

**Document of
The World Bank**

Report No: 24118-ME

PROJECT APPRAISAL DOCUMENT
ON A
PROPOSED LOAN
IN THE AMOUNT OF US\$ 52 MILLION
TO THE
UNITED MEXICAN STATES
IN SUPPORT OF A
TAX ADMINISTRATION INSTITUTIONAL DEVELOPMENT PROJECT
May 24th, 2002

Poverty Reduction and Economic Management
Colombia, Mexico, Venezuela Country Management Unit
Latin America and the Caribbean Region

FISCAL YEAR
January - December 31

CURRENCY EQUIVALENTS

(as of April 9th,2002)
Currency Unit = Peso
9.04 Pesos = US\$1

WEIGHTS AND MEASURES

Metric Systems

ABBREVIATIONS, ACRONYMS AND GLOSSARY

| | |
|------------------|---|
| BANOBRAS | National Bank of Public Services (<i>Banco Nacional de Obras y Servicios Públicos</i>) |
| CAS | Country Assistance Strategy |
| CIAT | Interamerican Center for Tax Administration <i>Centro Interamericano de Administración Tributaria</i> |
| CIDE | Center of Economics , Research and Education <i>(Centro de Investigación y Docencia Económica)</i> |
| COMPRANET | Government Electronic Procurement System <i>(Sistema Electrónico de Contrataciones Gubernamentales)</i> |
| CPAR | Country Procurement Assessment Report |
| CQ | Selection Based on Consultant Qualifications |
| DBR | Development Business Review |
| FMA | Financial Management Assessment |
| FMR | Financial Monitoring Report |
| G.A. | General Administration |
| GDP | Gross Domestic Product |
| GOM | Government of Mexico |
| IBRD | International Bank for Reconstruction and Development |
| ICB | International Competitive Bidding |
| ICT | Information and Communications Technology |
| IMF | International Monetary Fund |
| INTERNET | Inter-networking protocol for transmission of data through packets. |
| INTRANET | An Internet service restricted to a private group. |
| LCS | Least Cost Selection |
| MIS | Management Information System |
| NAFIN | National Financing Agent (<i>Nacional Financiera</i>) |
| NBF | Not Bank Financed |
| NCB | National Competitive Bidding |
| PAD | Project Appraisal Document |
| PCD | Project Concept Document |
| PIU | Project Implementation Unit |
| QCBS | Quality and Cost Based Selection |
| SAT | Tax Administration Service (<i>Servicio de Administración Tributaria</i>) |
| SBD | Standard Bidding Document |
| SECODEM | Ministry of Comptrollership and Administrative (<i>Secretaría de Contraloría y Desarrollo Administrativo</i>) |
| SFB | Selection Based on Fixed Budget |
| SHCP | Finance and Public Credit Secretariat (<i>Secretaría de Hacienda y Crédito Público</i>) |
| SOE | Statement of Expenses |
| SSI | Revenue Undersecretariat (<i>Subsecretaria de Ingresos</i>) |
| TRAL | Tax Reform Adjustment Loan |
| WBG | World Bank Group |

| | |
|------------------|--------------------|
| Vice President: | David de Ferranti |
| Chief Economist | Guillermo Perry |
| Country Director | Olivier Lafourcade |
| Sector Director | Ernesto May |
| Task Team Leader | Steven Webb |

Tax Administration Institutional Development Project

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The project was prepared under the general guidance of Marcelo Giugale (Lead Economist and Sector Leader) and Ronald Myers (Sector Manager). The project preparation team comprised Katherine Bain, Lea Braslavsky, Enrique Fanta, Pilar Gonzalez, Francisco Leiva, Luis Jose Mejia (co-task manager), Herman Nissenbaum, Victor Ordoñez, Judith Davidson Palmer, Reynaldo Pastor, Mariangeles Sabella, Harjit Singh, and Steven Webb (task manager). Patricia Chacon Holt and Elizabeth Toxtle supported the team. Peer reviewers were Michael Engelschalk and Jit Gill.

México
Tax Administration Institutional Development Project
Project Appraisal Document

Latin America and the Caribbean Regional Office
Country Management Unit

Date: May 24, 2002 **Task Team Leader:** Steven Benjamin Webb
Country Director: Olivier Lafourcade **Sector Manager:** Ernesto May
Project ID: P077602 **Sector:** BF - Public Financial Management
Lending Instrument: Technical Assistance Loan **Theme:** Public Sector
Program of Targeted Intervention: No

Program Financing Data

Loan Credit Grant Guarantee Other

For Loans/Credits/Others:

Loan Currency: United States Dollar

Amount (US\$m): 52 million.

Borrower Rationale for Choice of Loan Terms Available on File

Proposed Terms (IBRD): Fixed-spread Loan (FSL)

Grace Period (years): 5

Years to Maturity: 15

Commitment Fee: 0.85% per annum from the 60 days after the loan agreement and 0.75% after the 4th anniversary of this date.

Front end fee (FEF) on Bank loan: 1.00%

Initial Choice of Interest-rate basis: LIBOR plus Fixed spread

Type of Repayment Schedule:

Fixed at Commitment, with the following repayment method (choose one): Level repayments of principal of 5% per semester over 10 years.

| Financing Plan (US\$m) | Source | Foreign | Local | Total |
|------------------------|--------|---------|-------|-------|
| World Bank | | 19.7 | 32.3 | 52.0 |
| Government of Mexico | | 1.0 | 29.0 | 30.0 |
| | Total | 20.7 | 61.3 | 82.0 |

Borrower: United Mexican States

Responsible agency: Servicio de Administración Tributaria (SAT)

Ardes: Hidalgo 77 Module I, 1er piso, Col Guerrero 06300 México D.F.

Contact Person: Lic. Adriana Cuevas Argumedo. Tel: 52.55.5229-4406 Email: acuevas@shcp.ssi.gob.mx

| Bank Loan Disbursement Schedule (in US\$m) by | 2003 | 2004 | 2005 | 2006 | Total |
|---|------|-------|-------|-------|-------|
| Annual | 5.02 | 21.35 | 17.91 | 6.32 | 1.40 |
| Cumulative | 5.02 | 26.37 | 44.28 | 50.60 | 52.00 |

Program implementation period: July 2002 – December 2006

Expected effectiveness date: 07/01/2002 **Expected closing date:** 12/30/2006

A. Project Development Objective

1. Project Development Objective (see Annex 1)

The project objective is to improve tax compliance and reduce evasion of internal national taxes to increase government revenues by increasing the efficiency and effectiveness of the Mexican Government's Tax Administration Service (SAT).

The ultimate object of strengthening the tax system is to assure macroeconomic stability and that public resources are available to meet the country's growing needs for human resource development, both of which have proven essential in Mexico for the continued reduction of poverty.

2. Key performance indicators (see Annex 1)

Effectiveness:

- Increase in revenues due to tax administration improvement
- Increase in taxpayer coverage
- Increase in taxpayer perception of evasion risk
- Increase in taxpayer perception of SAT effectiveness

Internal Efficiency:

- Decrease in the cost to the Service per peso collected.
- Decrease in SAT's average collection time per peso

External Efficiency:

- Decrease in the taxpayer's cost of compliance
- Decrease in taxpayer's time for compliance

B. Strategic Context

1. Sector-related Country Assistance Strategy (CAS) goal supported by the project (see Annex 1). Document number: 19289 Date of latest CAS discussion: May 1999, May 2002 (CAS Update May 2001).

This project supports a goal of the 1999 CAS, subsequently reiterated in the 2000 CAS Update and the 2002 CAS, to provide continuing assistance for the Government's fiscal reform program in the interests of assuring macroeconomic stability.

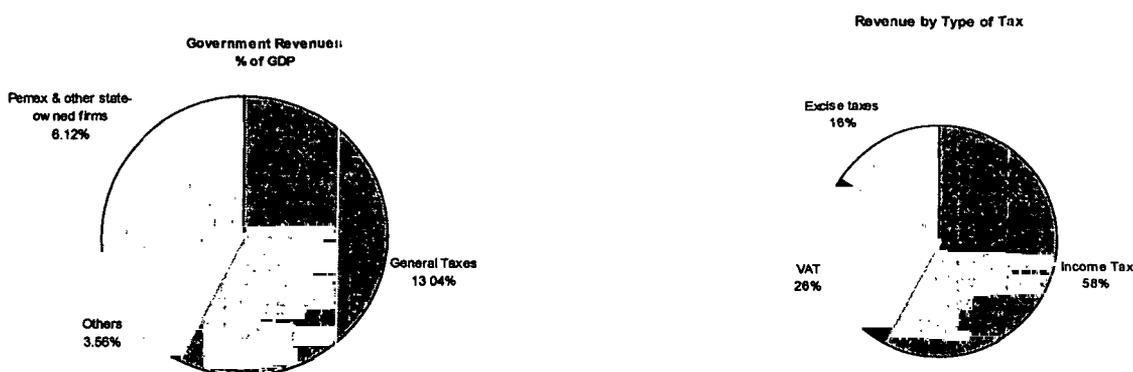
The Bank has carried out economic analyses and discussions with the Government on fiscal policy, in close collaboration with the IMF. As a result, a number of tax reforms have been carried out, the latest being the package of legislative change proposals sent to the Congress late last year. A Tax Reform Adjustment Loan (TRAL) is being presented at the same time. This loan targets reforms affecting several taxes and goals related to fiscal balances and sustaining key programs for investment and poverty reduction.

The Government has begun several worthwhile initiatives to improve Federal tax administration, and has requested technical assistance to accelerate planned improvements. This would support Mexico's efforts to reduce poverty and enhance social sustainability by increasing the public sector resources, particularly for expansion of social sector services and infrastructure investment. Recent ESW reports linked that requirement to traditionally low level domestic revenue collection, which is the prime target of this project.

2. Main sector issues and Government strategy

Mexico needs to invest more in human resource development and public economic infrastructure to modernize its economy, reduce poverty, and facilitate overall growth. This requirement for increasing revenues entails mobilizing resources in a manner which is sustainable in the long term.

Despite efforts in the early 1990s which temporarily pushed up Federal revenues as a share of GDP, the overall share of tax revenues in Mexico has changed little over the last two decades. By international and middle-income Latin American standards, tax collections in Mexico are comparatively low. Federal tax revenues (excluding social security and oil sector revenues) are only about 11.4 percent of GDP, putting Mexico at the bottom of the OECD ranking of tax revenues to GDP at that time. Moreover, the gap between Mexico's tax to GDP ratio and those of most Latin American countries with similar per capita GDPs is growing.



These deficiencies exist even though Mexico had frequent (and some quite major) tax policy changes in 1978-80, 1983, 1985-86, 1988, 1990-91, 1993-95, and 1997-98. The most recent, which took effect in 2002 (discussed in the Tax Reform Adjustment Loan documentation), were not as extensive as the Government had originally hoped but nonetheless made important progress. The Government intends to complete other parts of its comprehensive fiscal reform agenda in the next few years.

Meanwhile, the tax system continues to rely heavily on the petroleum sector, which accounts for 15 to 25 percent of total revenues. This makes budget revenues very sensitive to changes in international oil prices. In addition, the gross revenue from oil seems likely to stay roughly constant in real terms, which means that the growth in GDP and public services will necessitate an increase of non-oil revenues as a share of GDP.

The value-added tax (VAT) of 15 percent, currently the second largest revenue source after income taxes, holds the greatest potential for increasing revenues, as it now suffers from a high level of evasion, which a 1996 study estimated at about 60 percent. Revenues from personal income tax actually declined as a share of GDP over the past two decades (this should change with the recently enacted reforms).

SAT recognizes that deficiencies in its operations contribute to the low levels of compliance and revenue. Taxpayer coverage is insufficient. A national survey carried out toward the end of 2001 reported that global coverage reached 83 percent, of which 81 percent are individuals and 95.2

percent are firms. Nevertheless, the Taxpayer Registry today does not contain all potential taxpayers.

Based on the Twelfth General Population and Housing Census, the work force is calculated at 32.1 million people. Of these, 17.5 million are employees, 4.4 million are exempt agricultural workers, and 1.5 million are domestic employees, of which the latter would be difficult to register. Therefore, it can be reasonably calculated that in addition to the 7,148,800 taxpayers registered in December 2001, there are approximately 1.9 million unregistered potential taxpayers.

Of the registered taxpayers, 5.8 million must present tax returns, and of these only 3.95 million present them on time, thus producing a second gap.

The taxpayer auditing process needs to be improved, as a relatively low percentage of the unpaid amounts identified through audits are actually collected. Of the court cases filed against taxpayers who fail to fulfill their obligations, many of those submitted for administrative adjudication fail because of procedural errors, faulty notifications, and inadequate case preparation; there is a similar pattern for judicial cases.

SAT has recently introduced strategic planning concepts at the senior management level and defined initial organizational performance indicators. It is now refining SAT's planning to orient it to outcomes rather than activities. It also needs to further refine its performance indicators, take them farther down the management structure, calculate baseline values, and define individual performance indicators.

SAT requires careful management and coordination to create synergies among the various units and allow the timely sharing of information and multidisciplinary teamwork.

With respect to the sharing of information, SAT has the basic technology it requires, although it is somewhat old and requires upgrading and expansion to better support administrative work. The system development and maintenance services lack adequate prioritization and coordination, which has led to dissatisfaction with the services provided and the creation of independent informatics units in the organization. Application systems are redundant and uncoordinated and do not communicate efficiently with each other. SAT needs to improve its information systems and technology strategy, and to introduce internal service policies and strategies to better assign these resources.

In the past year, SAT has made significant efforts to improve its staffing and personnel management. The number of staff has been reduced to 37,000, although staff improvement and not reduction is a goal of SAT. Many of the incumbents, particularly in administrative positions, lack proper qualifications and/or do not perform adequately, according to recent personnel evaluations. Of the 37,000 staff, about 16,000 work full time, while the service provided by the remainder ends at 3 p.m.

The present staff mix is not appropriate for SAT's goals to provide consistent, effective public service, nor the essential internal institutional functions, and from this point of view, SAT may actually be understaffed. SAT has begun to survey skill levels and determine staff requirements, has improved management selection and salaries, which are competitive with the market. SAT

recognizes however the need for further improvement in its human resource management policies and procedures for selecting, training, evaluating, disciplining, etc. its employees.

SAT has also begun, with Bank help (see below), to introduce mechanisms to prevent, detect, arrest, or punish corrupt practices in key positions. It has rotated or fired about 2000 staff (especially in Customs) in an effort to reduce corruption.

Government Strategy

As alluded to above, Government has already taken steps to improve tax administration. The most important of these were the creation of SAT as an autonomous entity with potentially considerable internal flexibility and competitive salaries; absorption of the National Training Institute; introduction of strategic planning; initial rationalization and training of staff; introduction of more transparent personnel selection methods; initiation of programs for improving taxpayer services and physical infrastructure; simplified tax return and payment processes; and mechanisms to identify non-filing registered taxpayers. Furthermore, Government is embarking on a government-wide anti-corruption campaign.

The issues addressed are critical and have created a momentum for reform within SAT. This momentum needs to be encouraged and assisted, to transform SAT into an institution operationally more aligned with its strategic objectives and capable of continuous and sustainable improvement.

Some important changes in Mexico make it more likely that tax administration reform will have deeper and longer lasting effects now, compared with those in the past. During much of the last two decades the Secretariat of Finance and Public Credit (SHCP) has followed the implicit practice that any increase in revenues would be "spent" in the form of rate reductions or tax expenditures (special exemptions), rather than on the expenditure side of the budget.

Keeping tax effort constant largely resulted from negotiating tax burdens with representatives of the private sector. The political economy of taxation in Mexico has involved periodic discussions and agreements between a group of compliant large taxpayers (sometimes including the state petroleum monopoly, PEMEX) and the government authorities agreeing to an overall level of tax effort. Improvements in the level of enforcement or effort by the tax administration tended to come through concentrated tax enforcement crusades (only) when government revenues were dramatically down due to economic crises and business cycle downturns. The efforts suffered from the lack of commitment at the top political levels for administrative reform per se, rather than just for the sake of raising more revenue. Also, the time frame of the reforms was too short, and the reforms were piecemeal, not part of an integrated plan.

In contrast to the past, the current reforms to tax administration and policy are priorities of the President and of the Secretary of Finance. The Secretary's public reputation came primarily from the strong tax administration improvement efforts that he led as Subsecretary of Revenue in the early 1990s. As the current effort starts with the beginning of a new administration, it should, unlike his previous efforts, allow sufficient time to institutionalize the reforms.

3. Sector Issues to be addressed by the project and strategic choices

Sector Issues

The project will address the tax administration issues mentioned above through a comprehensive reform of the Tax Administration Service. This reform would encompass organizational and management strengthening in conjunction with operational capacity building. It would introduce the concept of taxpayer life cycle process, to integrate all phases of SAT's relationship with the taxpayer in a service-oriented manner. It would expand the taxpayer base and the control of fiscal obligations, and improve taxpayer access to improved SAT services.

The project aims to achieve its objectives by strengthening accountability within SAT, mostly through the introduction of measurable organizational and individual performance indicators, relative to newly determined baselines. It would strengthen its external service vision, introduce an internal service approach, change its focus from the functional approach to a business processes vision, and upgrade management to provide better integration and synergies among the functional units.

Strategic Choices

The Government and the Bank agreed on three strategic choices for the project. The first choice was to limit the scope of the project to domestic taxation. Therefore, the coordination of information with Customs is included in the project, but substantial changes to Customs administration are not, because Customs had recent reforms in the context of NAFTA. Nevertheless, a diagnostic and plan for future strengthening of Customs could be included in this project.

The second strategic choice was to exclude anti-corruption issues, which are being integrally addressed at a government-wide level in a separate project. Activities such as the creation of the post of Technology Security Officer, the modification of key systems to include provisions for audit trails and redundant processes for checks and balances, the inclusion of specific modules in the various management and control systems to provide information for anti-corruption analyses, as well as investigation, technical assistance from already identified friendly tax administrations, and training, will be considered for inclusion in the government-wide project (in preparation with Bank assistance).

The third choice was to focus the project on what could be reasonably achieved during the current administration, through the end of 2006. For this reason, the project is a TA loan, rather than an Adaptable Program Loan.

C. Project Description Summary

1. Project components (see Annex 2 for a detailed description and Annex 3 for a detailed cost breakdown):

Component 1- eSAT and Taxpayer Services

This component aims at strengthening SAT's on-going efforts to provide better taxpayer service and increase the transparency of SAT. The project will further simplify taxpayers' filing of returns by employing more advanced electronic means. It will upgrade the surveys of taxpayers and other stakeholders, and will create permanent focus groups. In addition, studies will be carried out on all of SAT's contact points with taxpayers, for more focused examination of the need for improvement

in its procedures, information services, public access, etc. Service standards will be established, particularly to increase SAT's transparency, and the National Service Center's present limited information capabilities will be strengthened. This component includes all web-based activities under SAT's e-business strategy (eSAT).

| Component | Sector | Indicative Costs (US\$M) | % of Total | Bank financing (US\$M) | % of Bank financing |
|---|------------|--------------------------|---------------|------------------------|---------------------|
| 1: eSAT/Taxpayer Services | Inst. Dev. | 5.38 | 6.6% | 3.71 | 7.1% |
| 2: Human, Financial and Physical Management | Inst. Dev. | 18.82 | 22.9% | 11.33 | 21.8% |
| 3: Information Hub | Inst. Dev. | 10.56 | 12.9% | 7.91 | 15.2% |
| 4: Technology Services | Inst. Dev. | 17.12 | 20.9% | 12.82 | 24.7% |
| 5: Compliance Process | Inst. Dev. | 17.16 | 20.9% | 5.59 | 10.8% |
| 6: Control & Enforcement Process | Inst. Dev. | 8.95 | 10.9% | 7.51 | 14.4% |
| 7: Planning and Quality Control | Inst. Dev. | 3.51 | 4.3% | 2.60 | 5.0% |
| Front End Fee | | 0.52 | 0.6% | 0.52 | 1.0% |
| Total Project Costs | | 82.00 | 100.0% | 52.00 | 100.0% |

Component 2 – Management: Human, Financial and Physical

This component will help SAT establish a better framework for planning and managing its manpower, financial and physical resources. Assistance will be provided for assessing SAT's staff, documenting the results in a Human Resource Management System, upgrading training, and introducing performance management policies and systems. Better human resource policies and monitoring will be sought, emphasizing greater performance-based and incentive-oriented management. Similar efforts will be undertaken to improve SAT's budgeting and accounting operations, and the whole will be brought together to form SAT's Integrated Resource Management System.

Component 3 – Information Hub

This component aims to improve the communication, sharing and management of information within SAT. Initially, SAT would appoint a Chief Information Officer in charge of policy, coordination, quality assurance and security of information, and will implement a series of databases that will be optimized for access and security and will automatically receive data from the operational databases in the various areas.

Seven major groups of information are essential to the business processes of the organization, and they must be accessible for use in a timely manner by those processes: (i) Taxpayer basic information; (ii) Information on taxpayer's tax compliance and transaction registry; (iii) External commerce information; (iv) Resource Management information; (v) General information database for the provision of information and services to the taxpayer and other organizations; (vi) Information for decision-making. The information hub therefore consists of a collection of databases used for information access ("read only"), configured for multiple queries and retrievals of information, with sophisticated security measures and firewalls, thus leaving the operational databases isolated and optimized for updating rather than access.

Component 4 – Technology services

The component would finance consulting assistance to develop an ICT strategy aligned with SAT's business strategy and goals, technical assistance for the development and implementation of an Internal Service Policy for ICT services, develop strategies for information security and integrity, a plan for hardware consolidation and upgrading, functional requirements and test bed for system integration testing, centralization of systems and data migration, development and implementation of a Disaster Recovery Plan (including actions for the resumption of service after a disaster, alternative sites, etc.) and a Contingency Plan (for minor faults which affect the business processes). In addition, equipment will be upgraded to improve performance; more efficient automated administrative systems would be introduced in offices nation-wide; and archived documents would be scanned to permit sharing them electronically throughout SAT's offices.

Component 5 – Compliance Process

The component would focus on the complete Compliance Process, financing activities to improve SAT's collections, Large Taxpayers, and elements of its Legal and Customs functions. These would be collectively treated within the redesign of the organization's application systems, the development of new databases and control systems. In addition, a management information system would be defined and developed, performance indicators defined and baseline measured, and the Standard Notification System defined (with performance indicators and a control system). In particular, this component would finance the increase in Taxpayer Registry coverage and the creation of the single taxpayer account.

