BANSEFI is responsible for coordinating the programming of resources for transfer to FIRA and for monitoring of the technical and financial aspects of the execution of these resources. BANSEFI has a department to serve as financial agent and liaison with international financial institutions, and this department will be responsible for coordinating efforts to monitor the contractual commitments with the Bank. This coordination work will include preparation of progress reports and disbursement requests, justification of expenses to the Bank, preparation of financial statements, and coordination with external auditors.

6.2 FIRA's participation and the eligibility of subloans will be in accordance with BANSEFI's policies and will be set forth in the Operating Regulations.

2. Accounting and information systems

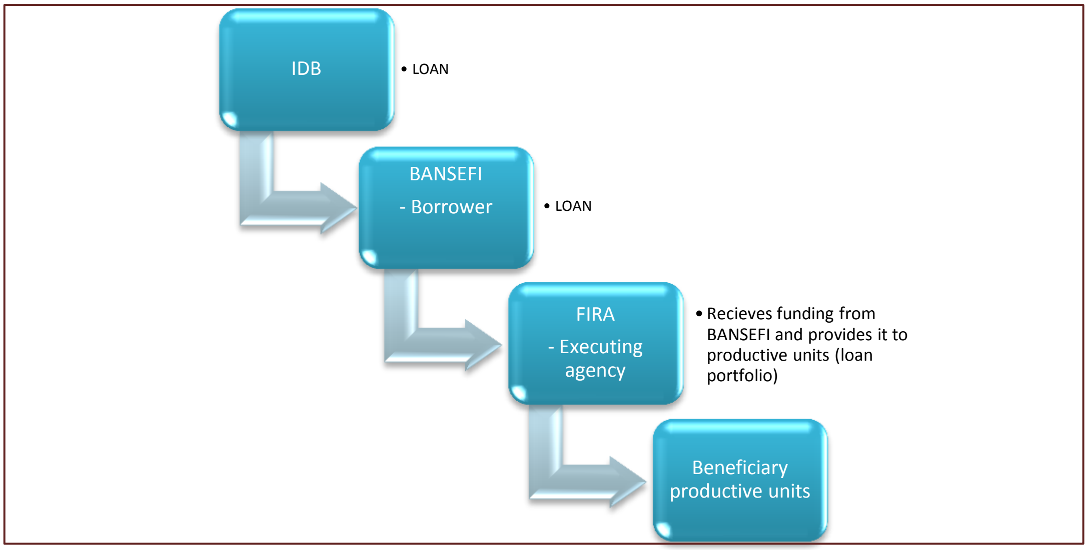
6.3 For financial administration, BANSEFI is governed by the Ley Federal de Presupuesto y Responsabilidad Hacendaria [Federal Budget and Financial Responsibility Law], the Ley General de Contabilidad Gubernamental [General Law on Government Accounting], and other applicable elements of the regulatory framework, as well as the nine general administrative manuals issued by the Civil Service Department (SFP) in conjunction with SHCP. BANSEFI records it budget execution in accordance with the Clasificador por Objeto del Gasto [expenditure classification system] used by the federal public administration, with the following structure: (i) category of expenditure; (ii) description; (iii) general line item; and (iv) specific line item.

6.4 BANSEFI has a multicurrency accounting system that allows it to record and monitor the funds placed with each intermediary. BANSEFI's chart of accounts, financial system, and information system must also comply with the requirements of Mexico's National Banking and Securities Commission (CNBV). In addition, its accounting system enables it to record loans granted and received in the currency used in each operation.

3. Disbursements, cash flow, and simplified justification of expenditures

6.5 IDB disbursements to BANSEFI will be made in accordance with BANSEFI's cash flow needs vis-à-vis FIRA. The operation calls for all disbursements to be made within a 48-month period. Figure 1 depicts the flow of resources.

Figure 1. Flow of resources



6.6 BANSEFI will provide the Bank with a detailed account of its transfers to FIRA, which will be subject to ex post review. BANSEFI may request disbursements from the IDB in local currency. This will be determined by the executing agency in view of conditions in the financial market at the time it requests the resources.

