



<b>1. Project Data:</b>		<b>Date Posted :</b> 09/08/2003	
<b>PROJ ID:</b> P070479		<b>Appraisal</b>	<b>Actual</b>
<b>Project Name:</b> Estado De Mexico Structural Adjustment Loan (Edomex)	<b>Project Costs (US\$M)</b>	505.6	505.6
<b>Country:</b> Mexico	<b>Loan/Credit (US\$M)</b>	505.6	505.6
<b>Sector(s):</b> Board: PS - General public administration sector (60%), General education sector (10%), Health (10%), Water supply (10%), Roads and highways (10%)	<b>Cofinancing (US\$M)</b>		
<b>L/C Number:</b> L7043			
	<b>Board Approval (FY)</b>		01
<b>Partners involved :</b>	<b>Closing Date</b>	12/31/2002	12/31/2002
<b>Prepared by :</b>	<b>Reviewed by :</b>	<b>Group Manager :</b>	<b>Group:</b>
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**2. Project Objectives and Components**

**a. Objectives**  
To support the Mexican government in strengthening its decentralization reform process by assisting the Estado de Mexico to adjust to the new framework of sub-national borrowing.

**b. Components**

1. Fiscal Policy. Elimination, within two years, of the state's fiscal deficit;
2. Tax Policy and Administration. Increase state government own revenues by measures focused on payroll and vehicle taxes.
3. Asset Management and Capital Revenue. Implement a plan for disposing of properties susceptible to commercialization.
4. Education. Protect the provision of education services in terms of quantity and quality during the adjustment process.
5. Health. Improve coverage, equity and efficiency of the state public health network by increasing budget allocation to the part of the system attending uninsured population .
6. Pension. Reform the state workers pension system in order to enhance its financial sustainability and reduce pressures on the state budget .
7. Water Supply. Impose fiscal discipline in the sector in order to turn the supply of water in the state sustainable and eliminate the need of state subsidies .
8. Road Transport. Strengthen the maintenance of the state highway network in order to prevent its deterioration .
9. Financial Administration and Relation with Municipalities. Enhance transparency and accountability of budget management and financial administration .
10. Public Debt Management. Restrain the accumulation of public debt and reduce the stock of arrears by setting explicit net borrowing ceilings and targets for the reduction of floating debt .

**c. Comments on Project Cost, Financing and Dates**  
Total project cost was \$505.6. Financing was \$505.6. Closing date remained unchanged.

**3. Achievement of Relevant Objectives:**

1. The macroeconomic framework of the federal government was satisfactory . The federal fiscal deficit was about 0.7 percent of GDP in 2001 and 0.6 percent of GDP in 2002.
2. The state carried out a program to improve tax administration that included (a) facilitating payments through the commercial banking system; (b) emphasizing enforcement; and (b) gathering more information at the tax filing stage and better integration of tax databases .
3. The state government took steps to improve control over human resources and began to use them better, and

advanced in integrating the state and federal education systems .

4. Congress passed a law in December 2001 that modified several aspects of the pension system . Current workers can switch to the new system and new entrants must take the new system . Under the new system, 75 percent of workers contribution goes to the existing defined -benefit system and 25 percent to the newly designed defined-contribution system. The pensionable base becomes the average of the last 10 years' salary instead of the average of the last six months' salary .

5. Some fiscal discipline was introduced into the water sector . The new State Water Law mandates that for the State Water Commission to enter into contracts to supply water to municipalities, these must offer their *participaciones* (transfers from the federal government) as collateral and source of payment .

**4. Significant Outcomes/Impacts:**

Macroeconomic stability allowed for a reduction of poverty from 53.7 percent to 51.7 percent between 2000 and 2002, and for a reduction of extreme poverty from 24.2 to 20.3 percent.

2. Revenue from the payroll tax increased from 1.3 billion pesos between 2000 and 2002.

3. Real education expenditure increased and teacher hiring depends on the need for services and is based on qualifications.

4. The State Water Commission signs with the municipalities contracts for sale of water only if municipalities meet the criteria of the regulations.

**5. Significant Shortcomings (including non-compliance with safeguard policies):**

1. During the program implementation period (December 2000-March 2002) the state government managed to increase revenues and contain the growth of programmable expenditure, but for the remainder of the year 2002 the authorities failed to adjust expenditures to lower than expected revenues . As a result of that failure the state ended with a deficit of 2.7 billion pesos, equal to 5.3 percent of ordinary income, rather than the 0.9 percent surplus envisaged in the budget.

2. The state failed to achieve the target of selling state assets worth 0.2 billion pesos.

3. Even though the state made considerable progress in its public debt management, its debt kept growing .

6. Ratings :	ICR	OED Review	Reason for Disagreement /Comments
<b>Outcome :</b>	Satisfactory	Moderately Satisfactory	Despite advances in managing some aspects of its public finances, the state failed to reduce its deficit and to restrain its accumulation of debt. The Region agreed with the OED rating but did not have the option for this rating .
<b>Institutional Dev .:</b>	Modest	Modest	
<b>Sustainability :</b>	Likely	Likely	Although sustainability is rated likely, it should be noted that after the program ended Estado de Mexico loosened its fiscal discipline; as the ICR notes, "the period of implementation and supervision of the program was too short-less than 16 months- to assure fiscal discipline and to regain access to viable sources of finance".
<b>Bank Performance :</b>	Satisfactory	Satisfactory	
<b>Borrower Perf .:</b>	Satisfactory	Satisfactory	It should be noted that once the third tranche was released, the government of the Estado de Mexico failed to meet its fiscal targets established in the 2002 budget as it did not adjust its expenditures in the face of lower than expected revenues.
<b>Quality of ICR :</b>		Exemplary	

**NOTE:** ICR rating values flagged with '\*' don't comply with OP/BP 13.55, but are listed for completeness.

**7. Lessons of Broad Applicability:**

Short period adjustment programs run high risks of having a deteriorated program outcome because conditionality is front-loaded, giving ample opportunity for achievements to be reversed . When reforms play central part in the program, an adjustment program loan may be more apt to help preserve the changes supported by the loan .

**8. Assessment Recommended?** ● Yes ○ No

**Why?** This loan should be discussed as part of a cluster of loans on decentralization . The Bank has been promoting decentralization all over the world, with success as measured by the number of loans and analytical work done. An audit of several loans could give a better perspective on how the loans have performed and how they have benefited the recipient countries .

**9. Comments on Quality of ICR:**

ICR presents the information clearly and concisely . ICR could have enhanced the benefits of Annex 1 by adding the items in the loan agreement met by each listed action