Component 6 – Compliance control and enforcement

The project would finance activities to integrate elements of SAT's enforcement, auditing, legal and other functions directed at problems of evasion, non-payment etc. into a "Compliance Control and Enforcement" process. These activities would include, among others: (i) design of methods to identify evasion and the development of evasion review guidelines and control system; (ii) development of a case selection system based on agreed priorities and policies, which limits discretionary selection; (iii) continuous and systematic evasion studies, in particular on VAT, oriented towards evasion by economic sector and type of taxpayer; (iv) development of a management & control system; (v) establishment of units or appointment of individuals specialized by economic sector or type of taxpayer, theoretical and on-the-job training; (vi) the establishment of a quality and integrity assurance unit and its corresponding systems; (vii) review of the notification system and its legal context; (viii) analyses of notification information provided by the enforcement MIS to provide feedback to the various processes and guidelines; (ix) analysis of compulsory collection measures and their legal context, recommendations for improvement, and integration with the MIS; (x) redesign of the administrative dispute process within SAT; (xi) development of an integrated system for jurisprudence and internal regulations and update of the jurisprudence and internal regulations system with information from SAT's cases in the Fiscal Administrative Tribunal and with information from SAT's cases in the Judicial Tribunals; (xii) development of a system for the assigning cases to lawyers; and (xiii) analysis of portfolio to develop criteria for the prioritization and planning of arrears collection.

Although institutional change is a long-term activity, some activities will provide short-term successes essential to enhancing the credibility of the reform and providing political support to the head of SAT, who is the Champion of the project. Two activities have been identified with the requisite characteristics: Audit of VAT refunds; and case selection for Large Taxpayers. Eventually, these efforts will be subsumed in the main thrust of the project.

Component 7: Planning and Quality Control

SAT senior management last year carried out their first Strategic Planning Exercise (for 2001). As is usual in such activities, an iterative, incremental effort is required to improve the plans yearly. The present Strategic Plan combines elements of strategy and operations. The next iteration should result in separate strategic and operational plans. The operational plan would define all the activities necessary to accomplish the Strategic Plan objectives (detailing their duration, sequence and resources). The activities in turn should have clearly defined results and performance indicators for gauging accomplishment, efficiency and effectiveness, together with proposed goals. Training, seminars and technical assistance on planning and performance indicators would be provided to senior and middle managers.

The existing advisory group to SAT's President will assume the function of Results Management, charged with assisting the various areas with strategic and operational planning, change management, conflict management, the definition and measurement techniques for performance indicators, and the monitoring of all project activities. One task would be to contract out a diagnosis of the relationship between Customs and Tax Administration, to be the basis for designing an action plan to strengthen the relationship.

Performance indicators would be gathered into a Management Information System, which, as business processes are revised, would be fed with information automatically generated. In addition, quality control will be introduced organization-wide, through policies, procedures, evaluation methodologies and training.

2. Key Policy and institutional reforms supported by the project

By contributing to more sustainable revenue flows, the project would help the Government meet its needs for fiscal stability and poverty reduction. The project is part of the Government's overall effort for fiscal reform, public sector rationalization and improved transparency. Key results would be improved accountability by management and staff, management coordination, a business-process approach, and a stronger internal and external service-oriented culture.

3. Benefits and target population

Taxpayers should benefit in several ways. Better targeted taxpayer auditing would improve popular perceptions of the tax system's fairness and equity--and thus enhance tax compliance. So too should better appeals and complaints procedures. More efficient SAT operational methods, resulting in faster turnaround of tax returns and refunds and a faster registration process, would ease the burden of compliance. Improved information to taxpayers could decrease compliance costs. Indirectly and ultimately, the project should benefit all citizens by increasing government revenues, generating greater assistance to the economy and to key development sectors.

4. Institutional and implementation arrangements

The proposed project will be implemented by the Sistema de Administración Tributaria - SAT. The project implementation unit will be located within the SAT, which will be in charge of the overall administration of the project funds and will be responsible for financial management and compliance with Bank requirements. The core SAT project team has been chosen based on project/Bank requirements and will receive support including training from Nacional Financiera, the Undersecretariat of Public Credit, and the Bank.

D. Project Rationale

1. Project alternatives considered and reasons for rejection

A hardware technology-driven project design was discarded because it was deemed more critical to focus on basic institutional issues and postpone any major improvements of the physical information technology infrastructure until the information itself and its organization were first improved.

2. Major related projects

No project in implementation relates to the proposed project, although it is closely linked with the Tax Reform AL and is complemented by the Anti-Corruption project and the State of Mexico Technical Assistance project, both in preparation. In addition, the Bank is coordinating closely with the IMF on issues pertaining to tax administration as well as policy.

3. Lessons learned and reflected in the project design

The project incorporates lessons learned from Bank Tax Administration Projects considered to be examples of their kind¹, as well as related projects; OED's Lessons and Practices - Technical Assistance, Report Number 7 (May 1996); and "Reforming Tax Systems: The World Bank Record in the 1990s", a report prepared by Tax Policy and Administration Thematic Group. The issues raised are summarized in Annex 4.

4. Indicators of borrower commitment/ownership

The strength of the Government's commitment to improved tax policies and administration is shown by its hard fight in 2001 to pass the fiscal reform package, of which Congress accepted important income tax reforms but deferred VAT policy changes to a more politically favorable circumstance. On the administrative side, the Government merged customs and tax administration and is pursuing an aggressive prosecution of problems of corruption within Customs. President Fox's administration has also demonstrated support for a Government-wide anti-corruption campaign, and for the federal decentralization strategy. The Government has also moved on other areas of public sector modernization. Tax administration improvement has been repeatedly discussed with the Bank and the IMF by the highest government officials, and there is a consensus for immediate reform.

5. Value added of Bank support in this project

Bank support would help Mexico set a more comprehensive course to tax administration reform based on worldwide experience in the field and key modern concepts and practices. The Bank would help ensure SAT's sustained progress on its major institutional effort by providing systematic technical as well as financial assistance during the implementation of the Service's reform measures. The Bank's dialogue and close supervision of these activities should help SAT see that they are well coordinated and internally consistent.

The Bank's coordination with the IMF on tax policy and administration should provide a solid foundation of support and cooperation, bolstering the Government's ability to implement their advice.

¹ Latvia State Revenue Modernization Project; (October 1998); Guatemala Tax Administration Technical Assistance Loan (August 1997); Turkey Public Financial Management Project (August 1995); in addition, lessons stated in the Russian Federation Second Tax Modernization Project (in preparation, January 2002) have been used.

E. Summary Project Analysis

1. Economic Assessment:

Since this is a technical assistance project focused on institutional improvements, it is not amenable to the calculation of an economic rate of return. However, the modernization of tax and customs administration would produce economic benefits. These include increases in the effectiveness of revenue administration, as manifested in improved cost effectiveness of revenue collection, as well as increases in its efficiency by lowering administrative expenses; widening the tax base and reducing taxpayer compliance costs. Other, less quantifiable benefits associated with the project include: (a) more equitable distribution of the tax burden; (b) tax revenues from the "underground" economy; and (c) increases in economic growth.

The revenue effects from improved administration are harder to predict than the effects of policy changes, holding enforcement constant. Historical and international comparisons provide some basis for estimation. The revenues from stronger enforcement of the VAT in 1992-94 with a 10 percent rate, compared with revenues with a 15 percent rate in 1998-99, suggest that improved enforcement could raise VAT revenues by 25 percent. This is conservative compared with the CIDE estimate of 60 percent evasion (reducing evasion to 40 percent would raise revenues by 50 percent) and with the international comparison of revenue shares. For the income taxes, revenues in the early 1990s peaked at about 20 percent higher than in recent years, and CIDE estimates of the potential for increasing income tax revenues suggest about a 25 percent increase due to better enforcement. An estimate of 15 percent increase in revenues due to better income tax administration could be made. Since the 2001 tax revenues were about US\$23 billion from the VAT and about US\$30 billion from the income tax, it would only take about 0.16 percent increase of revenue from these taxes in a single year to pay for the entire cost of the project.

2. Financial

| Counterpart Financing Schedule (in US\$ millions) | FY03 | FY04 | FY05 | FY06 | FY07 |
|---|------|-------|-------|-------|-------|
| Annual | 1.45 | 12.11 | 9.33 | 4.72 | 2.40 |
| Cumulative | 1.45 | 13.56 | 22.89 | 27.60 | 30.00 |

The project requires yearly counterpart funding of at most, less than 1 percent of SAT's annual budget. In addition, successful implementation of the project should have a favorable fiscal impact, without negatively affecting the level and quality of the provision of necessary public goods and services.

The budget for 2002 was defined and enacted into law earlier this year, and it is therefore too late to insert the project the budget for this calendar year. However, SAT can use its own funds by postponing some non-project expenditures until the next calendar year, and be reimbursed with project funds after it is included in next year's budget. SHCP and SAT are confident that the project will be inserted into the budget for calendar 2003 (still in the Bank's FY03) and subsequent years.

3. Technical:

There are no critical technical issues.

4. Institutional:

4.1 Executing agencies

SAT has a highly qualified and experienced senior staff, and its salary structure enables it to attract qualified experts for its management and technical positions. Project management assistance would be provided for implementation - the introduction of a project management culture is one of the features of this project.

4.2 Project management

The project will be managed and implemented by SAT's own management and staff. A project management committee, composed of the participating General Administrators, will be presided by the Undersecretary for Revenues and President of SAT. He would be assisted by a strengthened Results Management Group in charge of project planning, monitoring, evaluation and reporting, and by the Committee's Secretary, in charge of overall coordination. A Technical Group, composed of representatives of each area, would be responsible for carrying out the decisions of the Committee.

The Committee will prepare and implement Annual Action Plans that will be agreed with the Bank every year and revised every six months during supervision missions. Semi-annual progress reports will measure project performance compared with the baselines to be defined before initiation of each key activity.

4.3 Procurement issues

SAT's procurement department operates under the Acquisition Law of January 4th, 2000, and its Regulations of August 20th, 2001. This law and regulation provide for measures very similar to the Bank procurement guidelines for consultant selection. They provide for short-lists and an evaluation committee composed of members of the user, legal, budget and procurement areas of SAT, plus a representative from the Comptroller General's Office (SECODAM). The preparation of terms of reference and evaluation criteria will be the responsibility of the user areas, assisted and monitored by the Results Management Unit; the coordinator would be responsible for their clearance and the Bank's review. Standard contracts will be agreed with the procurement department before effectiveness.

Government uses its official gazette, the *Diario Oficial de la Federación*, for invitations to bid and for expressions of interest. In addition, SAT was authorized in June 2001 by SECODAM to participate in *COMPRANET*, the Federal Government's e-procurement system. All Bank-financed procurement will utilize *COMPRANET*, which permits open access through the Internet to the bidding documents, minutes of bidders' meeting and awards.

Personnel from SAT's procurement department will attend training in the Bank's procurement procedures as appropriate. By negotiations, the first project year's procurement plan and timetable was agreed and will be published in the Development Business Review by effectiveness; after this, semi-annual procurement announcements in the DBR will alert potential foreign consulting firms to opportunities under this project.

4.4 Financial management issues

The proposed project will be implemented by the Sistema de Administración Tributaria – SAT, assisted by a financial agency, NAFIN, which will be in charge of the overall administration of the

project funds and will be responsible for financial management and compliance with Bank requirements. NAFIN has many years of experience in working with Bank projects.

Financial Management. In order to comply with Bank requirements of OP/BP 10.02, a certified Financial Management Specialist (FMS) carried out a Financial Management Assessment of SAT's institutional capacity. The assessment was based on applicable Bank guidelines and covered project arrangements on budgeting, accounting, internal control, flow of funds, auditing, reporting and staffing. Based on his review and on the information of the ISO certification, the FMS concluded that Sistema de Administración Tributaria –(SAT), the implementing unit, is prepared to implement the project; it is currently fully staffed and operational, and has in operation a sound financial management system that meets minimum Bank financial management requirements. The existing financial management systems in SAT are acceptable but not yet fully satisfactory to the Bank, as they must be adjusted for project management, Bank reporting and project disbursing. One of the activities of the project aims to strengthen further these systems.

Overall Risk Assessment. *Moderate.*

The project will be audited on annual basis by auditors acceptable to the Bank and in line with Bank requirements on the subject. Annex 6 provides additional information on financial management.

As a condition of negotiations, SAT and the Bank agreed on the format for Financial Monitoring Reports and the use of an accounting system, satisfactory to the Bank, to record funds expended under the retroactive financing condition. As a condition of effectiveness, a project operations manual satisfactory to the Bank would be prepared, specifying procedures for project management, accounting, internal controls, planning, budgeting, auditing and disbursing.

5. Environment assessment: Environment Category A B C
The proposed project is expected to have no environmental impact.

6. Social:

6.1 Summarize key social issues relevant to the project objectives, and specify the project's social development outcomes.

Mexico's income distribution is highly inequitable. The TA Project would help lessen that by advancing changes designed to obtain greater tax revenues from higher income taxpayers, as well as broadening the tax base. These would help reduce the relative tax burden on the poor, and by providing funding for highly progressive social programs, would bring about greater progressivity in the overall fiscal system.

The Project would thus support poverty reduction aims mainly from the expenditure side. The successful implementation of the tax policy reforms and the changes within SAT under the Project to better administer the system will raise more resources for human resource and economic infrastructure programs and in this way enhance the fiscal sustainability of key social services for all Mexican residents.

6.2 Participatory Approach

During project preparation, consultations were carried out with NGOs and accounting firms in Mexico City, as well as selected large taxpayers, on their experiences with SAT services. The Taxpayer Assistance Administration, charged with out-reach responsibilities, through the project

will introduce and support arrangements for providing greater public access to information about the tax system, as well as educational campaigns regarding citizens' rights and obligations. Surveys of taxpayers will be carried out periodically throughout the project., An Advisory Committee of interested stakeholders (Chamber of Commerce, professional associations and others) provides on-going feedback on SAT's services and plans.

6.3 How does the project involve consultations or collaboration with NGOs or other civil society organizations?

It is expected that the greater transparency and information access provided by the project will stimulate NGOs and civil society organizations to monitor and participate in providing feedback to government on SAT and its performance.

6.4 What institutional arrangements have been provided to ensure the project achieves its social development outcomes?

Not applicable.

6.5 How will the project monitor performance in terms of social development outcomes?

Not applicable

7. Safeguard Policies:

7.1 Do any of the following safeguard policies apply to the project?

| Policy | Applicability |
|--|---|
| Environmental Assessment (OP 4.01, BP 4.01, GP 4.01) | <input type="radio"/> Yes <input checked="" type="radio"/> No |
| Natural Habitats (OP 4.04, BP 4.04, GP 4.04) | <input type="radio"/> Yes <input checked="" type="radio"/> No |
| Forestry (OP 4.36, GP 4.36) | <input type="radio"/> Yes <input checked="" type="radio"/> No |
| Pest Management (OP 4.09) | <input type="radio"/> Yes <input checked="" type="radio"/> No |
| Cultural Property (OPN 11.03) | <input type="radio"/> Yes <input checked="" type="radio"/> No |
| Indigenous Peoples (OD 4.20) | <input type="radio"/> Yes <input checked="" type="radio"/> No |
| Involuntary Resettlement (OP/BP 4.12) | <input type="radio"/> Yes <input checked="" type="radio"/> No |
| Safety of Dams (OP 4.37, BP 4.37) | <input type="radio"/> Yes <input checked="" type="radio"/> No |
| Projects in International Waters (OP 7.50, BP 7.50, GP 7.50) | <input type="radio"/> Yes <input checked="" type="radio"/> No |
| Projects in Disputed Areas (OP 7.60, BP 7.60, GP 7.60)* | <input type="radio"/> Yes <input checked="" type="radio"/> No |

7.2 Describe provisions made by the project to ensure compliance with applicable safeguard policies.

Not applicable.

F. Sustainability and Risks

1. Sustainability:

The sustainability of the benefits of the project will depend on the degree to which the Government:

1. Ensures that SAT's strategic objectives are aligned with the Government's.
2. Provides SAT with the authority and autonomy necessary to comply with these objectives
3. Requires periodic effectiveness and efficiency evaluations of SAT's performance and accountability.

And SAT:

1. Ensures that its functions, processes, projects, organization, personnel and incentive system are aligned with its strategic objectives and its values
2. Maintains a corps of professional staff and management working in coordination to achieve these objectives
3. Strives for measurable continuous improvement in effectiveness and efficiency.

As noted, there are indications of favorable Government commitment to the objectives of the Project. Moreover, there are reasonable prospects that the Government and SAT will provide and maintain the aforementioned six essential elements for sustainability. In the final analysis though, the successful perpetuation of the Project's outcomes will depend on continuing high level political support for SAT's institutional improvements, which has not been sufficiently steady in past decades.

2. Critical Risks (reflecting the fourth column of Annex 1):

| Risk | Risk Rating | Risk Mitigation Measure |
|---|-------------|---|
| <i>Annex 1, "From Outputs to Objective"</i> New borrower with a record of mixed success in past modernization attempts may not be able to carry out the project successfully | H | Continued high-level political commitment; project management expertise made available. |
| <i>Annex 1, "from Components to Outputs"</i> SAT does not have access to information on taxpayers from other public agencies | M | High-level political support |
| Resistance to performance measurement | M | Change management training; internal communication plan; staff participation |
| Delays due to day-to-day work pressure | M | Management training (time-management, leadership, planning & delegation) |
| Unions may resist the change | M | Timely communications and negotiation |
| Internal data is not fully obtainable | H | Reconstruction of data may be necessary |
| Probability of lost or damaged documents | H | Reconstruction of data may be necessary |
| Single taxpayer account information not accessible because of security constraints | M | Encryption |
| Overall Risk Rating | S | |

3. Possible Controversial Aspects

Strengthening SAT's fiscal presence (taxpayer's perception of SAT's ubiquity, enhanced amongst others by increased number of audits) might generate allegations or perceptions of administrative excesses or abuses. Steps will be taken to mitigate these through the introduction of more transparent appeals and complaints process and by keeping the public informed through the Internet. Individual's access to their account may generate fears of public disclosure—a concern that improved information management procedures will seek to address.

1. Effectiveness Conditions

- (i) Agreement on an operations manual which specifies, inter alia, procedures and requirements on project accounting system and internal controls; planning, budgeting, management and financial reporting, including format and contents of the accounting reports to be submitted on quarterly basis; auditing and disbursing; the first year's detailed work program

H. Readiness for Implementation

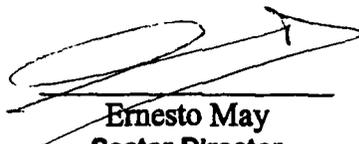
The engineering design documents for the first year's activities are complete and ready for the start of project implementation. Not applicable.

I. Compliance with Bank Policies

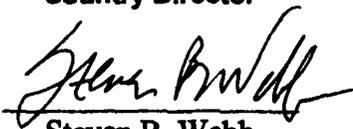
- This project complies with all applicable Bank policies.
- The following exceptions to Bank policies are recommended for approval: (see procurement annex 4). The project complies with all other applicable Bank policies.