4. Internal control and internal auditing

6.7 BANSEFI has a person in charge of its internal control body, designated by the SFP, whose duty is to inspect, monitor, and implement the good governance agenda at BANSEFI on the basis of transparency, accountability, and strict compliance with laws and regulations, in keeping with SFP requirements and other applicable regulations.

6.8 Federal public spending is carried out, controlled, and evaluated in fundamental accordance with the federal budget of expenditures and with the Federal Budget and Financial Responsibility Law and its regulations.

5. External control and reports

6.9 The Ley Orgánica de la Administración Pública Federal [Federal Public Administration Act] confers on the SFP, through the Dirección General de Auditorías Externas [External Audit Bureau], the responsibility for appointing external audit firms to audit projects with international financial institutions. The Bank signed a technical memorandum of understanding with the SFP and the World Bank in 2012, harmonizing the terms of reference for audits and the formats for presenting semiannual and annual financial reports.

6.10 **Reports.** Pursuant to paragraph 6.9, the SFP, the World Bank, and the IDB have harmonized their formats for semiannual and annual financial reports. The SFP has issued a document entitled, “Guía para la Gestión Financiera de los Proyectos Financiados por Organismos Financieros Internacionales” [Financial

Management Guide for Projects Financed by International Financial Institutions], which requires the executing agency to submit the program's semiannual financial reports to the financial agent every six months. These reports reflect the operation's financial progress at the end of the six-month period and its cumulative progress in each investment category. They also include a detailed account of requests submitted in that period and expenditures pending processing.

6.11 **Audits.** Each year, BANSEFI will submit the program's financial statements reviewed in accordance with the procedures agreed upon with an auditing firm acceptable to the Bank, within 180 days following the end of each fiscal year. The auditing firm will be designated by the SFP, with the Bank's no objection. The auditing work will be reviewed in accordance with the terms of reference agreed upon by the Bank, BANSEFI, and the SFP.

6.12 BANSEFI is also audited on an annual basis by the Auditoría Superior de la Federación [Federal Audit Office] and by the CNBV.

6. Financial supervision plan

Table 2. Financial supervision plan

Supervision activity	Supervision plan			
	Nature and scope	Frequency	Responsible party	
			IDB	Third party
Financial	Ex post review of disbursement requests	Periodic	Fiduciary team, limited sampling with review of controls	External auditor: review against audited financial statements
	Visit to inspect/analyze internal controls and control environment	Annual	Fiduciary-technical team, fiduciary-financial team, and procurement team	
	Annual allocation of budgetary resources needed for program execution	Annual	Fiduciary-financial team	Executing agency
Compliance	Submittal of financial statements	Annual	Fiduciary-technical team	External auditor
	Conditions precedent to first disbursement	Once	Fiduciary-technical team	Executing agency

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE-___/16

Mexico. Loan ____/OC-ME to Banco del Ahorro Nacional y Servicios Financieros, Sociedad Nacional de Crédito, Institución de Banca de Desarrollo (BANSEFI) Second Program for the Financing of Rural Sector Production Restructuring and Investment Projects – Individual Operation under the Conditional Credit Line for Investment Projects (CCLIP) for the Financing of Rural Sector Production Restructuring and Investment Projects ME-X1021, approved by Resolution DE-160/14

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with Banco del Ahorro Nacional y Servicios Financieros, Sociedad Nacional de Crédito, Institución de Banca de Desarrollo (BANSEFI), as Borrower, and with the United Mexican States, as Guarantor, for the purpose of granting the Borrower a financing to cooperate in the execution of the Second Program for the Financing of Rural Sector Production Restructuring and Investment Projects, individual operation under the Conditional Credit Line for Investment Projects (ME-X1021), approved by Resolution DE-160/14 dated November 12, 2014. Such financing will be for the amount of up to US$50,000,000, from the resources of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Project Summary of the Loan Proposal.

(Adopted on ___ __________ 2016)

LEG/SGO/CID/IDBDOCS#40318200
ME-L1190