Olivier Lafourcade
Country Director



Ernesto May
Sector Director



Steven B. Webb
Task Team Leader

Key Project Performance Indicators

| Hierarchy of Objectives | Key Performance Indicators | Data Collection Strategy | Critical Assumptions |
|--|--|--|---|
| <p>CAS Objective</p> <p>Promote macro-economic stability and social sustainability</p> | <p>Contribute to improved fiscal capacity</p> <p>Improved transparency and integrity of the system</p> <p>More equitable distribution of tax burden</p> | | <p>Political stability</p> <p>Continued public pressure for improved public sector performance</p> |
| <p>Project Development Objective</p> <p>To improve tax compliance and reduce evasion of internal national taxes to increase government revenues by increasing the efficiency and effectiveness of the Mexican Government's Tax Administration Service (SAT)</p> | <p>Effectiveness:</p> <p>Increase in revenues due to tax administration improvement</p> <p>Increase in taxpayer coverage: (umber of active taxpayers)</p> <p>Increase in taxpayer perception of evasion risk.</p> <p>Increase in taxpayer perception of SAT efficiency</p> <p>Internal Efficiency:</p> <p>Decrease in the cost to the Agency per monetary unit collected</p> <p>Decrease in SAT's average collection time per monetary unit</p> <p>External Efficiency:</p> <p>Decrease in the taxpayer's cost of compliance:</p> <p>Decrease in taxpayer's time for compliance</p> | <p>Annual report prepared by the Analysis and Studies Unit (baseline: 01.03)</p> <p>Annual report prepared by the Results Management Unit (baseline: 01.03)</p> <p>Annual reports prepared by the Results Management Unit based on external perception surveys (baseline: 01.03)</p> <p>Information prepared by the General Administration of Innovation and Quality (baseline: 01.03)</p> <p>Annual report prepared by the Results Management Unit (baseline: 01.03)</p> <p>Annual reports prepared by the Results Management Group based on studies of taxpayer costs by type of taxpayer and by taxpayer representative compliance by type of taxpayer activities (baseline: 01.04)</p> | <p>Continued political commitment to the reform</p> <p>New borrower with a record of mixed success in past modernization attempts will be able to carry out the project successfully</p> <p>Project management of the required caliber needed for effective change management to build ownership for the reforms and minimize resistance from managers, staff, taxpayers and other stakeholders</p> <p>SAT may fail to obtain access to information on taxpayers from other public agencies</p> <p>Government commitment to introduce a performance-based incentive system</p> <p>Ability of management to overcome to day-to-day work pressure</p> |

Key Project Performance Indicators

| Hierarchy of Objectives | Key Performance Indicators | Data Collection Strategy | Critical Assumptions |
|---|--|--|----------------------|
| Project Outputs | | | |
| eSAT/Taxpayer Services | | | |
| Simplified processes for easier compliance | Reduction in the cost and time of compliance | External surveys, data gathering and studies | |
| | Improvement in the quality of tax return presentations: # tax returns with errors/total received | MIS on service quality | |
| | # Internet tax returns/total tax returns | | |
| Assistance to taxpayer | Improved client satisfaction | External surveys, data gathering and studies | |
| | Office services: # people who go to the office this year/# people last year. | MIS; Annual reports | |
| | Telephone and Internet services: # unsuccessful calls & attempts/total number of calls & attempts | MIS; Annual reports | |
| | Decrease in the number of disputes and increase in the number of complaints resolved | MIS; Annual reports | |
| | Perception of taxpayers and other stakeholders regarding the level of professionalism, service and integrity of revenue administration staff | External surveys, data gathering and studies | |
| All business processes have a web-based window to the public | Annual decrease in paper processes; annual increase in the number of operations the taxpayer carries out electronically | Annual Reports for each business process compared to the Organization's e-strategy | |
| Management: Human, Financial, Physical and Organizational | | | |
| HR requirements in the new organization are flexibly and rapidly addressed | Job positions, staff profiles & workload mapped 50% profiles by 07.2003 100% by 12.2003 HR Policy prepared by 6.03 | Procedure Guidelines produced | |
| Training provided as a service in response to new organizational requirements | Training Policy by 06.03 | Procedure Guidelines produced | |

Annex 1

Key Project Performance Indicators

| Hierarchy of Objectives | Key Performance Indicators | Data Collection Strategy | Critical Assumptions |
|--|--|---|----------------------|
| Incentive system aligned with performance for all staff and management | Transition Training Plan by 06.03 Transition training plan implemented by 12.05 Permanent Training Plan by 12.05 Permanent Training Plan in implementation by 06.06 Perception of managers and staff regarding the level of professional skills in different areas Policy defined by 12.03 Individual performance indicators defined by 6.03; improved yearly System in full operation by 12.2005 | Internal surveys, data gathering and studies Yearly staff surveys show improved perception of transparency | |
| Staff informed on organization values, progress and plans | Communications policies and plan prepared by 6.2003 Implemented yearly | Yearly staff surveys show improved motivation | |
| Planning and management of human resources carried out based on full staff information | All staff in HRMIS by 12.2004 | Annual HR Management Reports | |
| Service culture introduced | Internal Service Policy established by July 2003 Service Standards defined by 12.03 Performance against standards measured by 06.04 Procurement carried out in a timely manner and in accordance to Bank Guidelines Project financial management carried out in accordance with Bank Guidelines Annual project audit conducted in a timely manner by independent auditors | Procedural Guidelines Internal staff survey MIS; Annual reports Supervision Missions | |
| Cost accounting and | New Policy on Budgeting and | Procedure Guidelines | |

Key Project Performance Indicators

| Hierarchy of Objectives | Key Performance Indicators | Data Collection Strategy | Critical Assumptions |
|--|---|--|----------------------|
| <p>budgeting as a planning tool for the organization</p> <p>Automated inventory and management of procurement of goods</p> | <p>Accounting defined by 06.03.</p> <p>All budgeting & accounting activities done through the FRMIS by 12.2005</p> <p>New Policy on materials management defined by 06.03.</p> <p>Goods managed by PRMIS by 12.2006</p> | <p>Annual Financial Management Reports</p> <p>Procedure Guidelines</p> <p>Annual Physical Management Reports</p> | |
| 1. Information Hub | | | |
| <p>Information is managed as a resource</p> | <p>CIO appointed by 01.03</p> <p>Information Policy 6.03</p> <p>Information Coordination Policy 6.04</p> <p>Information Quality Policy 6.04</p> <p>Information Security Policy 6.03</p> | <p>Procedure Guidelines</p> <p>Procedure Guidelines</p> <p>Procedure Guidelines</p> <p>Procedure Guidelines</p> | |
| <p>Taxpayer Registry Information is available for consultation</p> | <p>Use and Security Policy 07.03</p> <p>Database management system acquired and in operation 12.03</p> <p># of Registry records available = 90% of Operational Registry records (yearly)</p> | | |
| <p>Taxpayer Information is available for consultation</p> | <p>Use and Security Policy 07.03</p> <p># of records available = 90% of Operational Single Taxpayer Account Database records (yearly)</p> | | |
| <p>External Commerce Information is available for consultation</p> | <p>Use and Security Policy 07.03</p> <p># of records available = 90% of Operational External Commerce databases records (yearly)</p> | | |
| <p>Information on human, financial and physical resources available for consultation</p> | <p>Use and Security Policy for HRMIS 07.03</p> <p>For FRMIS 07.04</p> <p>For PRMIS 07.05</p> <p># of records available = 90% of Operational databases records</p> | | |

Key Project Performance Indicators

| Hierarchy of Objectives | Key Performance Indicators | Data Collection Strategy | Critical Assumptions |
|---|---|---|--|
| <p>Information necessary for staff available centrally through the Intranet</p> <p>Information necessary for taxpayers available centrally through the Internet</p> <p>Information for Decision-making available for consultation</p> | <p>(yearly)</p> <p>Use and Security Policy 12.03 Jurisprudence, regulations, procedures, guidelines available by 12.06</p> <p>Public access through Internet to information on taxpayer rights and responsibilities, procedures, individual's fiscal status, by 12.06</p> <p>Use and Security Policy 12.03 Information produced automatically available for consultation Integral High-level MIS operational by 12.07</p> | <p>Annual evaluation of system performance</p> <p>Annual evaluation of system performance</p> | |
| 2. Technology Services | | | |
| <p>IT offered as an internal service</p> | <p>IT Strategy aligned with SAT business processes by 6.03 IT Plan in operation by 12.03</p> | <p>Annual IT Performance Report</p> | |
| <p>Core systems and databases are centralized</p> | <p>All data is migrated to central systems by 12.05</p> | | |
| <p>Risk of business discontinuity due to disaster or accident averted</p> | <p>Disaster & Contingency Plans defined by 06.03</p> | | |
| <p>Critical documents and all new documents are available centrally on-line</p> | <p>Document prioritized scanning plan prepared by 6.03</p> <p>All new documents scanned by 12.04</p> <p>Priority documents scanned by 12.07</p> | <p>Implementation Plan</p> <p>Quality assessment report</p> <p>Quality assessment report</p> | <p>Probability of lost or damaged documents</p> |
| 3. Compliance Process | | | |
| <p>All potential taxpayers are in the Registry</p> | <p>7m active taxpayers by 6.03 15m active taxpayers by 6.04 25m active taxpayers by 6.06</p> | <p>Quality assessment report Quality assessment report Quality assessment report</p> | <p>Cross-check data from external sources is not forthcoming</p> |
| <p>Tax obligation and payment information for all taxpayers accessible in central</p> | <p>7m active taxpayers by 12.03 15m active taxpayers by 12.04 25m active taxpayers by 12.06</p> | <p>Quality assessment report Quality assessment report Quality assessment report</p> | <p>Internal data is not fully obtainable</p> |

Annex 1

Key Project Performance Indicators

| Hierarchy of Objectives | Key Performance Indicators | Data Collection Strategy | Critical Assumptions |
|--|---|---|---------------------------------------|
| Single Taxpayer Account database | 7m active taxpayers by 6.03 15m active taxpayers by 6.04 25m active taxpayers by 6.06 | Quality assessment report Quality assessment report Quality assessment report | Internal data is not fully obtainable |
| Information on the effectiveness and efficiency of the process | Baseline by 01.03 Indicators tied in to General MIS by 01.05 Indicators tied to individual performance by 01.06 | Annual Reports | |
| Increase effectiveness of the process | <p>Increase in the number of tax returns filed/number of registered active taxpayers</p> <p>Increase in the number of tax returns received on time/expected number of tax returns</p> <p>Increase in the tax revenues paid on time/total tax revenues assessed</p> <p>Reduction of time to process a refund request</p> <p>Reduction in process time & cost to SAT in absolute terms and compared to other OECD countries</p> <p>Ratio SAT staff/number of taxpayers compared with other OECD countries</p> <p>Reduction in process time & cost to the taxpayer in absolute terms and compared to other OECD countries</p> <p>Increase in the number of taxpayers filing electronically</p> <p>Decrease in the time and cost of identifying and notifying a taxpayer who fails to file tax returns or pay taxes</p> <p>Increase in the number of notifications with positive revenue results</p> <p>Decrease in registration time for individuals and firms</p> <p>Decrease in the number of disputes</p> | Annual Reports | |
| Improvement in notifications | System in operation 12.04 Baseline values 07.03 Increase in correct notifications | | |
| Surveys offered as a service | Policy and procedures 07.03 All surveys carried out under this unit's responsibility 12.05 Confirmation of user satisfaction (yearly) | | |

Annex 1

Key Project Performance Indicators

| Hierarchy of Objectives | Key Performance Indicators | Data Collection Strategy | Critical Assumptions |
|--|---|---|----------------------|
| 4. Compliance Control and Enforcement Process | | | |
| Information on the effectiveness and efficiency of the processes | Baseline by January 2003 Indicators tied in to General MIS by January 2005 Indicators tied to individual performance by January 2006 | Annual Reports for the business process | |
| Areas of evasion identified and tendencies | Two major economic sectors every year starting 06.03 One major taxpayer type every year starting 06.06 | Reports prepared by area. | |
| Prioritized audits according to transparent criteria | Annual audit plan Procedure Guidelines by 06.03 | Annual Reports for the business process | |
| Increased effectiveness of the process | Percentage of planned audits implemented Increase in percentage variation of revenues from audit Total value of audits for an office/# audit # audits of individuals/total # audits of firms/total by type of firms Additional tax assessed in audits/# audits Decrease in the average weighted cost of each audit Increase in the number of individuals correctly identified as evaders/# individuals in registry Increase in the number of firms correctly identified as evaders/# in registry Increase in the number of successful penalty cases/number of audits realized Decrease in the debt ageing Amount of arrears recovered during the period /amount at the beginning of the period Reduction in process time & cost for both SAT and the taxpayer Estimated share of the gray economy in the total economy | | |
| Increased "fiscal presence" of SAT | Estimated share of the gray economy in the total economy | Studies | |
| Improved Large Taxpayer audits | Increase in the number of firms correctly identified as evaders/# in registry Increase in the number of | Annual Reports | |

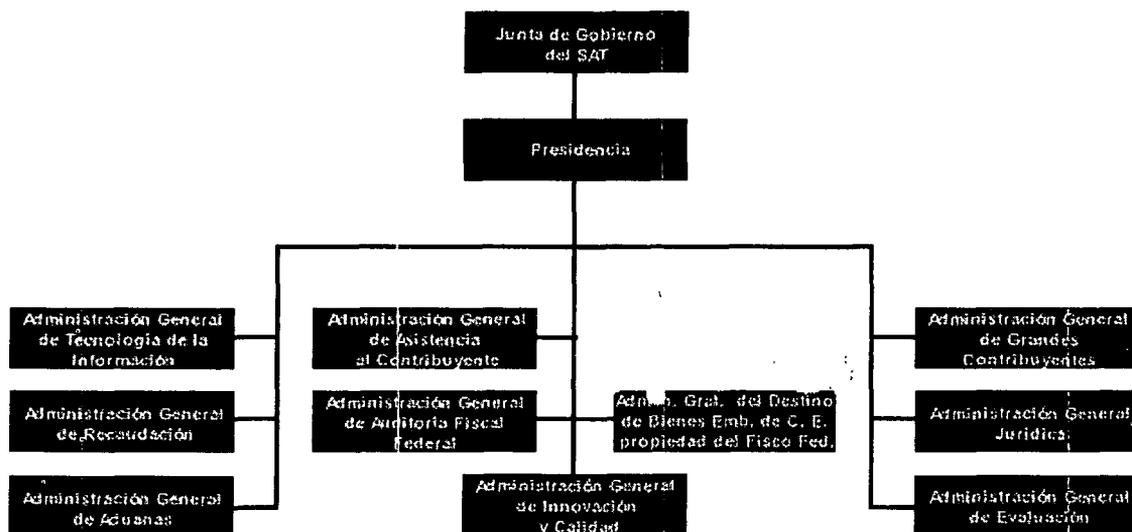
Key Project Performance Indicators

| Hierarchy of Objectives | Key Performance Indicators | Data Collection Strategy | Critical Assumptions |
|--|---|---|--|
| Improved VAT refund audits | successful penalty cases/number of audits realized Increase in the number of firms correctly identified as evaders/# in registry Increase in the number of successful penalty cases/number of audits realized | Annual Reports | |
| 5. Planning and Quality Control | | | |
| Quality focus on processes | Quality assurance and change management methodologies implemented by 01.03 | | |
| Strategic & Operational Plans | Measurable outcome and output indicators at all levels of the organization (baseline values in 10.02, produced every January from 2003). | Strategic and operational documents | There won't be excessive resistance to the measurement of organizational performance |
| Results Management Group in operation | Organizational performance indicators defined by 12.02 and improved annually Baseline values and indicators calculated by 12.02 and refined yearly | Annual SAT Results Report | |
| Project Components 1: eSAT/Taxpayer Services 5.38 (total cost) 2: Human, Financial and Physical Management 18.82 (total cost) 3: Information Hub 10.56 (total cost) 4: Technology Services 17.12 (total cost) 5: Compliance Process 17.16 (total cost) 6: Control & Enforcement Process 8.95 (total cost) 7: Planning and Quality Control 3.51 (total cost) Base Costs 81.48 (total cost) Front-End Fee 0.52 (total cost) TOTAL 82.00 (total cost) | | Project Reports: Semi-annual project reports Supervision missions Project audit reports Annual SAT reports | |

Annex 2

Project Description

The Tax Administration Service (SAT) was created in 1995², along with giving the Undersecretariat of Revenues more managerial, budgetary³ and technical autonomy. It is still, however, embedded in the organizational structure of the Secretaría de Hacienda y Crédito Público and is therefore constrained by public administration rules.



Current Situation

Various IMF and WB missions have noted improvements in tax administration since the creation of the SAT. The collection system is better, Large Taxpayer Units have been created, the use of information technology has improved, and there is a better tax statistics system. In spite of these though, revenues are lower than they ought to be. This is due to a number of factors:

- VAT is not given sufficient emphasis, and a large number of sector exemptions complicates its administration.
- Taxpayer auditing is not very effective – only about 30% of audits result in observations, compared to about 75% in other countries. Field visits are carried out for 0.2% of taxpayers, in spite of this technique being the most effective in their tool arsenal.
- Penalties are weakly applied, the full extent of the law not being applied.
- Complexity in user requirements
- Insufficient assistance to taxpayers
- Emphasis on formal controls to the detriment of effectiveness
- Lack of appropriate personnel policies

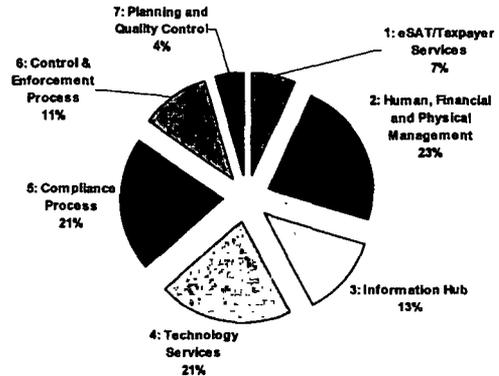
² Tax Administration Service Law, of December 15, 1995.

³ Starting on January 1998

- Lack of budgetary flexibility
- Perceived widespread corruption
- Excessive complexity of the legal framework.
- Insufficient flow of information for management and operations

To address these and other issues, the project will finance assistance to support activities under these components:

| Component | US\$ |
|---|--------------|
| 1: eSAT/Taxpayer Services | 5.38 |
| 2: Human, Financial and Physical Management | 18.82 |
| 3: Information Hub | 10.56 |
| 4: Technology Services | 17.12 |
| 5: Compliance Process | 17.16 |
| 6: Control & Enforcement Process | 8.95 |
| 7: Planning and Quality Control | 3.51 |
| <i>Base Costs</i> | 81.48 |
| <i>Front-End Fee</i> | 0.52 |
| TOTAL | 82.00 |
| <i>Divided into:</i> | |
| <i>World Bank</i> | 52.00 |
| <i>Government of Mexico</i> | 30.00 |



Component 1 – eSAT/Taxpayer Services

The taxpayer as a customer is an organization-wide vision of SAT, which initially has taken form with the creation of a Taxpayer Services General Administration early in 2001. This Administration has an overarching objective to improve the perception of the taxpayer towards the organization in terms of its efficiency, transparency, quality and equity in service. To this effect, they have identified a number of general activities which they are addressing:

- Enhance and improve SAT’s presence and services using the Internet
- Improve assistance to the taxpayer
- Improve taxpayer feedback mechanisms
- Improve the process for client complaints.
- Improve the client service orientation

With respect to the first area, SAT has implemented a tax return e-filing system, which 10,000 (mostly large) taxpayers are using already⁴. In May 2002, 2.8 million cards will be delivered to all taxpayers whose tax base exceeds 1 m\$ (approximately \$100,000); henceforth, these taxpayers will present tax returns and pay electronically in banks or through the Internet. The card is a plastic credit-card type with the taxpayer’s name and taxpayer number, which will eliminate a large source of error. This system is available but not compulsory for the rest of taxpayers. SAT has also implemented a Fast Registry scheme for firms, where SAT delegates to public notaries the authorization for registration of firms.

⁴ By law, all taxpayers who use electronic accounting must file electronically also.

The General Administration of Taxpayer Assistance provides assistance to the taxpayer to reduce the cost of compliance, through the telephone, internet and electronic mail. At present, there is one group in the capital, the National Telephone Assistance Center. Their efficiency, however, is not very high because of several factors. The most important one, is that they lack the information needed to provide good customized service. This should to a large extent be remedied by the Information Hub component, which would give access (with due regard for security) to taxpayer account and transaction information, to the legal database and to the electronic filing system, to mention only three important sources of information. They need to evaluate client demand to better organize themselves to respond, and in addition, their efficiency could improve if they introduced a telephone menu system to better direct calls and provide FAQ ("frequently asked questions") automatic service, which requires specialized telephonic equipment. FAQ can also be put on the web.

Taxpayer Assistance intends to replicate the National Service Center to up to 66 local offices, which the project would help in. Finally, they need to carry out a feasibility study of alternatives of the provision of services to taxpayers with access difficulties. Another study to be carried out is the evaluation of service queues, diagnostic of problems, identification of information requirements, training and performance measurement.

Taxpayer Assistance is also responsible of the provision of information through radio, newspaper and television media, through presentations to professional organizations and through the web. They need to obtain and present more information, including eventually portions of SAT's annual action plans, goals, achievements of the last year, and effectiveness and efficiency indicators. The project would assist with technical assistance on the design of communication, including improved web design, and the design of periodic surveys to obtain feedback on the effectiveness of the various communication efforts.

There are many areas of SAT which directly or indirectly impact the client. A mapping exercise will be carried out to identify the points of contact between SAT and the client, using participatory diagnosis, to obtain taxpayer feedback on their perceptions of SAT's strengths and weaknesses in areas such as (i) procedures, (ii) information provided, (iii) access to SAT, (iv) treatment by SAT personnel (v) use of revenues collected, (vi) transparency and corruption and (vii) equity issues. In addition, a system to measure the cost of taxpayer compliance in money and time would be developed.

The improvement of the service culture requires the definition of service standards and the definition of quality standards, based on benchmarking against other tax administrations. It would also require the development of a client service management system to measure the quality of services and provide feedback to the redesign of the services offered, and the design of an incentive system directed at taxpayer services. Feedback mechanisms could include score cards, or similar method, to be used across SAT to gauge annual, user feedback on different aspects of service provision, to be published and create incentive between departments to offer better quality service, Client surveys are already being carried out, as well as other efforts such as focus groups in order to obtain client feedback; improvement in survey design techniques is required, as well as more flexible mechanisms to obtain feedback from the permanent focus group of important stakeholders (various non-governmental associations including the Chamber of Commerce, Industry, etc.)

Finally, a formal monitoring system for complaints would be introduced. Similarly, SAT's administrative appeals procedures would be reviewed and upgraded.

Component 2: Management: Human, Financial, Physical and Organizational

Human Resource Management

SAT has elements of a good Human Resource Policy. With respect to the Staff Life Cycle, they have a merit-based selection process for management, which should be expanded to all staff, and an induction process which needs to be formalized and expanded. The evaluation and incentive systems need improvement, particularly in reference to individual and collective performance indicators, and their link to salaries. Training is quite comprehensive, and needs to be better linked to SAT's strategic objectives and the incentive system. Out-placement is difficult because of the legal environmental conditions.

A new Human Resource Policy needs to be developed, with the following characteristics:

- it should be fair and transparent,
- assured by comprehensive internal communications;
- encourage a good organizational climate;
- be flexible, to permit the recruitment of new skills and deployment of staff where needed,
- have a pervasive client orientation (evaluation and promotion systems must be responsive to the needs of the clients and not just internally driven);
- be results oriented (a reward system that recognizes and values "results on the ground");
- encourage collaborative decision-making, consensus, teamwork and the sharing of information and knowledge).

The salary and incentive structures should be reviewed annually to encourage continuity, motivation and the retention of critical staff. Incentive programs should be designed to encourage and reward achievements tied to the organization's business plans and budgets, a specific reward programs designed, to reward special achievements and contributions of staff beyond normal ongoing job responsibilities or other achievements which are important for the organization as a whole (innovation, cost reduction, quality improvements).

With respect to the evaluation system, performance management should be business driven, and managers themselves evaluated for their leadership performance, including their own performance management practices. SAT's strategic agenda should drive the selection, development and assessment of existing and future managers.

A strong recruitment, out-placement, comprehensive program of professional development and a coherent strategy for leadership selection and development would be required to counteract the depletion of technical and managerial skills over the years and reach the professional levels of skills and competence required by SAT. As mentioned above, a new, differentiated compensation scheme tied to performance is required.

With respect to the tools needed for HR Management, a initial survey of staff profiles has been carried out and needs expansion; a survey of existing capabilities is needed, as well as a mapping of skills requirements with the needs of the organization – this would go together with the proposed reorganization. A human resource management system is required to implement these policies, and

the audit capability of the Human Resource area needs to be strengthened to enable it to carry periodic progress reviews.

SAT is embarked in a process of skills improvement. In 2001, SAT reported 37,011 staff compared with 38,446 staff in 2000. 1,337 of these positions were vacated through voluntary retirement leaving 696 for other reasons. The largest increase in positions (N=1912) was in the area Assistance to Taxpayers. The largest areas of decrease were Fiscal Audit and Collections. It is noted that Audit and Collections are the two largest components of the organization. Staffing strength requirements are reviewed annually. There is an overall goal to reduce the budget by 30% in five years. Further, there is an expressed intention to remove incumbents in administrative positions who do not meet more professional qualifications or who were not performing adequately. Many of these are identified as union members, which will delay the process. The purpose of this staffing adjustment is not associated with the overall proposed reduction in budget but rather with the objective of replacing these personnel with more qualified incumbents. There is, however, no detailed plan on how the 30% budget reduction is to be achieved, and which areas might experience growth. Clarification of human resources needs in very specific qualitative and quantitative terms (as related to functional areas and specific requirements) is essential.

There is a stated concern with respect to the competencies and qualifications of relatively large numbers of SAT staff in regard to the requirements of the positions that they hold. While some individual employee information is retained in individual files, there is no overall assessment and profile of the competencies of staff relative to the needs of the organization. It is important (as noted above) that both the needs of the organization in regard to staff complement and competencies, or lack thereof, of existing staff be identified. The acknowledged deficiency in competencies of staff also raises the question of the approach of the organization in dealing with this fact. In what balance does the organization train or buy the needed competencies? The issue of training will be dealt with in more detail later.

With respect to complement and competencies, therefore:

- (i) the defined HR needs of the organization (as per strategic and business plans) must be articulated in detail and reflected in the number and competencies of staff;
- (ii) the areas of growth and planned reduction in staff need to be clearly articulated and action plans formulated to achieve same; and,
- (iii) the necessary information must be available to permit appropriate HR planning and action

SAT has its own human resource information system which provides information for payroll purposes. Individual employee information is also retained in separate files. The system as indicated above can generate overall stock employee data as well as similar data by functional area. In addition, information is retained and can be generated on numbers of hires and promotions. Detailed analyses for HR purposes are more difficult and in some cases, impossible, to obtain; e.g., profiles of length of service overall and by functional area, profiles of competencies by area and training requirements. In addition to providing corporate and functional rationalization for positions, the HR information system should generate regular reports (e.g. ongoing staffing strength relative to positions/budget, hires relative to separations) and provide access to managers to non-confidential fields for their planning, decision-making and management purposes. All systems as noted in the SAT Strategic Plan should be integrated.

A comprehensive, efficient, integrated HRIS is essential for good HR planning, development and management. A significant enhancement in this area is necessary to the efficient, effective, and equitable functioning of SAT.

Training is one of SAT's Strategic Objectives - with particular emphasis on the new culture, service orientation and quality. In light of concerns with respect to:

- (i) Competencies of staff;
- (ii) Employee culture and performance (including corruption),
- (iii) Issues related to planning, and
- (iv) Culture change,

training assumes an important role in the re-vitalization and renewal of SAT. Other stated objectives also rely heavily on training e.g. developing organizational pride, providing improved customer service, managing the change and evolution of the organization. A specific, targeted **Transition Training Plan** would assist managers in moving the organization forward in the desired directions.

The initial focus of the Transition Training Plan would be on what are in essence baseline areas such as: internal organizational culture change and change management, more effective strategic and business planning (establishing appropriate indicators and timeframes and integrating these with HR requirements), providing leadership and direction (in terms of realizing mission and vision through targeted activities), performance management (process implementation and management), and interviewing and reference checks (especially in light of current problems with respect to competency and corruption). A new approach to reference checks was put in place on March 1st - it is important that this be consistently applied, job-related, and monitored in terms of its effectiveness.

Another significant area is training in the development and management of effective union negotiation and interaction strategies. While SAT is in significant respects governed by federal government negotiations, it also has some latitude in negotiating working conditions. These can have bottom-line impacts on expenditures and employee relations specifically motivation and satisfaction.

It is also apparent that skill training will continue to be required to deal with areas such as new computer applications, investigations, anti-corruption activities, customer service, and implications of the new law.

The Transition Training Plan of the organization is something that will require ongoing assessment with respect to business needs, recognizing that the SAT organization will continue to evolve and change. It should be an important element in all three phases. The development and maintenance of high quality management and staff will be achieved over time. In order to not over-burden SAT staff and to ensure the latest in training approaches, the training itself should be out-sourced.

An integral and complimentary program to the Transition Training Plan is the **Performance Management System**. Such a system would allow managers to identify not only deficits in individual employee performance which may be addressed by training interventions or other actions, but also gaps in organizational competencies and corporate training needs. Performance management needs to be supported with appropriate incentives and disincentives. Policies and

practices related to the system must be developed with full awareness of legal requirements, union agreements, and corporate culture.

An important tool in achieving the above is an internal and external **Communication Plan**. This plan will have among its internal objectives the desired cultural change, enhancement of motivation and performance, increase in pride and reduction in corruption. Externally, the plan will focus on raising public awareness of the principles and positive image of the organization.

The structure of the Human Resources function is centralized in terms of policies and decentralized as far as day to day service delivery such as staffing. Directors of HR are found in functional areas along with staffing personnel etc. The latter are also present in large field offices. This places an important emphasis on both the development of sufficiently detailed corporate policies and monitoring of their implementation. It is not known to what degree practices deviate from policies or to what extent there are any gaps in the current policy framework. Policies with respect to staffing, promotion, classification and compensation, performance management, training access and funding, discipline and working conditions need to be developed and managed in light of corporate objectives, clearly articulated and consistently and fairly applied.

It is important that SAT review and revise as necessary its HR policies and practices in light of its organizational enhancement objectives and ensure that it has in place a process for monitoring their application. Such a monitoring process should be ongoing and should flag and address any deviations or deficiencies.

It is also important that the monitoring process includes the capacity to track the actions of the executing authority at various stages so that levels of efficiency can be monitored. E.g. Staffing actions from advertisement, to interview, to reference check, to offer, to incumbent in place. This will permit SAT to enhance its systems precisely at the point where adjustment is required thereby improving the efficiency, cost effectiveness and outcome of the process. It will also provide information with which to compare the human resource functioning of different parts of the organization on specific organizational performance criteria which will have to be established.

A Human Resource Planning and Development Framework should be developed first. This would consist of a definition of SAT's human and financial resources needs in line with its strategic and business plans, supplemented by the qualifications and sources of required personnel. To this effect, a determination of existing resources would be carried out and a modern Human Resource Information Database created. The Database will permit HR analyses and information for managerial decision-making and the rationalization of positions.

In addition, an initial survey of existing competencies and strengths as well as unit workloads will be carried out, leading to the development of a Transition Training Plan (including management training, customer service, planning, interviewing, performance management, etc.). One important aspect of the Transition Training Plan would be culture change and change management. The Framework would be revised every year according to the previous year's performance and next year's organizational requirements as proposed in the updated Strategy and as affected by the reengineering processes. One important aspect of the Transition Training Plan is aimed at assisting senior and middle management with issues of leadership and direction, including issues of union negotiation strategies. The Transition Plan would later be transformed into an on-going Training Plan, aligned with the organization's corporate objectives, and aimed at maintaining the skill level

of staff and management in the long-term. Consideration would be given to out-sourcing the training.

This component would also include provisions for enhancing SAT's HR Policies and Monitoring Structures, as well as introducing a performance management system (including software) complemented by motivational incentives and improvement of the work environment. There would in addition be a review of policies and practices related to incentives, selection, hiring, discipline and separation processes. A number of laws would be reviewed and proposals drafted for their modification directed at ensuring their transparency, consistency and internalization by the staff. Along with the introduction of a performance-based incentive system, assistance would be provide to help SAT achieve a culture change within its staff through a Communication Plan. This would be aimed at ensuring that the new principles and image of the organization are well known and understood.

Financial Management

SAT uses a budget-oriented accounting system which aggregates costs by line item, although a project-oriented budget and accounting system was designed but not applied during the 1990s. It is SAT's intention to re-introduce and enhance the latter system to permit the use of budgeting as a planning tool, with cost accounting by activity, project, and process. This will permit better alignment of operations with the Strategic Plan, efficiency performance measurement and improved managerial decision-making.

Physical Resources Management

SAT needs to be able to manage their own physical resources as well as third-party physical resources temporarily under SAT's responsibility, as a result of SAT's control and enforcement activities. It would therefore require an automated system, to be eventually integrated with the Human and Financial Resource Systems, as well as initial inventories, nationwide.

SAT's reform will be based on a business process and service orientation. In particular, SAT's service orientation would require the definition of an Internal Service Policy. This need is particularly clear for such services as information technology, surveys carried out under Taxpayer Assistance direction in which other areas participate, and training. This activity would also consider prospects of installing a system of internal chargebacks, as well as outsourcing services to the private sector.

Component 3 – Information Hub

There is a lack of information necessary for SAT's business process; in addition, there is insufficient sharing of existing information. Seven major groups of information are essential to the business processes of the organization, and they must be accessible for use in a timely manner by those processes: taxpayer basic information, information on taxpayer's tax compliance and transaction registry, external commerce information, Resource Management information, documentation, a general information database for the provision of information and services to the taxpayer and other organizations, information for decision-making.

The information hub consists of a collection of databases used for information access ("read only"). The operational databases can thus be better protected form unauthorized access, and optimized for update through the appropriate software, whereas the information databases can be configured for multiple queries and retrievals of information, with sophisticated security measures.

The project would provide the technical and consulting assistance to permit SAT to:

- a) Designate a high level staff as Chief Information Officer in charge of policy, coordination, quality assurance and security of information. This is necessary for the institutionalization of data sharing and control.
- b) Acquire a database management system
- c) Define access and security policies
- d) Define data to be extracted from operational databases and develop the extraction processes and systems.
- e) Develop quality control and management information systems.

Component 4 – Technology services

SAT's use of technology suffers from a lack of prioritization and coordination of efforts, which has led to the creation of independent system development units, redundancy of efforts and a loss of a coherent approach to information and application systems throughout the organization. In addition, it is lacking a number of fundamental policies and strategies, such as security, back-up and information integrity.

Note that as an operational concept, all information processed through SAT's computer and telecommunications equipment belongs to the organization as a whole under the responsibility of the appropriate user areas. This concept is reflected in the separation of components 3 and 4 and the creation of the function of Chief Information Officer described in Component 3. The second operational concept to be introduced is that the Information Technology G.A. is a provider of infrastructure services.

The project would finance consulting assistance to develop an IT strategy aligned with SAT's business strategy and goals, technical assistance for the development of business intelligence for IT, the development and implementation of an Internal Service Policy for IT services, the development of SAT's e-business strategy (eSAT), develop strategies for information security and integrity, a plan for hardware consolidation and upgrade, and develop and implement a Disaster Recovery Plan (including actions for the resumption of service after a disaster, alternative sites, etc.) and a Contingency Plan (for minor faults which affect the business processes).

At present, SAT's system testing facilities are too small for full integration testing of new systems; the project would finance equipment upgrade as well as technical assistance to include testing for data integrity and anti-corruption measures.

The present client-server approach used by SAT is obsolete in view of today's technologies and the need for increased security and integrity of data. SAT is therefore centralizing databases and systems, and migrating data from the old systems, which the project would support with technical assistance, upgrade of equipment and the acquisition of appropriate package software.

The project will support SAT's efforts to increase administrative efficiency by financing studies of office workflows, introduction of automated processes and equipment.

SAT has millions of documents stored around the country. Some of these files are essential for legal processes and for taxpayer auditing, but their geographic dispersion makes them at best difficult to retrieve and use; at worst, storage difficulties has resulted in deteriorated or missing files. Access to the information contained therein is necessary for accountability. Electronic document management consists of the digitalization of paper files, storage and management, and permits users to operate on exact *images* of the original, which may even be stored in their own local computers. This enables multiple and simultaneous uses from a single original. The technology creates great opportunities for collaboration and for editing, but also for controlling corruption. It also creates great challenges for records management and for archiving.

A feasibility study to determine viable document management options is being carried out. This is in keeping with the growing international tendency to consider electronic documentation to be legal (under certain conditions of quality control and security), and SAT's own move towards electronic taxpayer return and payment processing.

Component 5 – Compliance Process

The main operational areas (Collections, Large Tax Payers, Taxpayer Auditing, Legal, Customs) each address a different aspect of the tax compliance, with insufficient information transfer and formal coordination among them. This impacts the cost of taxpayer compliance and makes more difficult a complete view of the taxpayer, both to the institution and to the taxpayer, and results in a diversity of application systems which do not effectively communicate with each other (in an extreme case, Customs uses a different main transaction identifier than the rest of the organization). This is aggravated by the complexity of regulations and relationships with other institutions which participate in the taxpayer identification process, the information technology structure in use (client-server) and the geographic dispersion of the taxpayer.

The Compliance process is composed of several essential steps, beginning with the incorporation and registration of all potential taxpayers, the reception of tax returns (either by the employee or self-prepared) and payments, the verification by SAT of its consistency (arithmetic, procedural, documentary), request for further payment (or refund) by SAT, possible dispute resolution via administrative means, or collection through the judicial process. The last step in the cycle is transfer of the taxpayer records to permanent inactive status. A similar compliance cycle can be described for legal entities. The project would finance a study of the Compliance Process to identify needs for shared information and responsibilities, with a global focus crossing all areas to facilitate the de-compartmentalization of SAT's existing functions.

The project would finance activities to improve the quality of the taxpayer registry by (a) cleaning up the existing information; (b) acquiring software; and (b) developing a permanent updating system, using, among other methods, the information provided by the taxpayer in his/her tax return; conducting a number of field exercises to determine the quality of the data, crosschecking with social security and other databases. It would also extend the Registry from the present 7 million to an amount to be calculated through an early study. In addition, a management information system would be defined and developed, performance indicators defined and baseline values measured.

If the Tax Registry represents the first step in the Compliance Process, the single taxpayer account is the essence of the process. It should contain taxpayer's fiscal compliance information, payment and refund information, and a record of all tax return and payment transactions with the taxpayer. This database contains the information necessary for enforcement of taxpayer compliance. The design of this database and the control of its integrity should take into account the bill on electronic document and signature being discussed in Congress. This database is required to carry out evasion studies, and to properly prepare cases, among others. At present, the account is being designed; no feasibility study has yet been done, but it is known that the task of creating the Single Taxpayer Account will entail the prioritized review and verification of millions of paper files and hundreds of databases. The project would finance technical assistance and equipment upgrade to create the single taxpayer account database, with information on taxpayers' tax profiles and payment history beginning with the highest revenue producing taxes/taxpayers by (a) gathering and verifying information from existing databases and files; (b) acquiring software; (c) consolidating the existing database (over 260) into one. The population of this database would parallel the Registry's. In addition, a management information system would be defined and developed, performance indicators defined and baseline values measured.

One of the most important causes of errors and loss of revenue is the present Notification System whereby SAT legally transacts business with taxpayers on the results of audits, requests for payments and fines, and arrears. An analysis of the existing system would be carried out, and a new process and system, including a control system, developed.

Finally, for historic reasons, the General Administration for Collections has the most experienced survey design and management staff in SAT. The project would finance technical assistance to create an internal survey service, including policies, procedures and training, to offer survey design and monitoring services to other areas which require information gathered through such means. The policy on this service would consider internal contract, chargeback and quality control issues. The project would also finance pilot surveys to internalize the service approach to surveys.

Component 6 –Control and Enforcement Process

Compliance control is recognized as a key function in SAT's Strategic Plan, and its present weakness represents a large loss of revenues for Government. Only in VAT, currently the second largest revenue source after income taxes, a 1996 study estimated evasion to be about 60 percent. Other studies put it at 45%, still comparatively high with respect to other countries in the region.

The two areas which address direct taxpayer auditing (General Administration for Federal Fiscal Auditing and the G.A. for Large Taxpayers) have annual auditing plans with some, but not complete, performance indicators. One difficulty is that these indicators are oriented to the efficiency and effectiveness of the auditing activities carried out by the two areas, whereas evasion control is an *auditing process* which involves many other areas of SAT, and whose indicator of performance should be *actual collections due to all auditing activities*.

Also, the selection of taxpayers to be audited is not a systematic process, being a collegial effort on the part of auditors in both Large and Other taxpayer areas. Evasion studies are limited, and further work is necessary to know the parameters of evasion by sector and economic activity, by taxpayer size and geographic location. Similarly, an effort must be made to evaluate evasion methods by type of taxpayer and tax, to develop appropriately targeted auditing strategies and to modify them dynamically according to results obtained. To do this, a better performance indicator and auditing

methods must be designed, accompanied by training. Based on this, a “Risk Administration” strategy can be devised, to select cases and determine the auditing effort for each based on objective parameters.

SAT is also increasing its fiscal presence through site visits, which has resulted in a strong increase in business suspensions and closures, especially in the restaurant sector. This is very important to maintain, even if its immediate effects are difficult to measure, as international experience indicates that this type of activity has an important effect on compliance.

The weakness in control and enforcement is basically due to the same causes mentioned above, in particular, the lack of coordination, organizational performance indicators, and inadequate information, and the fact that control and enforcement are not being addressed as a process, and each area concentrates on its own bailiwick.

Control is the process which begins with the identification of possible evasion (through automated systems, guidelines based on evasion studies, desk checking, site visits, and informers); selection of cases to investigate based on agreed priorities; investigation; preparation of the action file.

A number of activities to improve control would be supported by the proposed project:

1. Redesign of the control process, through a review of the workflows, organization, information systems and management of the Federal Fiscal Auditing G.A. and auditing within the Large Taxpayer G.A.
2. Design of methods for the identification of evasion tendencies, which includes the development of evasion trends detection algorithms, systems and guidelines (based on evasion studies included in component 1); guidelines for desk checking, site visits and informers; identification and development of risk indicators for types of taxpayers and progressively for individual taxpayers.
3. Evasion review guidelines and control system, to record auditors’ preliminary analysis of cases.
4. Based on the above, development of a case selection system based on agreed priorities and policies, which limits discretionary selection, to assist in the planning control activities for Large and Other taxpayers. The system would initially consist of cross-checking available information sources, eventually growing into intelligent and dynamic risk analysis systems for the different types of taxpayers.
5. Continuous and systematic evasion studies, in particular on VAT, oriented towards evasion by economic sector and type of taxpayer, to provide feedback for the update of the selection system, which improves as the institution learns and also to take into account the evader learning process (see component 1 – Analysis and Studies Unit)
6. Management & control system for the control process, which permits measuring the effectiveness of individual audits as well as control plans, and permits their modification through feedback.
7. Establishment of units or appointment of individuals specialized by economic sector or type of taxpayer, to systematically study each sector to discover evasion methods.
8. Theoretical and on-the-job training, to be carried out in coordination with component 2.

9. Quality and integrity assurance unit and systems, to control corruption, increase effectiveness and provide feedback to the process systems and guidelines.

The enforcement process begins with an identified evader, and based on the case prepared by the control process (action file), assessing the appropriate amounts and fines; notifying the evader; carrying out compulsory collection measures; possible administrative dispute process; and possibly then judicial disputes (to obtain assessed amounts or in some cases to prove felony).

A number of activities to improve enforcement would be supported by the proposed project:

1. Redesign of the enforcement process, through a review of the workflows, organization, information systems and management of the Federal Fiscal Auditing G.A. and auditing within the Large Taxpayer G.A., Legal A.G., and Collections A.G.
2. Design of methods and guidelines for the non-discretionary assessment of owed amounts and fines.
3. Assessment control system, to record assessment activities.
4. Review of the notification system and its legal context, with a view to improving its efficiency and effectiveness, including outsourcing alternatives.
5. Development of a management and control system enforcement to measure the effectiveness of enforcement activities and to identify areas of process failure (e.g., non-located individual, erroneous notifications, lost cases, etc.). This system would include both "normal" collections and arrears.
6. Analyses of notification information provided by the enforcement MIS to provide feedback to the various processes and guidelines.
7. Analysis of compulsory collection measures and their legal context, recommendations for improvement, integration with the enforcement MIS.
8. Redesign the administrative dispute process within SAT; develop an integrated system for jurisprudence and internal regulations; develop guidelines and in coordination with component 2, provide training, integration with the MIS.
9. Update of the jurisprudence and internal regulations system with information from SAT's cases in the Fiscal Administrative Tribunal; analyses of successes and failures.
10. Update of the jurisprudence and internal regulations system with information from SAT's cases in the Judicial Tribunals; analyses of successes and failures.
11. Development of a system for the assigning cases to lawyers and integration with the Enforcement MIS.
12. Analysis of portfolio to develop criteria for the prioritization and planning of arrears collection;
13. Integration with the Enforcement MIS.

Two activities have been identified with the requisite characteristics: Audit of export VAT refund; and case selection for Large Taxpayers. The first activity would consist of the design of a specialized audit method, analysis of methods of tax returns and payments, collection of internal information, cross-checking the information with major partners customs, analysis and assessment of amounts owed and penalties. The second activities would consist of an analysis of existing

procedures, the collection of internal and external information, and a proposal for selection methods.

Component 7 – Planning and Quality Control

SAT senior management last year carried out their first Strategic Planning Exercise (for 2001). As is usual in such activities, an iterative, incremental effort is required to improve the plans yearly. The present Strategic Plan combines elements of strategy and operations. The next iteration should result in separate strategic and operational plans. The operational plan would define all the activities necessary to accomplish the Strategic Plan objectives (detailing their duration, sequence and resources). The activities in turn should have clearly defined results and performance indicators for gauging accomplishment, efficiency and effectiveness, together with proposed goals.

SAT's administrative units have been working relatively independently, with non-formalized means of coordination. For an organization with processes cutting across different functions and geographic areas, this has produced a lack of synergy and caused duplication of activities and efforts. This is harmful in an institution with very considerable inter-dependence. SAT's lack of adequate performance monitoring precludes result-oriented management and weakens accountability and transparency. The lack of coordination induces "stove-piping" of information which handicaps units which depend on derived data. This affects SAT's attempts to transform the existing culture into one of service-orientation.

The present SAT organizational structure combines vertical functional areas with horizontal support elements. This functional approach splits essential business processes into discrete areas, which creates breaks in the workflow and loss of information. These breaks, as well as the lack of systematic managerial coordination, has impeded the horizontal support areas from fully assuming their organization-wide support role, which in cases has resulted in duplication of functions.

Training, seminars and technical assistance on planning and performance indicators would be provided to senior and middle managers, with a view to achieving a Strategic Plan which:

- a. Integrates and reflects the organization as a whole rather than a bottom-up consolidation of individual efforts. A greater "top-down" approach would facilitate the alignment of each unit's objectives with the mission and values of SAT.
- b. Is multi-annual, to be revised every year based on the accomplishments of the previous year and the political, economic and technological environment and context of the coming year.
- c. Has objectives, from the very top down, that are oriented towards clearly defined and measurable results, with agreed annual goals. As some initial SAT baseline figures are lacking, the project would finance the identification of performance indicators, baseline measurement and forecasting studies.

As a step towards transparency and accountability, the Strategic Plan would be eventually published in SAT's website, together with other important pertinent information such as each year's projected achievements measured against the organization's indicators, achievements for the last year, financial and other resource uses.

The existing advisory group to SAT's President will assume the function of Results Management, charged with assisting the various areas with strategic and operational planning, change management, conflict management, the definition and measurement techniques for performance indicators, and the monitoring of all project activities. One task would be to contract out a diagnosis the relationship between Customs and Tax Administration to prepare the basis for design of an action plan to strengthen the relationship.

Performance indicators would be gathered into a Management Information System, which, as management processes are revised, would be fed with information automatically generated.

In addition, quality control will be introduced organization-wide, through policies, procedures, evaluation methodologies and training.

Annex 3 Estimated Project Costs

| | Local US\$ million | Foreign US\$ million | Total US\$ million |
|---------------------------------|--------------------------|----------------------------|--------------------------|
| Total Baseline Cost | 56.94 | 19.25 | 76.19 |
| Physical Contingencies | 0.00 | 0.00 | 0.00 |
| Price Contingencies | 4.38 | 0.91 | 5.29 |
| Front end Fee | 0.00 | 0.52 | 0.52 |
| Total Project Costs | 61.33 | 20.67 | 82.00 |
| Total Financing Required | 32.29 | 19.71 | 52.00 |
| | | | |
| | Local US\$ | Foreign US\$ | Total US\$ |
| Works | 0.70 | 0.00 | 0.70 |
| Goods | 3.28 | 6.62 | 9.90 |
| Consulting Services | 52.47 | 13.38 | 65.85 |
| Training Expenditures | 1.00 | 0.16 | 1.16 |
| Counterpart Staff | 3.87 | 0.00 | 3.87 |
| Front end fee | 0.00 | 0.52 | 0.52 |
| Total Project Costs | 61.33 | 20.67 | 82.00 |
| Total Financing Required | 32.29 | 19.71 | 52.00 |

Componente 1: ESAT/SERVICIOS AL CONTRIBUYENTE

| Año: 2013 (BIR) | Año: Calendario | Total |
|---|---|---------|
| 1.1 Obligaciones Fiscales Electronicas (Internet) | | |
| 1.1.1 | Desarrollo de la estrategia e-SAT | 80,000 |
| 1.1.2 | Declaraciones, informacion de terceros, dictámenes y pagos electronicos con sus respectivas consultas, lo que incluye el rediseño de procesos y sistemas: fase 1 | 220,000 |
| 1.1.3 | Declaraciones, informacion de terceros, dictámenes y pagos electronicos con sus respectivas consultas, lo que incluye el rediseño de procesos y sistemas: fase 2 | 600,000 |
| 1.1.4 | Preparacion y acceso de borradores de declaraciones para casos | 120,000 |
| 1.1.5 | Diseño de acceso a Internet para contribuyentes sin acceso propio | 80,000 |
| 1.1.6 | Apoyo y capacitacion para el diseño y servicios de paginas web | 90,000 |
| 1.1.7 | Sistema de consultas en web (FAQ) y chat | 160,000 |
| 1.1.8 | Perfeccionamiento de la pagina web de metas y planes SAT | 100,000 |
| 1.1.9 | Notificaciones por medio electronico | 60,000 |
| 1.1.10 | Estudio sobre aspectos de seguridad y certificacion de la modificacion remota de informacion personal por telefono e internet | 100,000 |
| 1.1.11 | Estudio de impacto de nuevas leyes y reglamentos sobre Propiedad, Acceso y Proteccion de la Informacion del ciudadano. | 60,000 |
| 1.2 Asistencia por medios presenciales y no presenciales | | |
| 1.2.1 | Diagnostico y medidas de inicio, definicion de indicadores | 80,000 |
| 1.2.2 | Comunicacion externa: preparacion e implementacion del plan | 800,000 |
| 1.2.3 | Diseño y desarrollo del sistema de control de gestion y de calidad | 100,000 |
| 1.2.4 | Sistema automatizado de respuestas a consultas telefonicas | 80,000 |
| 1.2.5 | Estudio de factibilidad sobre metodos alternativos de provision de servicios a contribuyentes con dificultades de acceso | 150,000 |
| 1.2.6 | Estrategia de creacion de puntos de asistencia directa | 150,000 |
| 1.2.7 | Evaluacion de mecanismos de atencion personal, costo para el SAT y el contribuyente, y propuesta de rediseño de procesos, donde sea apropiado, hacia la asistencia por medios no presenciales | 400,000 |
| 1.3 Perfeccionamiento de la Retro-alimentacion | | |
| 1.3.1 | Analisis de los mecanismos existentes de retro-alimentacion y recomendaciones para su mejora (sondeos, encuestas, otros) | 100,000 |
| 1.3.2 | Capacitacion en desarrollo, monitoreo y medida de calidad de encuestas; preparacion de terminos de referencia y contrataciones | 100,000 |
| 1.3.3 | Desarrollo de un sistema automatizado de seguimiento de reclamos | 100,000 |
| 1.3.4 | Perfeccionamiento del sistema de opiniones a traves de sindicatos | 100,000 |
| 1.3.5 | Desarrollo de metodologias para medir el costo y tiempo de cumplimiento por parte del contribuyente por tipo de obligacion y contribuyente | 70,000 |
| 1.3.6 | Desarrollo del sistema de monitoreo permanente de costos y tiempos de cumplimiento por parte del contribuyente por tipo de obligacion y contribuyente | 70,000 |

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|---|------------------|
| 1.4 Medios de Defensa Administrativos | |
| 1.4.1 Perfeccionamiento de los medios de defensa | 100,000 |
| 1.4.2 Desarrollo del control de gestion | 100,000 |
| 1.5 Perfeccionamiento de la Cultura de Servicio al Ciudadano | |
| 1.5.1 Levantamiento de todos los puntos de contacto SAT-ciudadano | 70,000 |
| 1.5.2 Obtencion de informacion sobre la percepcion de la calidad de servicio al ciudadano | 400,000 |
| 1.5.3 Definicion de estandares de servicio al ciudadano y sistema de incentivos | 70,000 |
| 1.5.4 Desarrollo del sistema de control de gestion, desarrollo de indicadores | 55,000 |
| 1.5.5 Extension a nivel nacional de la mentalidad de servicio | 255,000 |
| 1.5.6 Gastos de capacitacion | 56,000 |
| <hr/> | |
| Costos de Base sin contingencias | 4,065,000 |

Componente 2: PROFESIONALIZACION DEL SAT

| Año Fiscal (BIRF) | Descripción | Total |
|-------------------|--|-----------|
| Año Calendario | | |
| | 2.1 Descripción de cargos y cargas de trabajo | |
| | 2.1.1 Marco de planificación y mejoramiento de recursos humanos | 160,000 |
| | 2.1.2 Continuación del levantamiento de perfiles, incluyendo requerimientos y cargas de trabajo presentes y futuras; inventario del personal | 770,000 |
| | 2.1.3 Diseño y desarrollo de la base de datos de perfiles | 270,000 |
| | 2.1.4 Reasignación de personal | 730,000 |
| | 2.1.5 Marco de dirección y políticas de gerenciamiento, delegación y descentralización | 200,000 |
| | 2.2 Marco Legal de RRHH | |
| | 2.2.1 Revisión de leyes, políticas y reglamentos y propuestas de mejora | 30,000 |
| | 2.2.2 Apoyo jurídico en materia laboral | 430,000 |
| | 2.3 Capacitación | |
| | 2.3.1 Identificación de necesidades, preparación del Plan de Transición de Capacitación y ejecución | 800,000 |
| | 2.3.2 Profesorado | 220,000 |
| | 2.3.3 Gastos de capacitación | 200,000 |
| | 2.3.4 Desarrollo del sistema de control de gestión de capacitación, incluyendo indicadores y evaluación del aumento de capacidades | 270,000 |
| | 2.3.5 Identificación de necesidades, preparación del Plan Permanente de Capacitación y ejecución | 850,000 |
| | 2.3.6 Gastos de capacitación | 135,000 |
| | 2.3.7 Seminarios y capacitación en planificación estratégica | 180,000 |
| | 2.3.8 Gastos de capacitación | 120,000 |
| | 2.3.9 Capacitación en habilidades de dirección (liderazgo, control del tiempo, trabajo en equipo, etc.) | 80,000 |
| | 2.3.10 Gastos de capacitación | 130,000 |
| | 2.3.10 Desarrollo de la carrera de directivo público, incluyendo identificación de candidatos, perfeccionamiento mediante capacitación y práctica | 175,000 |
| | 2.4 Sistema de incentivos | |
| | 2.4.1 Análisis de las políticas existentes y propuesta de perfeccionamiento del sistema de incentivos (monetarios y no monetarios) atado al cumplimiento | 250,000 |
| | 2.4.2 Definición del sistema de evaluación de desempeño individual | 250,000 |
| | 2.4.3 Definición del sistema de evaluación de desempeño gerencial | 150,000 |
| | 2.4.4 Análisis de las políticas existentes y propuesta de perfeccionamiento del sistema de selección, contratación y despido de funcionarios | 150,000 |
| | 2.4.5 Gastos de capacitación | 60,000 |
| | 2.4.6 Análisis del sistema de reclamos y quejas internas y propuesta para su perfeccionamiento | 170,000 |
| | 2.5 Comunicaciones Internas | |
| | 2.5.1 Preparación del Plan de Comunicaciones Internas y ejecución | 600,000 |
| | 2.5.2 Desarrollo del sistema de control de gestión de comunicaciones | 100,000 |
| | 2.5.3 Definición de la encuesta interna, piloto | 50,000 |
| | 2.5.4 Encuesta interna | 750,000 |
| | 2.5.5 Plan y desarrollo del sistema de inducción | 280,000 |
| | 2.5.6 Políticas y procedimientos de servicio interno de comunicaciones | 90,000 |
| | 2.6 Sistema de Gestión | |
| | 2.6.1 Definición de requerimientos y adquisición del software integrado con módulos RRHH, Financieros y Materiales | 2,700,000 |
| | 2.6.2 Gastos de capacitación | 300,000 |
| | 2.6.3 Definición de información para usos reservados | 100,000 |
| | 2.6.4 Alimentación, adaptación y puesta en marcha del sistema incluyendo el subsistema de control de gestión | 750,000 |

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|---|--|-------------------|
| 2.7 | Optimizacion del gasto del SAT | |
| 2.7.1 | Analisis de los sistemas existentes de contabilidad y presupuesto, y definicion de requerimientos para utilizacion de contabilidad de costos y presupuesto como util de planificacion y control de gasto | 100,000 |
| 2.7.2 | Alimentacion, adaptacion y puesta en marcha del sistema incluyendo el subsistema de control de gestion | 700,000 |
| 2.8 | Sistema de Gestion de Recursos Materiales | |
| 2.8.1 | Analisis de los procesos de gestion de recursos materiales y definicion de requerimientos | 100,000 |
| 2.8.2 | Adaptacion y puesta en marcha del sistema incluyendo el subsistema de control de gestion | 700,000 |
| 2.8.3 | Ejecucion de inventario | 800,000 |
| 2.8.4 | Desarrollo del modulo de control de mercancías embargadas y remates | 250,000 |
| 2.8.5 | Ejecucion del inventario de mercancías... | 1,000,000 |
| 2.8.6 | Implementacion del sistema | 600,000 |
| 2.9 | Organizacion de los Servicios Internos del SAT | |
| 2.9.1 | Definicion de politicas y procedimientos, incluyendo el concepto de precios y pagos de servicios | 150,000 |
| 2.9.2 | Preparacion de la estrategia de implantacion, incluyendo inventario de servicios y priorizacion de areas | 150,000 |
| 2.9.3 | Definicion de medidas de calidad de servicios y metodologias de "contratacion" y monitoreo; capacitacion | 150,000 |
| 2.9.4 | Ejecucion de la estrategia | 200,000 |
| Costos de Base sin contingencias | | 17,400,000 |

Componente 3: NUCLEO DE INFORMACION

| No. Proyecto (BIRP) No. Categoría | Descripción | Total |
|---|--|------------------|
| 3.1 | Gestion de la Informacion | |
| 3.1.1 | Establecimiento de la funcion de CIO | 510,000 |
| 3.1.2 | Apoyo | 60,000 |
| 3.1.3 | DBMS optimizado para el acceso y la seguridad | 800,000 |
| 3.1.4 | Políticas de acceso y seguridad; procedimientos | 240,000 |
| 3.1.5 | Sistemas de seguridad perimetral (internos y externos) | 4,200,000 |
| 3.1.6 | Gastos de capacitacion | 35,000 |
| 3.1.7 | Medicion de calidad de la informacion e indicadores | 240,000 |
| 3.2 | Registro Unico de Contribuyentes (Base de consulta) | |
| 3.2.1 | Definicion de política y mecanismos de transferencia | 30,000 |
| 3.2.2 | Desarrollo del mecanismo de transferencia | 140,000 |
| 3.3 | Cuenta Unica Integral del Contribuyente (Base de consulta) | |
| 3.3.1 | Definicion de informacion a ser transferida a la base y sus fuentes | 30,000 |
| 3.3.2 | Estrategia de integracion (secuencia y prioridades) | 60,000 |
| 3.3.3 | Definicion de política y mecanismos de transferencia | 30,000 |
| 3.3.4 | Desarrollo de los mecanismos de transferencia | 240,000 |
| 3.4 | Informacion de Comercio Exterior (Base de consulta) | |
| 3.4.1 | Definicion de informacion a ser transferida | 30,000 |
| 3.4.2 | Estrategia de integracion (secuencia y prioridades) | 60,000 |
| 3.4.3 | Definicion de política y mecanismos de transferencia | 30,000 |
| 3.4.4 | Desarrollo de los mecanismos de transferencia | 240,000 |
| 3.5 | Informacion de recursos humanos, financieros y fisicos (base de consul) | |
| 3.5.1 | Definicion de política y mecanismos de transferencia | 30,000 |
| 3.5.2 | Desarrollo del mecanismo de transferencia | 350,000 |
| 3.6 | Warehouse de Documentos Digitalizados (base de consulta) | |
| 3.6.1 | Definicion de política y mecanismos de transferencia | 30,000 |
| 3.6.2 | Desarrollo del mecanismo de transferencia | 150,000 |
| 3.7 | Informacion de apoyo para la operacion interna (base de consulta) | |
| 3.7.1 | Analisis de requerimientos | 50,000 |
| 3.7.2 | Estrategia de integracion (secuencia y prioridades) | 60,000 |
| 3.7.3 | Definicion de política y mecanismos de transferencia | 50,000 |
| 3.7.4 | Desarrollo de los mecanismos de transferencia | 200,000 |
| 3.7.5 | Obtencion de la informacion | 300,000 |
| 3.8 | Informacion para la toma de decisiones (base de consulta) | |
| 3.8.1 | Definicion de política y mecanismos de transferencia | 30,000 |
| 3.8.2 | Desarrollo del mecanismo de transferencia | 250,000 |
| 3.9 | Sistema de Informes especializados | |
| 3.9.1 | Desarrollo de sistemas e informes | 250,000 |
| 3.10 | Informacion proveniente de fuentes externas (base de consulta) | |
| 3.10.1 | Analisis de requerimientos | 200,000 |
| 3.10.2 | Estrategia de integracion (secuencia y prioridades) | 180,000 |
| 3.10.3 | Definicion de política y mecanismos de transferencia | 200,000 |
| 3.10.4 | Desarrollo de los mecanismos de transferencia | 400,000 |
| 3.10.5 | Medidas de seguridad | 50,000 |
| 3.10.6 | Segregacion de informacion para grupos especializados | 100,000 |
| Costos de Base sin contingencias | | 9,855,000 |

Componente 4: SERVICIOS DE TECNOLOGIA

| Año Fiscal (BIR) | Año Calendario | Total |
|---|--|-------------------|
| 4.1 Estudios y Estrategias | | |
| 4.1.1 | Desarrollo de plan informatico de apoyo al Plan Estrategico: servicios y tecnologia | 70,000 |
| 4.1.2 | Desarrollo de la politica de servicios internos de tecnologia, procedimientos y guias; comite de priorizacion; trabajo en equipo | 70,000 |
| 4.1.3 | Desarrollar estrategia, politicas y procedimientos para asegurar la calidad e integridad de los datos | 80,000 |
| 4.1.4 | Desarrollo e implementacion de un Plan de Respaldos | 70,000 |
| 4.1.5 | Actualizacion de equipo de respaldo | 220,000 |
| 4.1.6 | Actualizacion de equipo de respaldo (2) | 320,000 |
| 4.1.7 | Desarrollo e implementacion de un Plan de Contingencias | 250,000 |
| 4.1.8 | Desarrollo e implementacion de un Plan de Recuperacion de Desastres | 550,000 |
| 4.2 Ampliacion del Laboratorio de Pruebas de Sistema | | |
| 4.2.1 | Desarrollo de requerimientos | 95,000 |
| 4.2.2 | Adquisicion de equipos | 583,000 |
| 4.2.3 | Asistencia tecnica y capacitacion para mejorar el grado de anti-corrupibilidad de los sistemas | 200,000 |
| 4.3 Centralizacion de sistemas distribuidos | | |
| 4.3.1 | Desarrollo de estrategia de centralizacion | 80,000 |
| 4.3.2 | Modificacion y prueba de sistemas | 570,000 |
| 4.4 Migracion de datos a nuevos sistemas | | |
| 4.4.1 | Analisis, evaluacion, priorizacion y plan de migracion | 44,000 |
| 4.4.2 | Definicion de aplicativos de migracion y adquisicion | 150,000 |
| 4.4.3 | Migracion | 670,000 |
| 4.4.4 | Definicion de metodologia de control de calidad y aplicacion | 168,000 |
| 4.5 Reemplazo o actualizacion de equipos | | |
| 4.5.1 | Analisis, evaluacion, priorizacion y plan de reemplazo o actualizacion | 50,000 |
| 4.5.2 | Preparacion de especificaciones | 50,000 |
| 4.5.3 | Adquisicion de equipos | 1,000,000 |
| 4.5.4 | Adquisicion de equipos (2) | 1,000,000 |
| 4.5.5 | Adquisicion de equipos (3) | 4,400,000 |
| 4.5.6 | Rehabilitacion de oficinas para la instalacion de equipos | 475,000 |
| 4.5.7 | Rehabilitacion de oficinas para la instalacion de equipos 2 | 198,000 |
| 4.6 Sistemas de apoyo para procesos administrativos | | |
| 4.6.1 | Inventario y evaluacion de tecnologia de oficina | 250,000 |
| 4.6.2 | Analisis de flujos de trabajo administrativo | 250,000 |
| 4.6.3 | Introduccion de nuevos procesos administrativos automatizados y capacitacion | 700,000 |
| 4.6.4 | Adquisicion de equipos | 1,200,000 |
| 4.7 Digitalizacion de documentos | | |
| 4.7.1 | Estudio de factibilidad de digitalizacion y identificacion de requerimientos | 50,000 |
| 4.7.2 | Desarrollo de estrategia y plan de digitalizacion, incluyendo priorizacion de documentos por tipo y uso de documento | 70,000 |
| 4.7.3 | firmas | 70,000 |
| 4.7.4 | Adquisicion de software aplicativo | 450,000 |
| 4.7.5 | Escaneo de documentos | 1,800,000 |
| 4.7.6 | Definicion de metodologia de control de calidad y aplicacion | 40,000 |
| Costos de Base sin contingencias | | 16,243,000 |

Componente 5: RECAUDACION

| Año Fiscal (BIRF) | Año Calendario | | |
|---|---|-----------|-------------------|
| 5.1 Ampliacion y depuracion del Registro Federal de Contribuyentes | | | |
| 5.1.1 | Ampliacion del estudio de estimacion del universo de contribuyentes fuera del padron | 70,000 | |
| 5.1.2 | Continuacion del desarrollo de la estrategia de depuracion, metodologias y plan para el aseguramiento de la calidad, validacion | 70,000 | |
| 5.1.3 | Continuacion del desarrollo de la estrategia de ampliacion, metodologias y plan para el aseguramiento de la calidad, validacion de las metodologias | 100,000 | |
| 5.1.4 | Diseño de la base de datos, actualizacion de sistemas aplicativos y de control (incluyendo pistas de auditoria y otros) | 300,000 | |
| 5.1.5 | Definicion de especificaciones de equipo y aplicativos de base | 50,000 | |
| 5.1.6 | Adquisicion de aplicativos de base | 300,000 | |
| 5.1.7 | Actualizacion de equipos | 300,000 | |
| 5.1.8 | Ejecucion de la depuracion | 750,000 | |
| 5.1.9 | Ejecucion de la ampliacion (cambios, cruces, etc.) | 7,000,000 | |
| 5.1.10 | Direccion de la ampliacion, contraparte | 340,000 | |
| 5.1.11 | Sistema de control de gestion y aseguramiento de calidad | 110,000 | |
| 5.2 Cuenta Unica del Contribuyente (basica) | | | |
| 5.2.1 | Definicion del ciclo de vida del cumplimiento del contribuyente y determinacion de responsabilidades; propuesta de perfeccionamiento | 80,000 | |
| 5.2.2 | Desarrollo de la estrategia de depuracion, metodologias y plan para el aseguramiento de la calidad, validacion de las metodologias | 70,000 | |
| 5.2.3 | Desarrollo de la estrategia de ampliacion, metodologias y plan para el aseguramiento de la calidad, validacion de las metodologias | 100,000 | |
| 5.2.4 | Diseño de la base de datos, actualizacion de sistemas aplicativos y de control (incluyendo pistas de auditoria y otros) | 50,000 | |
| 5.2.5 | Definicion de especificaciones de equipo y aplicativos de base | 50,000 | |
| 5.2.6 | Adquisicion de aplicativos de base | 300,000 | |
| 5.2.7 | Actualizacion de equipos | 362,000 | |
| 5.2.8 | Ejecucion de la depuracion | 590,000 | |
| 5.2.9 | Ejecucion de la ampliacion | 1,270,000 | |
| 5.2.10 | Sistema de control de gestion y aseguramiento de calidad | 130,000 | |
| 5.3 Ducto de recaudacion | | | |
| 5.3.1 | Base de datos de declaraciones y pagos | 50,000 | |
| 5.3.2 | Base de datos de contabilidad | 50,000 | |
| 5.3.3 | Base de datos de retenedores | 50,000 | |
| 5.3.4 | Otras bases datos | 50,000 | |
| 5.3.5 | Desarrollo de sistemas | 100,000 | |
| 5.4 Sistema Geo-referenciado | | | |
| 5.4.1 | Marco Geo-fiscal | 50,000 | |
| 5.4.2 | Sistema de informacion geografico-fiscal | 500,000 | |
| 5.4.3 | Grupo especial de localizacion de contribuyentes | 400,000 | |
| 5.4.4 | Sistema de control de gestion y aseguramiento de calidad | 100,000 | |
| 5.5 Sistema de Notificaciones del SAT | | | |
| 5.5.1 | Analisis del sistema actual y evaluacion de alternativas de tercerizacion. | 150,000 | |
| 5.5.2 | Políticas y procedimientos de servicio interno de notificaciones | 50,000 | |
| 5.5.3 | Desarrollo de sistemas de enlace de informacion de notificacion al area sustantiva | 150,000 | |
| 5.5.3 | Sistema de control de gestion y aseguramiento de calidad | 110,000 | |
| 5.6 Servicio de encuestas | | | |
| 5.6.1 | Analisis del sistema actual y evaluacion de alternativas de tercerizacion. | 230,000 | |
| 5.6.2 | Sistema de control de gestion y aseguramiento de calidad | 110,000 | |
| 5.6.3 | Capacitacion en el diseño, validacion, contratacion y monitoreo de encuestas | 130,000 | |
| 5.6.4 | Encuestas especificas en apoyo a diferentes areas | 1,220,000 | |
| Costos de Base sin contingencias | | | 15,892,000 |

Componente 6: PROCESO DE CONTROL Y FISCALIZACION

| Año Fiscal (BIRF) | | |
|---|--|------------------|
| Año Calendario | | |
| 6.1 | Selección de casos para evasión en Grandes Contribuyentes (acción de corto plazo) | |
| 6.1.1 | Análisis de procedimientos actuales | 100,000 |
| 6.1.2 | Recolección de información interna y externa | 100,000 |
| 6.1.3 | Propuesta de métodos de selección | 80,000 |
| 6.1.4 | Ejecución | 220,000 |
| 6.2 | Auditoría de Devoluciones de IVA (acción de corto plazo) | |
| 6.2.1 | Diseño de métodos de auditoría especiales | 80,000 |
| 6.2.2 | Análisis de métodos de devolución y pago | 80,000 |
| 6.2.3 | Recolección de información interna y externa | 80,000 |
| 6.2.4 | Cruces de información y análisis, especializados por tipo de devolución | 120,000 |
| 6.2.5 | Cálculo de montos a devolver/pagar y multas | 150,000 |
| 6.3 | Proceso Integral de Control y Seguimiento | |
| 6.3.1 | Definición del ciclo de actividades de control y seguimiento, determinación de responsabilidades; retro-alimentación entre las áreas; identificación de información requerida por las diversas áreas | 100,000 |
| 6.3.2 | Sistema de control de gestión integral y aseguramiento de calidad | 160,000 |
| 6.3.3 | Evaluación de la percepción de riesgo por parte de los contribuyentes y plan de mejora | 530,000 |
| 6.3.4 | Implementación del plan y aseguramiento de calidad | 750,000 |
| 6.4 | Detección de tendencias de evasión y elusión | |
| 6.4.1 | Preparación de algoritmos de detección de tendencias de evasión en base a estudios de evasión e información interna o externa | 800,000 |
| 6.4.2 | Creación de una base de datos de apoyo a la planificación de la fiscalización | 160,000 |
| 6.4.3 | Estudios de métodos de evasión y elusión | 160,000 |
| 6.5 | Detección de tendencias de evasión (Grandes Contribuyentes) | |
| 6.5.1 | Preparación de algoritmos de detección de tendencias de evasión en base a estudios de evasión e información interna o externa | 800,000 |
| 6.5.2 | Creación de una base de datos de apoyo a la planificación de la fiscalización | 160,000 |
| 6.5.3 | Estudios de métodos de evasión y elusión | 320,000 |
| 6.5 | Control y Fiscalización | |
| 6.5.1 | Evaluación del proceso de auditoría del contribuyente y propuesta de perfeccionamiento | 100,000 |
| 6.5.2 | Diseño de métodos de identificación de fuentes de evasión | 240,000 |
| 6.5.3 | Guías sectoriales para el control de evasión | 240,000 |
| 6.5.4 | Desarrollo de un sistema automatizado de selección de casos y sistema de control | 150,000 |
| 6.5.5 | Sistema de control de gestión y aseguramiento de calidad | 120,000 |
| 6.5.6 | Especialización de profesionales/unidades para sectores económicos relevantes | 200,000 |
| 6.5.7 | Capacitación académica y de terreno | |
| 6.5.8 | Coordinación con Autoridades Fiscales del extranjero | 100,000 |
| 6.6 | Seguimiento pre-judicial y judicial | |
| | Evaluación del proceso de seguimiento y propuesta de perfeccionamiento | 70,000 |
| 6.6.1 | perfeccionamiento | |
| 6.6.2 | Diseño de estrategias legales para determinar montos a devolver/pagar, multas y sanciones penales | 120,000 |
| 6.6.3 | Sistema de control de gestión y aseguramiento de calidad | 100,000 |
| 6.6.4 | Análisis de la información relacionadas con los contribuyentes con orientación hacia los aspectos penales | 100,000 |
| 6.6.5 | Análisis de medidas compulsivas de recaudación y cobro | 100,000 |
| 6.6.6 | Evaluación del proceso de disputa administrativa y propuesta de perfeccionamiento | 100,000 |
| 6.6.7 | Sistema integrado de jurisprudencia y normatividad | 400,000 |
| 6.6.8 | Manuales de procedimientos y capacitación | 210,000 |
| 6.6.9 | Análisis de información de casos en el Tribunal Administrativo | 150,000 |
| 6.6.10 | Análisis de información de casos en el Tribunal Judiciales | 150,000 |
| 6.6.11 | Sistema de asignación de casos a abogados y seguimiento | 145,000 |
| 6.6.12 | Análisis de la cartera de morosos, preparación de estrategia y políticas de priorización y plan operacional de cobro | 210,000 |
| 6.6.13 | Análisis de conductas post-cobranza y percepción de riesgo | 210,000 |
| 6.6.14 | Capacitación académica y de terreno en Investigación | 300,000 |
| Costos de Base sin contingencias | | 8,465,000 |

Componente 7: PLANIFICACION Y CONTROL DE CALIDAD

| Año Fiscal (BIR) | Año Calendario | | |
|---|----------------|---|------------------|
| 7.1 Planificacion | | | |
| | | 7.1.1 Definicion de indicadores estrategicos y de gestion | 180,000 |
| | | 7.1.2 Calculo de valores iniciales de indicadores | 520,000 |
| | | 7.1.3 Diagnostico y planificacion del fortalecimiento de la relacion entre Aduanas y la administracion tributaria | 300,000 |
| | | 7.1.4 Diseño y desarrollo del Sistema de Control de Gestion de la Alta Direccion | 187,000 |
| | | 7.1.5 Asistencia Tecnica - intercambio de experiencias y apoyo | 750,000 |
| | | 7.1.6 Fortalecimiento del Grupo de Planificacion y Gestion de Resultados | 180,000 |
| | | 7.1.7 Gastos de capacitacion | 20,000 |
| | | 7.1.8 Perfeccionamiento de la gestion matricial y de proyecto en el SAT | 130,000 |
| | | 7.1.9 Coordinacion del proyecto | 390,000 |
| | | 7.1.10 Fortalecimiento del Grupo de Seguimiento del Proyecto | 240,000 |
| 7.2 Control de Calidad | | | |
| | | 7.2.1 Definicion del marco de calidad del SAT, introduccion del concepto de calidad | 100,000 |
| | | 7.2.2 Definicion de politicas y procedimientos de evaluacion | 50,000 |
| | | 7.2.3 Desarrollo de metodos de evaluacion y formacion | 210,000 |
| Costos de Base sin contingencias | | | 3,257,000 |

Annex 4

Lessons Learned

Need for a Leader: The Undersecretary of Revenues, who is in charge of both tax policy and administration, is strongly committed to the reform of the tax administration. He is supported by the President and by the Secretary of Finance and Public Credit, and at this early stage of a new administration, has the opportunity to make his reform mandate effective.

Inadequate change/closure of nonperforming components: Performance indicators will assist in identifying slow performing components; a decision on their continuation will be formally made during supervision missions.

Inadequate monitoring and evaluation, and accountability: The improvement of accountability and performance monitoring throughout the institution is explicitly addressed by the project. Baselines will be calculated during the first year of project execution.

Institutional modernization as an iterative process: The project action plan will be revised semi-annually during supervision missions, to provide flexibility to introduce changes, gather knowledge, credibility and consensus for reform.

Need for immediate gains to gain project credibility: Although institutional change is a long-term activity, short-term successes are essential to enhance the credibility of the reform and facilitate political support. Short-term results from activities will be made known; one component specifically addresses short-term activities not in line with the principles of the reform.

Address institutional constraints and not only systems and technology: A correct approach to strengthening an organization would be to address its strategy and corporate objectives first, complemented by a comprehensive review of its management, organization and personnel needs. Processes are then adjusted or created to support the corporate objectives, and finally technology brought in where appropriate. This is the approach explicitly taken in the project.

Result-orientation is sought: Objectives and performance indicators for staff, management and processes are required for management decision-making throughout the organization. This project would assist the organization in implementing them, through baseline calculations, measuring, and modification of systems to provide indicators and training.

Decentralization sought: Given existing technology and communications, centralization of data is the correct approach sought for a tax administration. However, this must be accompanied by a decentralization of authority and tasks for improved efficiency. The project contemplates horizontal management coordination combined with a substantial broadening of regional and local office management within an integrated management framework.

Change management is needed: The extensive organizational redesign and culture change sought requires careful attention to change and conflict management to lessen resistance to change. The first component of the project aims to assure that these critical aspects of change are addressed.

Annex 5 Financial Summary

| | Implementation Period | | | | |
|---------------------------------|-----------------------|-------|-------|-------|------|
| | FY03 | FY04 | FY05 | FY06 | FY07 |
| Total Financing Required | | | | | |
| Project Costs | 6.48 | 33.46 | 27.23 | 11.04 | 3.80 |
| Investment Costs | 6.48 | 33.46 | 27.23 | 11.04 | 3.80 |
| Recurrent Costs | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total Project Costs | 6.48 | 33.46 | 27.23 | 11.04 | 3.80 |
| Total Financing | 5.02 | 21.35 | 17.91 | 6.32 | 1.40 |
| | | | | | |
| Financing | | | | | |
| IBRD/IDA | 5.02 | 21.35 | 17.91 | 6.32 | 1.40 |
| Government | 1.45 | 12.11 | 9.33 | 4.72 | 2.40 |
| Central | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Provincial | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Co-financiers | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| User-fees/beneficiaries | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Other | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total Project Financing | 6.48 | 33.46 | 27.23 | 11.04 | 3.80 |

| | Implementation Period | | | | | Total | |
|---|-----------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| | FY03 | FY04 | FY05 | FY06 | FY07 | | |
| 1: eSAT/Taxpayer Services | 1.01 | 2.12 | 1.39 | 0.73 | 0.12 | 5.38 | |
| 2: Human, Financial and Physical Management | 1.31 | 5.94 | 7.35 | 3.34 | 0.87 | 18.82 | |
| 3: Information Hub | 0.11 | 2.67 | 6.35 | 0.85 | 0.58 | 10.56 | |
| 4: Technology Services | 0.54 | 10.77 | 4.12 | 1.64 | 0.04 | 17.12 | |
| 5: Compliance Process | 0.64 | 7.90 | 4.62 | 2.45 | 1.55 | 17.16 | |
| 6: Control & Enforcement Process | 1.83 | 3.28 | 2.49 | 1.18 | 0.18 | 8.95 | |
| 7: Planning and Quality Control | 0.51 | 0.77 | 0.91 | 0.84 | 0.47 | 3.51 | |
| | <i>Base Costs</i> | 5.96 | 33.46 | 27.23 | 11.04 | 3.80 | 81.48 |
| | <i>Front-End Fee</i> | 0.52 | | | | | |
| | TOTAL | 6.48 | 33.46 | 27.23 | 11.04 | 3.80 | 82.00 |
| | <i>Divided into:</i> | | | | | | |
| <i>World Bank</i> | 5.02 | 21.35 | 17.91 | 6.32 | 1.40 | 52.00 | |
| <i>Government of Mexico</i> | 1.45 | 12.11 | 9.33 | 4.72 | 2.40 | 30.00 | |

Annex 6(A) : Procurement and Disbursement Arrangements

Procurement of Goods

Procurement of goods financed by the World Bank under the project would be carried out in accordance with World Bank's Guidelines for Procurement under IBRD Loans and IDA Credits (January 1995, revised in January and August 1996, September 1997 and January 1999) and the following provisions of Section I of this Annex. The executing agency for the project will be the *Sistema de Administración Tributaria (SAT)*.

Grouping of contracts. To the extent practicable contracts for goods shall be grouped in bid packages estimated to cost US\$500,000 equivalent or more each.

Notification and advertising. The General Procurement Notice to be published in the *Development Business*, shall be updated annually for outstanding procurement. All invitation to bid shall be published in the "*Diario Oficial de la Federación*" and in *COMPRANET*. In addition, invitation to bid for each contract estimated to cost US\$10,000,000 equivalent or more shall be advertised in the *Development Business* in accordance with the procedures applicable to large contracts under paragraph 2.8 of the Guidelines. To obtain expressions of interest for large consultant assignments (contracts expected to cost more than US\$200,000 equivalent) a specific procurement notice shall be also published in *Development Business*.

Section I-Procurement Methods

The methods to be used for the procurement describe below, and the estimated amounts for each method, are summarized in Table A. The threshold contract values for the use of each method are fixed in Table B.

Procurement of Works

Minor works to prepare offices for the installation of equipment, cabling, etc., up to an aggregate of US\$700,000 may be procured using National shopping procedures based on a request for quotations acceptable to the Bank.

Procurement of Goods

Goods procured under this project will include information technology equipment totaling US\$9.90 million equivalent. Major contracts for these goods will be procured following International Competitive Bidding procedures (ICB), using Bank Standard Bidding Documents (SBDs). Contracts estimated to cost less than US\$500,000 equivalent per contract, up to an aggregated amount of US\$3.00 million equivalent, may be procured using National Competitive Bidding procedures (NCB) and agreed Standard Bidding Documents. Contracts for goods that cannot be grouped into large bidding packages and estimated to cost less than US\$100,000 equivalent per contract, up to an aggregated amount of US\$1.00 million equivalent, may be procured using shopping (National or International) procedures based on a request for quotations acceptable to the Bank.

Section II-Employment of Consultants

Consultant services shall be procured in accordance with Guidelines for the use of Consultants by the World Bank Borrowers and the Bank as Executing Agency (January 1997, revised in September 1997, January 1999 and May 2002) and the following provisions of Section II of this Annex. Consultant services will be contracted under this project in the following areas of expertise training and institutional development. These services are estimated to cost US\$67.74 million equivalent and would be procured using World Bank Standard Request of Proposals.

Firms. All contracts for firms would be procured using QCBS procedures except for small contracts for assignments of standard or routine nature and estimated to cost less than US\$100,000 equivalent that would be procured using LCS, up to an aggregate amount of US\$1.5 million equivalent. Single-Source Selection only will be acceptable, previous Bank No-objection, to assignments when only one firm is qualified or has experience of exceptional worth. Training expenditures will be procured using national shopping for rental of equipment and locales.

Individuals. Specialized advisory services would be provided by individual consultants selected by comparison of qualifications of at least three candidates and hired in accordance with the provisions of paragraph 5.1 to 5.3 of the Consultant Guidelines, up to an aggregated amount of US\$5.0 million equivalent.

The following provisions shall apply to consultants' services to be procured under contracts awarded in accordance with the provisions of the preceding paragraphs. The short list of consultants, estimated to cost less than \$200,000 equivalent per contract, may comprise entirely national consultants in accordance with the provisions of paragraph 2.7 of the Consultant Guidelines.

Prior review: The prior review arrangements are presented in Table B.

Procurement plan. By Negotiations, the Borrower presented to the Bank for comments a procurement plan for project implementation which provided the basis of the aggregate amounts for the procurement methods. Each year, the Borrower would update the procurement schedule for the following year, including the ICB procedures, the smaller procurement and the consultancy and training services to be financed under the proposed loan following the model procurement plan.

Section III-Procurement Responsibilities and Capacity

A procurement capacity assessment for the project was carried out by Ms. Lea Braslavsky, Country Procurement Specialist, LCOPR, and approved by RPA on May 1, 2002. The National Development Bank (*Nacional Financiera-NAFIN*), one of the three financial intermediary institutions of the Mexican Government will be responsible through its Special Financing Unit for: (i) reviewing all procurement procedures and bid evaluation reports submitted by SAT, (ii) give the no-objection for the award of contracts below the agreed threshold for Bank prior review; and (iii) maintaining all the corresponding records. NAFIN's performance under previous Bank financing projects was satisfactory. The Bank's Implementation Unit in Mexico will provide procurement advice to SAT and NAFIN as required and carried out the Bank's fiduciary functions delegated to it.

To ensure SAT's staff knowledge of World Bank procurement Guidelines and procedures, a special procurement seminar was given by the Mexico Resident Mission to SAT's staff.

During project preparation, NAFIN and SAT have confirmed their will for ethical behavior and have expressed their commitment to adhere to competitive selection and transparency in all activities. The Operational Manual will include a chapter call “Code of Ethic” Based on the above procurement risk for the project is rated as “average”.

Section IV: Procurement Monitoring

SAT will prepare annually a Procurement Plan satisfactory to the World Bank and establish procedures for monitoring project execution and impact, procurement implementation, including monitoring of contracts. SAT as well as Nafin will maintain detailed records of procurement activities.

Review by the Bank. The proposed thresholds for prior review by the World Bank are based on the procurement assessment of the project executing agency and are summarized in Table B. In addition to this review of individual procurement actions, the annual procurement plan will be reviewed and approved by the Bank, as well as procurement audits to be carried out during the life of the project.

Frequency of Procurement Supervision. Based on the overall risk assessment (average) the post-review mission for the project shall be completed every 12 months and shall cover not less than 1 in 20 contracts signed.

TABLE A: Project Costs by Procurement Arrangements
(US\$ million equivalent)

| Expenditure Category | Procurement Method | | | | Total Costs |
|----------------------------------|--------------------|--------|---------|--------|-------------|
| | ICB | NCB | Others | N.B.F. | |
| 1. Works | - | - | 0.70 | - | 0.70 |
| | - | - | (0.50) | - | (0.50) |
| 2. Goods | 5.26 | 3.48 | 1.16 | - | 9.90 |
| | (4.52) | (3.00) | (1.00) | - | (8.52) |
| 3. Consulting Services a/ | - | - | 65.85 | - | 65.85 |
| | - | - | (41.46) | - | (41.46) |
| 4. Training b/ | - | - | 1.16 | - | 1.16 |
| | - | - | (1.00) | - | (1.00) |
| 5. Counterpart Staff | - | - | - | 3.87 | 3.87 |
| | - | - | - | - | - |
| 6. Front end Fee | - | - | - | - | 0.52 |
| | - | - | - | - | (0.52) |
| Total | 5.26 | 3.49 | 69.39 | 3.87 | 82.00 |
| | (4.52) | (3.00) | (44.48) | - | (52.00) |

Figures in parenthesis are amount to be financed by the Loan

ICB= International Competitive Bidding

NCB=National Competitive Bidding

Others=Local and International Shopping; hiring consultant services according Bank Guidelines; and training using LCS.

**TABLE A1:
Consultant Selection Arrangements
(in US\$ million equivalent)**

| Consultant Services Expenditure Category | Selection Method | | | | | | Cost (including contingenc |
|--|------------------|------|------|--------|------|--------|-------------------------------|
| | QCBS | QBS | SFB | LCS | CQ | Other | |
| A. Firms | 43.65 | 0.00 | 0.00 | 16.72 | 0.00 | 0.00 | 60.37 |
| | (29.80) | - | - | (6.38) | - | - | (36.18) |
| B. Individuals | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 5.48 | 5.48 |
| | - | - | - | - | - | (5.28) | (5.28) |
| | 43.65 | 0.00 | 0.00 | 16.72 | 0.00 | 5.48 | 65.85 |
| | (29.80) | - | - | (6.38) | - | (5.28) | (41.46) |

Note: Figures in parenthesis are amount to be financed by the Loan

QCBS = Quality- and Cost-Based Selection

LCS = Least Cost Selection

Other = Selection of individual consultants (per Section V of Consultants Guidelines), Service Delivery, etc.

**TABLE B
Thresholds for Procurement Methods and Prior Review
(US\$1,000 equivalent)**

| Category | Contract Value (thresholds) | Procurement Method | Contracts Subject to Prior Reviews by Bank |
|--|--------------------------------|-------------------------------------|---|
| Goods | >500,000 | ICB | All |
| | <500,000 | NCB | First two contracts |
| | <100,000 | Shopping at least 3 suppliers | None |
| Services Consulting Services: Firms | >200,000 | QCBS-Short List | All |
| | >100,000 | International QCBS | All |
| | <100,000 | QCBS | TORs |
| Individual | >50,000 | Consultant Qualifications | All |
| | < 50,000 | Consultant Qualifications | TORs |
| Training services | | National Shopping | First two contracts |

ICB = International Competitive Bidding

NCB= National Competitive Bidding

QCBS= Quality and Cost Based Selection

LCS= Least Cost Selection

ANNEX 6(B): Financial Management and Disbursement Arrangements

Financial Management

1. Summary of the Financial Management Assessment (FMA)

Financial Management Assessment. A financial management assessment was carried out based on applicable Bank guidelines and procedures. It concluded that Sistema de Administración Tributaria - SAT, the implementing unit, is currently prepared to implement the project. Based on the FMA review and on the information of the ISO certification, it was concluded that SAT is currently fully staffed and operational, and that it is operating a sound financial management system which meets minimum Bank financial management requirements. The FMA recognizes that that one of the activities of the project aims at the further strengthening of the systems concerned, which will enable them to meet all Bank requirements.

Overall Risk Assessment. *Moderate*, based on that inherent risk (country, entity and project) and control risk (entity, flow of funds, staffing, accounting policies and procedures, internal audit, external audit, reporting & monitoring and MIS) are overall moderate.

Frequency of financial management supervision missions proposed. As required but at least once a year.

Financial Agency. SAT will be responsible for all project activities with the support of the designated financial agency, Nacional Financiera.

Staffing. There is a good financial management team, skilled and well trained. The project manual will reflect all related information for this project i.e. organizational chart, job descriptions, specific responsibilities for this project.

FMR Reporting. The project will produce FMR on semi-annual basis starting after project effectiveness. The format and contents of the FMR were agreed before negotiations.

Management Information System. Existing SAT's systems are acceptable to the Bank as they satisfy minimum Bank requirements on financial management, however, those systems will be adjusted to be fully satisfactory to the Bank based on project needs.

Budgeting. Financing for the proposed project would be included under standard SAT budget and, therefore, it would be fully pre-financed by the federal government. Flow of funds will be separately identified in all records, reports and files i.e. authorized budget, modified, committed, reserved, spent and reimbursed. Project budget will be in line with PAD projections, which will be up-dated as needed.

2. Audit Arrangements

Accounting and auditing. SAT will maintain separate project records which will reflect, in accordance with sound accounting practices, the operations, resources and expenditures of all

project activities. Independent annual audits will be carried out in line with standards compatible with the International Standards on Auditing (ISA), applicable Bank guidelines, legal documents and the technical memorandum of understanding on auditing dated June 2001. These audits will be carried out by auditors acceptable to the Bank and corresponding reports will be submitted to the Bank within the six months after the end of each fiscal year.

The audit review will include all project operations and its Special Account.

3. Disbursement Arrangements

Traditional documentation requirements apply for direct payments, special commitments and statements of expenditures. Full documentation is required for contracts that are above the prior review limit. If project is converted to FMR-based disbursement methodology, all procedures should be satisfactory to the Bank. For prompt disbursements, the SAT will prepare necessary documentation.

Retroactive Financing. The project is considering retroactive financing from preparation activities prior to loan signing. Retroactive financing of up to US\$ 5.0 million would be permitted for eligible expenditures made after February 10, 2002 (beginning of Project Identification).

Project Manual. The manual will include a financial management section satisfactory to the Bank; this will be a project effectiveness condition.

Use of statements of expenditures (SOEs):

Disbursements will be made against Statements of Expenditures. Detailed supporting documents showing evidence of payments to contractors and suppliers will be kept in SAT files and will be made available to Bank supervision missions and the annual audits

Based on thresholds recommended, full supporting documentation will be required for all contracts for goods higher than US\$ 500,000.00, consultant firm contracts above US\$ 100,000.00, individual consultant contracts above US\$ 50,000.00. All expenditures for training, except those which relates to contracts with firms and training institutions will be disbursed by SOE.

Special account:

A Special Account in US dollars will be established at the Banco de México, Nacional Financiera (NAFIN), or in a commercial bank on terms and conditions satisfactory to the Bank. The authorized allocation is US\$ 4 million and the initial deposit is \$2 million.

The SAT might opt to request up to US\$2 million out of the pre-authorized revolving fund above mentioned. When the aggregate disbursements under the loan have reached US\$ 8 million, this allocation may be increased up to the total allocation.

Replenishment applications should be submitted on a monthly basis or when one-third of the amount deposited has been utilized. The replenishment application would be supported by the necessary documentation, the Special Account bank statement, and a reconciliation of this bank statement.

Table C: Allocation of Loan Proceeds (US\$ million equivalent)

| Category | Amount of Loan Proceeds | % of Proceeds to be Financed | % of Expenditures to be Financed |
|---------------------|-------------------------|------------------------------|---|
| Works | 0.50 | | 70.00% |
| Goods | 8.52 | | 86.00% local 100.00% foreign |
| Consulting Services | 41.46 | | 83.00% for local consultants 100.00% for foreign consultants |
| Training | 1.00 | | 83.00% |
| Front End Fee | 0.52 | | |
| TOTAL | 52.00 | | |

Annex 7

Project Processing Budget and Schedule

| | | |
|---|---|---------------|
| A. Project Budget (US\$000) | <u>Planned</u> (At final PCD stage) | <u>Actual</u> |
| | 85,000 | 144,000 |
| B. Project Schedule | <u>Planned</u> (At final PCD stage) | <u>Actual</u> |
| Time taken to prepare the project (months) | 2 | |
| First Bank mission (identification) | 02/10/2002 | 02/10/2002 |
| Appraisal mission departure | 03/012/2002 | 03/12/2002 |
| Negotiations | 05/08/2002 | 05/16/2002 |
| Planned Date of Effectiveness | 7/1/2002 | |
| Prepared by: SAT | | |
| Preparation assistance: | | |
| Bank team who worked on the project included: | | |
| Name | Specialty | |
| Steven Webb | Task Team Leader | |
| Luis-José Mejía | Public Sector and Project Management (cons) | |
| Enrique Fanta | Tax Administration (consultant) | |
| Herman Nissenbaum | Editor; Loan processing (consultant) | |
| Harjit Singh | Information Technology (consultant) | |
| Judith Davidson-Palmer | Human Resources (consultant) | |
| Katherine Bain | Civil Society & Participation | |
| Francisco Leiva | Project Administration (consultant) | |
| Patricia Holt | Administrative Assistant | |
| Victor Ordóñez Conde | Financial Management Specialist | |
| Joseph P. Formoso | Disbursement Officer | |
| Mariángeles Sabella | Lawyer | |
| Pilar González | Lawyer | |
| Reynaldo Pastor | Lawyer | |
| Elizabeth Toxtle | Task Assistant | |
| Lea Braslavsky | Procurement Specialist | |

Annex 8

Documents in the Project File*

A. Project Implementation Plan

Preliminary Plan – see Annex 2.

B. Bank Staff Assessments

Country Assistance Strategy of June 8, 1999.

Country Assistance Strategy Progress Report, May 21, 2001

BTO of December 2001 Identification Mission, Identification Mission, Steve Webb

Reforming Tax Systems: The World Bank Record in the 1990s, by Luca Barbone, Arindam Das-Gupta, Luc de Wulf and Anna Hansson. Tax Policy and Administration Thematic Group.

Country Economic Memorandum: Challenges and Prospects for Tax Reform" 2001

Mexico: Tax Reform Adjustment Loan

C. Other

Mexico: Fortalecimiento de la Administración Tributaria Federal. Casanegra, dos Santos, Escolano & Castro, IMF Report, February 1997.

Performance Indicators for Tax Structure and Administration, a Preliminary Proposal, by Arindam Das-Gupta, PRMPS, The World Bank, May 1999.

*Including electronic files.

Annex 9: Statement of Loans and Credits
MEXICO: Tax Admin Institutional Development
02-May-2002

| Project ID | FY | Purpose | Original Amount in US\$ Millions | | | | Difference between expected and actual disbursements ¹ | | |
|---------------|------|--|----------------------------------|-------------|--------------|---------------|---|----------------|---------------|
| | | | IBRD | IDA | GEF | Cancel. | Undisb. | Ong | Frm Rev'd |
| P057531 | 2002 | MX Basic Ed Dev Phase II | 300.00 | 0.00 | 0.00 | 0.00 | 300.00 | 0.00 | 0.00 |
| P060577 | 2002 | MX Southeast Reg'l Development LIL | 5.00 | 0.00 | 0.00 | 0.00 | 5.00 | 0.08 | 0.00 |
| P065988 | 2002 | GEF MX-Consolidation of Protected Areas | 0.00 | 0.00 | 16.10 | 0.00 | 0.01 | 0.00 | 0.00 |
| P064887 | 2001 | DISASTER MANAGEMENT (ERL) | 404.05 | 0.00 | 0.00 | 0.00 | 395.74 | 58.36 | 0.00 |
| P063463 | 2001 | METHANE CAPTURE & USE AT A LANDFILL | 0.00 | 0.00 | 6.27 | 0.00 | 6.35 | 1.94 | 0.29 |
| P060908 | 2001 | GEF MX-MESO AMERICAN CORRIDOR | 0.00 | 0.00 | 14.84 | 0.00 | 13.85 | 3.07 | 0.00 |
| P065779 | 2001 | FEDERAL HIGHWAY MAINTENANCE PROJECT | 218.00 | 0.00 | 0.00 | 0.00 | 203.93 | -14.07 | 0.00 |
| P066321 | 2001 | MX: III BASIC HEALTH CARE PROJECT | 350.00 | 0.00 | 0.00 | 0.00 | 350.00 | 0.00 | 0.00 |
| P066874 | 2001 | GEF MX-Indigenous&Community Biodiversity | 0.00 | 0.00 | 7.50 | 0.00 | 6.84 | 2.22 | 0.00 |
| P071323 | 2001 | Bank Restructuring Facility II | 505.06 | 0.00 | 0.00 | 0.00 | 350.01 | 0.01 | 0.00 |
| P057530 | 2000 | RURAL DEV.MARG.ARII (APL) | 55.00 | 0.00 | 0.00 | 0.00 | 38.92 | 3.25 | 0.00 |
| P060718 | 2000 | ALTERNATIVE ENERGY | 0.00 | 0.00 | 8.90 | 0.00 | 6.98 | 6.92 | 0.00 |
| P066938 | 2000 | MX GENDER (LIL) | 3.07 | 0.00 | 0.00 | 0.00 | 3.07 | 1.63 | 0.00 |
| P048505 | 1999 | AGRICULTURAL PRODUCT | 444.45 | 0.00 | 0.00 | 0.00 | 139.94 | 50.19 | -27.05 |
| P007610 | 1999 | FOVI RESTRUCTURING | 505.50 | 0.00 | 0.00 | 0.00 | 312.00 | 312.00 | 0.00 |
| P007711 | 1998 | MX RURAL DEV. MARG.AREA (APL) | 47.00 | 0.00 | 0.00 | 0.00 | 29.07 | 22.75 | 0.00 |
| P007720 | 1998 | MX HEALTH SYSTEM REFORM - SAL | 700.00 | 0.00 | 0.00 | 0.00 | 150.00 | 150.00 | 50.00 |
| P044531 | 1998 | KNOWLEDGE & INNOV | 300.00 | 0.00 | 0.00 | 0.00 | 195.37 | 78.71 | 0.00 |
| P055061 | 1998 | MX: HEALTH SYSTEM REFORM TA | 25.00 | 0.00 | 0.00 | 0.00 | 1.31 | 1.31 | 0.00 |
| P049895 | 1998 | MX. HIGHER ED. FINANCING | 180.20 | 0.00 | 0.00 | 0.00 | 140.19 | 75.92 | 0.00 |
| P007700 | 1997 | COMMUNITY FORESTRY | 15.00 | 0.00 | 0.00 | 0.00 | 6.07 | 5.59 | 0.00 |
| P007713 | 1996 | WATER RESOURCES MANA | 186.50 | 0.00 | 0.00 | 0.00 | 117.29 | 101.96 | 44.17 |
| P007689 | 1996 | MX: BASIC HEALTH II | 310.00 | 0.00 | 0.00 | 0.00 | 23.83 | 23.83 | 23.83 |
| P034490 | 1995 | MX TECHNICAL EDUC/TRAINING | 265.00 | 0.00 | 0.00 | 69.69 | 48.07 | 117.75 | 87.72 |
| P007710 | 1994 | N. BORDER I ENVIRONM | 368.00 | 0.00 | 0.00 | 313.36 | 22.03 | 335.40 | 62.00 |
| P007648 | 1993 | MX MEDIUM CITIES TRANSP | 200.00 | 0.00 | 0.00 | 65.50 | 40.93 | 106.43 | 83.43 |
| Total: | | | 5388.83 | 0.00 | 53.61 | 448.55 | 2906.81 | 1445.28 | 324.39 |

MEXICO
STATEMENT OF IFC's
Held and Disbursed Portfolio
Jan - 2002
In Millions US Dollars

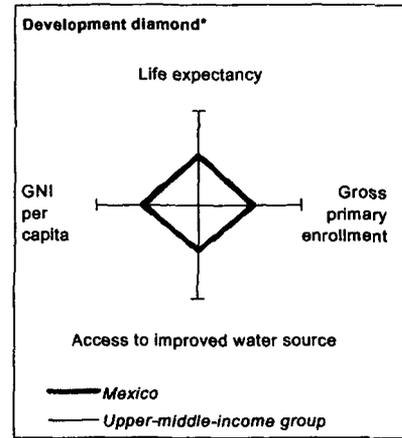
| FY Approval | Company | Committed | | | | Disbursed | | | |
|-------------------------|------------------|---------------|---------------|--------------|---------------|---------------|---------------|--------------|---------------|
| | | IFC | | | | IFC | | | |
| | | Loan | Equity | Quasi | Partic | Loan | Equity | Quasi | Partic |
| 1988/91/92/93/95 | Apasco | 10.80 | 0.00 | 0.00 | 43.20 | 10.80 | 0.00 | 0.00 | 43.20 |
| 1998 | Ayvi | 8.57 | 0.00 | 0.00 | 0.00 | 8.57 | 0.00 | 0.00 | 0.00 |
| 1990/92/96 | BANAMEX | 75.71 | 0.00 | 0.00 | 5.49 | 75.71 | 0.00 | 0.00 | 5.49 |
| 0 | BBVA-Bancomer | 86.47 | 0.00 | 0.00 | 0.00 | 86.47 | 0.00 | 0.00 | 0.00 |
| 1995/99 | Baring MexFnd | 0.00 | 2.73 | 0.00 | 0.00 | 0.00 | 1.90 | 0.00 | 0.00 |
| 1998 | CIMA Mexico | 0.00 | 4.80 | 0.00 | 0.00 | 0.00 | 4.80 | 0.00 | 0.00 |
| 1998 | CIMA Puebla | 7.00 | 0.00 | 0.00 | 0.00 | 3.50 | 0.00 | 0.00 | 0.00 |
| 1994 | CTAPV | 2.88 | 0.00 | 1.69 | 0.00 | 2.88 | 0.00 | 1.69 | 0.00 |
| 0 | Chiapas-Propalma | 0.00 | 0.82 | 0.00 | 0.00 | 0.00 | 0.82 | 0.00 | 0.00 |
| 1997 | Comercializadora | 2.41 | 0.00 | 1.72 | 4.38 | 2.41 | 0.00 | 1.72 | 4.38 |
| 2001 | Compartamos | 1.00 | 0.66 | 0.00 | 0.00 | 1.00 | 0.66 | 0.00 | 0.00 |
| 1999 | Corsa | 11.14 | 3.00 | 0.00 | 0.00 | 11.14 | 3.00 | 0.00 | 0.00 |
| 2001 | Ecomex | 5.00 | 0.00 | 1.50 | 0.00 | 3.00 | 0.00 | 1.50 | 0.00 |
| 2000 | Educacion | 6.50 | 0.00 | 0.00 | 0.00 | 4.90 | 0.00 | 0.00 | 0.00 |
| 1997 | Fondo Chiapas | 0.00 | 4.18 | 0.00 | 0.00 | 0.00 | 0.54 | 0.00 | 0.00 |
| 1998 | Forja Monterrey | 12.07 | 3.00 | 0.00 | 12.07 | 12.07 | 3.00 | 0.00 | 12.07 |
| 1991/96 | GIBSA | 18.93 | 0.00 | 10.00 | 63.67 | 18.93 | 0.00 | 10.00 | 63.67 |
| 1993 | GIDESA | 2.50 | 0.00 | 0.00 | 0.00 | 2.50 | 0.00 | 0.00 | 0.00 |
| 1996/00 | GIRSA | 45.00 | 0.00 | 0.00 | 60.00 | 45.00 | 0.00 | 0.00 | 60.00 |
| 1993 | GOTM | 0.49 | 0.00 | 0.00 | 0.00 | 0.49 | 0.00 | 0.00 | 0.00 |
| 1997/98 | Gen. Hipotecaria | 0.00 | 1.20 | 0.00 | 0.00 | 0.00 | 1.20 | 0.00 | 0.00 |
| 0 | Grupo BBVA | 0.00 | 2.67 | 0.00 | 0.00 | 0.00 | 2.67 | 0.00 | 0.00 |
| 1998 | Grupo Calidra | 10.00 | 6.00 | 0.00 | 7.50 | 10.00 | 6.00 | 0.00 | 7.50 |
| | Grupo FEMSA | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| 1989 | Grupo Minsa | 12.00 | 10.00 | 0.00 | 18.00 | 12.00 | 10.00 | 0.00 | 18.00 |
| 1997 | Grupo Posadas | 25.00 | 0.00 | 10.00 | 0.00 | 25.00 | 0.00 | 10.00 | 0.00 |
| 1992/93/95/96/99 | Grupo Sanfandila | 8.09 | 0.00 | 0.00 | 3.61 | 6.76 | 0.00 | 0.00 | 2.95 |
| 1998 | Heller Financial | 0.00 | 0.32 | 0.00 | 0.00 | 0.00 | 0.32 | 0.00 | 0.00 |
| 1994/96/98/00 | Hospital ABC | 30.00 | 0.00 | 0.00 | 14.00 | 1.76 | 0.00 | 0.00 | 1.24 |
| 2000 | ITR | 14.00 | 0.00 | 0.00 | 4.00 | 14.00 | 0.00 | 0.00 | 4.00 |
| 2000 | Innopack | 0.00 | 15.00 | 0.00 | 0.00 | 0.00 | 15.00 | 0.00 | 0.00 |
| 2000 | Interceramic | 5.00 | 0.00 | 4.00 | 0.00 | 5.00 | 0.00 | 4.00 | 0.00 |
| 1994 | InverCap | 0.00 | 0.07 | 0.00 | 0.00 | 0.00 | 0.06 | 0.00 | 0.00 |
| 2000/01 | Merida III | 29.59 | 0.00 | 0.00 | 72.15 | 29.59 | 0.00 | 0.00 | 72.15 |
| 1998 | Mexplus Puertos | 0.00 | 1.41 | 0.00 | 0.00 | 0.00 | 1.41 | 0.00 | 0.00 |
| 1995/99 | NEMAK | 0.00 | 0.00 | 1.51 | 0.00 | 0.00 | 0.00 | 1.51 | 0.00 |
| 1996/99/00/01 | Pan American | 0.00 | 9.00 | 0.00 | 0.00 | 0.00 | 9.00 | 0.00 | 0.00 |
| 2000 | Rio Bravo | 50.00 | 0.00 | 0.00 | 59.50 | 50.00 | 0.00 | 0.00 | 59.50 |
| 2000 | Saltillo S.A. | 35.00 | 0.00 | 0.00 | 43.00 | 35.00 | 0.00 | 0.00 | 43.00 |
| 2000 | Servicios | 10.50 | 1.90 | 0.00 | 10.00 | 10.50 | 1.90 | 0.00 | 10.00 |
| 2000 | Su Casita | 0.00 | 10.62 | 0.00 | 0.00 | 0.00 | 10.62 | 0.00 | 0.00 |
| 2001 | Sudamerica | 0.00 | 15.00 | 0.00 | 0.00 | 0.00 | 15.00 | 0.00 | 0.00 |
| 1999 | TMA | 2.58 | 0.00 | 2.60 | 8.95 | 2.58 | 0.00 | 2.60 | 8.95 |
| 1997 | Toluca Toll Road | 4.83 | 0.00 | 0.00 | 0.00 | 4.83 | 0.00 | 0.00 | 0.00 |
| 1992 | | | | | | | | | |
| Total Portfolio: | | 533.06 | 117.68 | 33.02 | 429.52 | 496.39 | 102.67 | 33.02 | 416.10 |

| FY Approval | Company | Approvals Pending Commitment | | | |
|---------------------------|------------------|------------------------------|--------|-------|--------|
| | | Loan | Equity | Quasi | Partic |
| 1999 | BANAMEX LRF II | 50.00 | 0.00 | 0.00 | 0.00 |
| 2001 | BBVA-Bancomer CL | 100.00 | 0.00 | 0.00 | 0.00 |
| 1998 | Cima Hermosillo | 7.00 | 0.00 | 0.00 | 0.00 |
| 2002 | Coppel | 30.00 | 0.00 | 0.00 | 0.00 |
| 2001 | Ecomex | 3.50 | 0.00 | 0.00 | 0.00 |
| 2000 | Educacion | 3.20 | 0.00 | 0.00 | 0.00 |
| 2001 | GFNorte-CL | 50.00 | 0.00 | 0.00 | 100.00 |
| 2001 | Greenmanor | 7.00 | 0.00 | 0.00 | 0.00 |
| 2001 | La Colorada | 4.30 | 6.00 | 0.00 | 18.30 |
| 2001 | PanAme-La Colora | 0.00 | 0.00 | 1.20 | 0.00 |
| 2002 | Puertas Finas | 13.00 | 0.00 | 0.00 | 0.00 |
| 2001 | Su Casita | 0.00 | 2.40 | 0.00 | 0.00 |
| Total Pending Commitment: | | 268.00 | 8.40 | 1.20 | 118.30 |

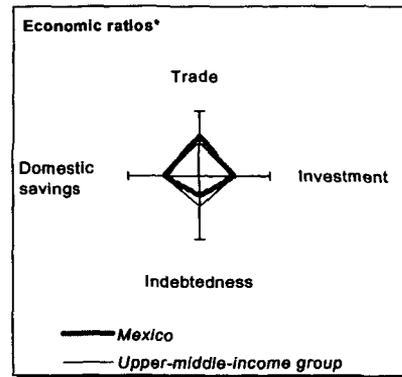
Annex 10: Country at a Glance

MEXICO: Tax Admin Institutional Development

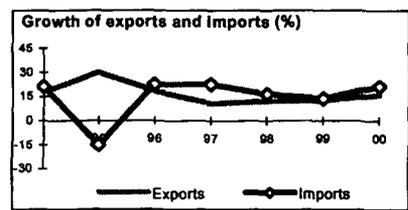
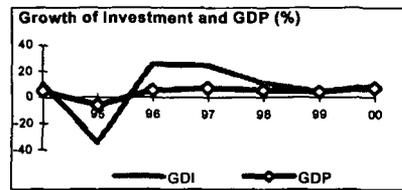
| | Mexico | Latin America & Carib. | Upper-middle-income |
|--|--------|------------------------|---------------------|
| POVERTY and SOCIAL | | | |
| 2000 | | | |
| Population, mid-year (millions) | 98.0 | 516 | 647 |
| GNI per capita (Atlas method, US\$) | 5,070 | 3,680 | 4,620 |
| GNI (Atlas method, US\$ billions) | 497.0 | 1,895 | 2,986 |
| Average annual growth, 1994-00 | | | |
| Population (%) | 1.5 | 1.6 | 1.3 |
| Labor force (%) | 2.5 | 2.3 | 2.0 |
| Most recent estimate (latest year available, 1994-00) | | | |
| Poverty (% of population below national poverty line) | .. | .. | .. |
| Urban population (% of total population) | 74 | 75 | 76 |
| Life expectancy at birth (years) | 72 | 70 | 69 |
| Infant mortality (per 1,000 live births) | 29 | 30 | 28 |
| Child malnutrition (% of children under 5) | 8 | 9 | .. |
| Access to an improved water source (% of population) | 86 | 85 | 87 |
| Illiteracy (% of population age 15+) | 9 | 12 | 10 |
| Gross primary enrollment (% of school-age population) | 114 | 113 | 107 |
| Male | 116 | .. | 106 |
| Female | 113 | .. | 105 |



| | 1980 | 1990 | 1999 | 2000 | |
|---|-------|-------|-------|-------|-----|
| KEY ECONOMIC RATIOS and LONG-TERM TRENDS | | | | | |
| GDP (US\$ billions) | 223.5 | 262.7 | 479.4 | 574.5 | |
| Gross domestic investment/GDP | 27.2 | 23.1 | 23.5 | 23.3 | |
| Exports of goods and services/GDP | 10.7 | 18.6 | 30.9 | 31.4 | |
| Gross domestic savings/GDP | 24.9 | 22.0 | 21.9 | 21.5 | |
| Gross national savings/GDP | 22.4 | 20.3 | 20.5 | 20.1 | |
| Current account balance/GDP | -4.7 | -2.8 | -3.0 | -3.1 | |
| Interest payments/GDP | 2.0 | 2.2 | 2.1 | 2.0 | |
| Total debt/GDP | 25.7 | 39.8 | 35.0 | 26.9 | |
| Total debt service/exports | 45.4 | 20.9 | 25.1 | 32.7 | |
| Present value of debt/GDP | .. | .. | 33.9 | 28.1 | |
| Present value of debt/exports | .. | .. | 102.6 | 77.8 | |
| (average annual growth) | | | | | |
| GDP | 1.1 | 3.1 | 3.8 | 6.9 | 4.3 |
| GDP per capita | -1.0 | 1.4 | 2.3 | 5.4 | 2.3 |
| Exports of goods and services | 7.0 | 14.6 | 12.4 | 16.0 | 8.5 |



| | 1980 | 1990 | 1999 | 2000 |
|---------------------------------|------|------|------|------|
| STRUCTURE of the ECONOMY | | | | |
| (% of GDP) | | | | |
| Agriculture | 9.0 | 7.8 | 4.7 | 4.4 |
| Industry | 33.6 | 28.4 | 28.8 | 28.4 |
| Manufacturing | 22.3 | 20.8 | 21.1 | 20.7 |
| Services | 57.4 | 63.7 | 66.5 | 67.3 |
| Private consumption | 65.1 | 69.6 | 67.1 | 67.5 |
| General government consumption | 10.0 | 8.4 | 10.9 | 11.0 |
| Imports of goods and services | 13.0 | 19.7 | 32.4 | 33.2 |
| (average annual growth) | | | | |
| Agriculture | 0.8 | 1.8 | 2.0 | 2.1 |
| Industry | 1.1 | 3.8 | 4.2 | 6.6 |
| Manufacturing | 1.5 | 4.4 | 4.2 | 7.1 |
| Services | 1.4 | 2.9 | 3.7 | 7.4 |
| Private consumption | 1.4 | 2.4 | 4.3 | 9.5 |
| General government consumption | 2.4 | 1.8 | 3.9 | 3.5 |
| Gross domestic investment | -3.3 | 4.6 | 4.1 | 8.8 |
| Imports of goods and services | 1.0 | 12.3 | 13.8 | 21.4 |

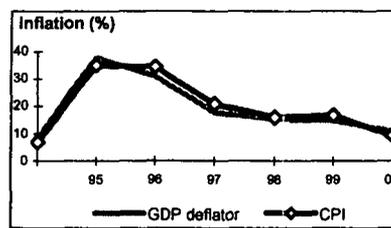


Note: 2000 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

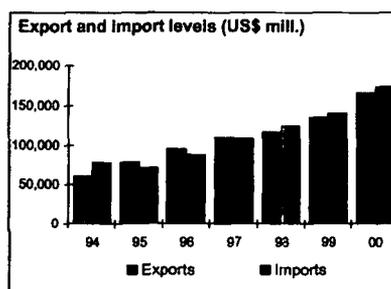
PRICES and GOVERNMENT FINANCE

| | 1980 | 1990 | 1999 | 2000 |
|--|------|------|------|------|
| Domestic prices | | | | |
| <i>(% change)</i> | | | | |
| Consumer prices | .. | 26.7 | 16.6 | 9.5 |
| implicit GDP deflator | 33.4 | 28.1 | 14.9 | 10.9 |
| Government finance | | | | |
| <i>(% of GDP, includes current grants)</i> | | | | |
| Current revenue | 27.4 | 25.3 | 20.9 | 21.8 |
| Current budget balance | 4.1 | 0.9 | 1.5 | 2.0 |
| Overall surplus/deficit | -3.6 | -2.6 | -1.1 | -1.1 |



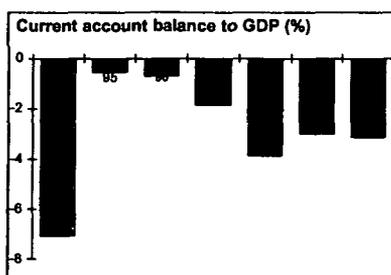
TRADE

| | 1980 | 1990 | 1999 | 2000 |
|-------------------------------|--------|--------|---------|---------|
| <i>(US\$ millions)</i> | | | | |
| Total exports (fob) | 16,284 | 40,711 | 136,391 | 166,455 |
| Oil | 10,441 | 10,104 | 9,928 | 16,383 |
| Agriculture | 1,528 | 2,162 | 3,926 | 4,217 |
| Manufactures | 3,802 | 27,828 | 122,085 | 145,334 |
| Total imports (cif) | 19,342 | 41,593 | 141,975 | 174,458 |
| Consumer goods | 2,448 | 5,099 | 12,175 | 16,691 |
| Intermediate goods | 11,720 | 29,705 | 109,270 | 133,637 |
| Capital goods | 5,174 | 6,790 | 20,530 | 24,130 |
| Export price index (1995=100) | 134 | 99 | 98 | 106 |
| Import price index (1995=100) | 67 | 90 | 99 | 102 |
| Terms of trade (1995=100) | 201 | 110 | 99 | 103 |



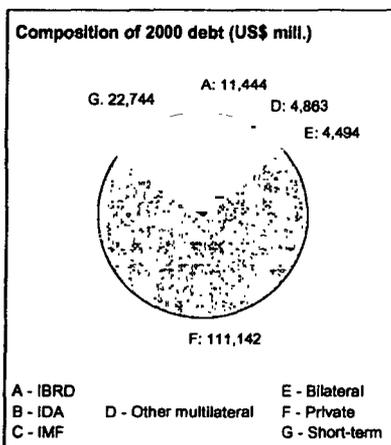
BALANCE of PAYMENTS

| | 1980 | 1990 | 1999 | 2000 |
|---|---------|--------|---------|---------|
| <i>(US\$ millions)</i> | | | | |
| Exports of goods and services | 22,600 | 48,732 | 148,083 | 180,167 |
| Imports of goods and services | 27,430 | 51,535 | 155,465 | 190,494 |
| Resource balance | -4,830 | -2,803 | -7,382 | -10,326 |
| Net income | -6,438 | -8,626 | -13,306 | -14,747 |
| Net current transfers | 833 | 3,978 | 6,313 | 6,994 |
| Current account balance | -10,434 | -7,451 | -14,375 | -18,079 |
| Financing items (net) | 11,453 | 10,999 | 14,969 | 20,901 |
| Changes in net reserves | -1,019 | -3,548 | -594 | -2,822 |
| Memo: | | | | |
| Reserves including gold (US\$ millions) | 3,052 | 9,909 | 31,829 | 33,595 |
| Conversion rate (DEC, local/US\$) | 2.00E-2 | 2.8 | 9.6 | 9.5 |



EXTERNAL DEBT and RESOURCE FLOWS

| | 1980 | 1990 | 1999 | 2000 |
|--|--------|---------|---------|---------|
| <i>(US\$ millions)</i> | | | | |
| Total debt outstanding and disbursed | 57,378 | 104,442 | 167,626 | 154,687 |
| IBRD | 2,063 | 11,030 | 11,027 | 11,444 |
| IDA | 0 | 0 | 0 | 0 |
| Total debt service | 10,958 | 11,311 | 39,760 | 63,038 |
| IBRD | 255 | 1,552 | 2,155 | 2,220 |
| IDA | 0 | 0 | 0 | 0 |
| Composition of net resource flows | | | | |
| Official grants | 14 | 54 | .. | .. |
| Official creditors | 795 | 4,168 | -1,708 | -525 |
| Private creditors | -524 | -582 | 13,181 | -5,059 |
| Foreign direct investment | 2,156 | 2,549 | 11,915 | 13,286 |
| Portfolio equity | 0 | 563 | 3,901 | 478 |
| World Bank program | | | | |
| Commitments | 625 | 2,562 | 1,671 | 1,130 |
| Disbursements | 422 | 3,326 | 844 | 1,647 |
| Principal repayments | 89 | 801 | 1,323 | 1,330 |
| Net flows | 333 | 2,525 | -479 | 318 |
| Interest payments | 166 | 751 | 832 | 890 |
| Net transfers | 167 | 1,774 | -1,311 | -573 |





SECRETARIA
DE
HACIENDA Y CREDITO PUBLICO

SUBSECRETARIA DE HACIENDA Y CREDITO PUBLICO

102-B- 131

México, D. F., 14 de mayo de 2002.

SR. JAMES D. WOLFENSOHN

Presidente
Banco Mundial
Washington DC, 20433
USA

Estimado Sr. Wolfensohn:

Por medio de la presente, me dirijo a usted para hacer de su conocimiento la intención de la presente Administración de avanzar en el programa de fortalecimiento del sistema tributario nacional. En tal virtud, el Gobierno de México solicita apoyo del Banco Mundial a través de los préstamos *Tax Reform Adjustment Loan* y *Tax Administration Institutional Development Project*, con el objeto de poder solventar los programas puestos en marcha recientemente en nuestro país.

Para resaltar la importancia que representa para México continuar con la agenda en materia tributaria, a continuación se presenta un breve resumen de lo más destacado de la evolución de la economía mexicana; lo más relevante de las reformas tributarias aprobadas recientemente por el H. Congreso de la Unión, y los temas principales en materia tributaria en los que el Gobierno de México planea enfocar sus esfuerzos en el mediano plazo.

I. Evolución macroeconómica

En los últimos años, la economía mexicana se ha recuperado favorablemente de la crisis enfrentada a mediados de la década pasada, y avanza con paso firme hacia la integración con sus principales socios comerciales y la economía mundial. México ha recuperado la estabilidad de precios gracias a la disciplina fiscal adoptada por las autoridades y al prudente manejo de la política monetaria por parte del Banco Central. A pesar de los vaivenes del ciclo económico, las cuentas internas y externas se han mantenido en orden en todo momento, fortaleciendo así la confianza de los agentes económicos dentro y fuera del país. Esto ha permitido crear un entorno de estabilidad que ha favorecido la inversión, tanto nacional como extranjera.



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La evolución de las variables macroeconómicas refleja el fortalecimiento de las bases de la economía nacional. En el periodo 1996-2000, el PIB registró una tasa de crecimiento real anual promedio de 5.6 por ciento, proceso que se interrumpió temporalmente en 2001 en sintonía con la desaceleración de la economía mundial.

La prudencia en el manejo de la política monetaria y la disciplina fiscal han coadyuvado a disminuir considerablemente la inflación. Durante 2001, por ejemplo, el Índice Nacional de Precios al Consumidor (INPC) alcanzó la menor tasa de crecimiento desde su creación en 1968, registrando un aumento de 4.4 por ciento anual, menor incluso que la meta oficial de 6.5 por ciento. Las tasas de interés nacionales también han registrado una clara tendencia a la baja, alcanzando niveles mínimos históricos en abril de 2002. Además, el tipo de cambio muestra fortaleza y estabilidad.

Las cuentas con el exterior han evolucionado de manera ordenada. El déficit de la cuenta corriente de la balanza de pagos se ha mantenido en niveles congruentes con la disponibilidad de ahorro externo de largo plazo.

Lo anterior ha sido posible gracias a la disciplina en el manejo de la política fiscal. Las autoridades han reaccionado oportunamente ante los vaivenes del ciclo económico y los cambios abruptos en el precio internacional del petróleo, manejo que ha permitido alcanzar las metas fiscales anunciadas en los últimos años. En este proceso, el déficit público ha disminuido de 1.3 por ciento del PIB en 1998 a 0.7 por ciento en 2001.

En materia de deuda pública el gobierno ha instrumentado una política proactiva que le ha permitido aprovechar distintas oportunidades para prepagar algunas emisiones, hecho que se ha traducido en ahorros a futuro y mejoras en el perfil de vencimientos.

Los retos que la economía mexicana tendrá que enfrentar en el corto y mediano plazos son mantener la disciplina en el manejo de la política económica para garantizar una recuperación ordenada y sostenible, así como avanzar en la agenda de reformas estructurales que permitan modernizar el marco regulatorio y mejorar la productividad y competitividad del aparato productivo.



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II. Reforma Fiscal

Desde su inicio en diciembre de 2000, la actual Administración ha considerado la reforma fiscal como una alta prioridad. La creciente necesidad de recursos para cubrir satisfactoriamente las responsabilidades del Estado, requiere de un aumento en las fuentes permanentes de ingresos públicos, por lo que ha sido necesario implementar acciones en las siguientes tres áreas:

- Política Tributaria.- Reducir distorsiones y aumentar las fuentes permanentes de recaudación, avanzar en un esquema tributario más equitativo, simplificar y mejorar el cumplimiento fiscal, hacer el esquema fiscal más competitivo y cerrar los espacios para la evasión y elusión fiscales.
- Administración Tributaria.- Diseñar e implementar programas para aumentar la eficiencia en la recaudación y el cumplimiento fiscal, disminuir la corrupción y facilitar el cumplimiento de las obligaciones con el fisco, ampliar los mecanismos y la cobertura de la asistencia fiscal al contribuyente y fortalecer las facultades de la administración tributaria para combatir la evasión fiscal.
- Federalismo Fiscal.- Aumentar las potestades tributarias de los gobiernos estatales y municipales en forma congruente con la Federación.

Gracias al esfuerzo conjunto del Ejecutivo y del H. Congreso por trabajar constructivamente y buscar consensos entre sus representantes, el 31 de diciembre de 2001 se aprobaron importantes cambios en materia de legislación tributaria. A continuación se presentan algunos de los avances logrados.

Política Tributaria. Uno de los objetivos de la reforma es aumentar la recaudación sin introducir distorsiones. En este sentido, la reforma busca incrementar la captación tributaria, expandiendo la base gravable a través de la eliminación de exenciones y regímenes especiales.

La reforma fiscal aprobada contiene avances significativos, especialmente en materia del impuesto sobre la renta. Esta reforma elimina el régimen especial a los sectores agrícola, de autotransporte y editorial; unifica la tasa de gravamen para las utilidades de las empresas, independientemente de si se reparten o no; reduce gradualmente las tasas de gravamen, tanto para las empresas como para personas físicas, durante los siguientes 3 años; reduce el número de rangos de tasas para personas físicas; propone la acumulación total de ingresos gravables para personas físicas, incluyendo los intereses de bonos gubernamentales o



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corporativos, dividendos y utilidades bursátiles; elimina el costo del crédito al salario hasta en 3% de la nómina de las empresas; y simplifica el cálculo del ajuste inflacionario y el cumplimiento fiscal de pequeñas y medianas empresas. Asimismo, la reforma incluye cambios a las tasas de los impuestos especiales al tabaco y a las bebidas alcohólicas, e introduce nuevos gravámenes a los refrescos endulzados con fructuosa y a las telecomunicaciones. El impacto de estas reformas en los ingresos públicos comenzó desde su entrada en vigor en enero de 2002, y se espera que crezca en el mediano plazo conforme los contribuyentes asimilen por completo las mejoras regulatorias.

En relación con la agenda de política tributaria, en el mediano plazo se pretende continuar con el impulso de dar más peso a los impuestos indirectos sobre los directos, a efecto de seguir expandiendo la base gravable, minimizar las distorsiones y reducir la evasión y elusión fiscales, así como seguir fortaleciendo las finanzas de los gobiernos estatales y municipales.

Administración Tributaria. La mejora de la administración tributaria también forma parte de los objetivos de la reforma fiscal. En este sentido, se han instrumentado una serie de medidas para mejorar la eficacia y eficiencia de la administración tributaria, que a la fecha, han arrojado resultados favorables. Entre otras medidas, destacan las siguientes: mejorar la coordinación entre las unidades administrativas del Servicio de Administración Tributaria (SAT); mejorar el proceso de auditoría; reducir la corrupción; mejorar la captura, calidad y seguridad de la información dentro de la organización; intensificar la capacitación del personal; mejorar la atención y el servicio al contribuyente, y modernizar los programas y el equipo informático. El Gobierno de México planea continuar con esas tendencias de mejoras en el mediano plazo. El antes mencionado Tax Administration Institutional Development Project será una contribución importante en ese esfuerzo.

Federalismo Fiscal. En materia de federalismo, la reforma aprobada reconoce la necesidad de incrementar las potestades tributarias de los estados y municipios, toda vez que son éstos quienes, en buena medida, ejercen el gasto público. En este sentido, la reforma otorga a los estados nuevas potestades, para que previa autorización de sus respectivos Congresos Estatales, fortalezcan sus ingresos propios. En particular, la Ley de Ingresos 2002 faculta a los estados para establecer una tasa adicional máxima a las ventas finales de bienes y servicios y para gravar en base neta a las personas físicas con actividades empresariales y profesionales con ingresos de hasta 4 mdp, con una tasa de hasta 5%, y de 2% sobre base bruta cuando los ingresos por actividades empresariales no rebasen los 1.5 mdp. Se debe mencionar que los ingresos adicionales que recauden los



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estados por estos conceptos no se comparten con el Gobierno Federal. En adelante, el Gobierno Federal continuará con el esfuerzo para mejorar la coordinación fiscal entre los gobiernos locales y la Federación (SAT) y mantendrá el apoyo para que los gobiernos locales fortalezcan sus fuentes de ingresos propias, y así consoliden la estabilidad en sus finanzas locales.

III. Otras Medidas

Una de las prioridades de la presente Administración es fortalecer las finanzas públicas. En este sentido, el gobierno ha instrumentado una serie de medidas, adicionales a la reforma tributaria aprobada recientemente por el H. Congreso, orientadas a garantizar la sostenibilidad de la postura fiscal. Entre otras, destacan las siguientes:

- **Disciplina y Transparencia Fiscal.**- Con el objeto de preservar la estabilidad y certidumbre en el entorno macroeconómico, el gobierno ha mantenido la disciplina fiscal. En este sentido, y para garantizar el cumplimiento de las metas fiscales aprobadas por el H. Congreso, se han incluido en el Presupuesto de Egresos de la Federación una serie de ajustadores automáticos. En particular, el Presupuesto de Egresos para 2002 dispone que en caso de que los ingresos sean menores de lo estimado es necesario ajustar el gasto presupuestario. Por el contrario, si los ingresos obtenidos son mayores de lo previsto, los recursos adicionales deben destinarse, en iguales proporciones, al Fondo de Estabilización de los Ingresos Petroleros (FEIP), a mejorar el balance del sector público y al impulso de programas de infraestructura. Asimismo, el gobierno continúa con el esfuerzo de mejorar la transparencia fiscal, publicando periódicamente los principales resultados fiscales y de deuda pública, así como indicadores fiscales ampliados que revelan fehacientemente las necesidades de financiamiento del sector público (RFSP). Gracias al cumplimiento de metas fiscales y a la transparencia fiscal, entre otros logros, es que México ha obtenido recientemente el grado de inversión por las principales corredurías internacionales.



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- **Reforma Presupuestaria.**- Como parte de la iniciativa de reforma para la Nueva Hacienda Publica enviada al H. Congreso en 2001, el Ejecutivo envió una propuesta de reforma presupuestaria, que tiene por objeto reducir la incertidumbre de los procesos de discusión y aprobación del presupuesto, así como facilitar la ejecución de proyectos de inversión multianuales.
- **Política de Gasto Publico.**- Es un compromiso del Gobierno de México continuar con el esfuerzo por atender las necesidades de salud, educación, seguridad social e infraestructura básica de todos los grupos de la población, y en especial, de los más necesitados. Para ello, se han instrumentado una serie de programas sociales incluyendo *Contigo y Oportunidades* que tienen por objeto combatir la pobreza, especialmente en zonas urbanas. Sin embargo, debido a las crecientes necesidades en materia social, es imperativo continuar impulsando medidas que permitan fortalecer los ingresos permanentes del Estado y así poder asignar mayores recursos al combate a la pobreza.
- **Política de Precios Energéticos.**- Reconociendo la importancia del sector energético en las finanzas publicas, y con el objeto de promover la conservación, en febrero de 2002 el gobierno anunció la reducción del subsidio a las tarifas eléctricas residenciales. Esta política se tradujo en un incremento en las tarifas para aquellos hogares con consumos mayores al mínimo, a efecto de proteger el ingreso de las familias con menores recursos.

IV. Apoyo del Banco Mundial

Si bien la reforma fiscal aprobada representa avances importantes en todas las áreas tributarias, se reconoce que aún queda mucho por hacer, especialmente en materia de administración tributaria. Para ello, el Gobierno de México solicita al Banco Mundial de su apoyo a través del *Tax Reform Adjustment Loan*. De la misma manera, se pretende continuar con las mejoras en materia de administración tributaria, proceso para el cual México solicita apoyo técnico y financiero del Banco Mundial a través del *Tax Administration Institutional Development Project*.



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Consciente de la importancia de mantener una postura fiscal sana y sostenible, el Banco Mundial ha mostrado un especial interés en el tema de Reforma Fiscal. En virtud de lo anterior, el Gobierno de México solicita al Banco Mundial de su apoyo técnico y financiero para la consolidación de los programas antes mencionados, considerados por las autoridades nacionales de suma importancia para continuar con el Programa de Reforma Fiscal durante los próximos cuatro años.

Atentamente.
SUFRAGIO EFECTIVO, NO REELECCION.
El Subsecretario,

A handwritten signature in black ink, appearing to read "AGUSTIN CARSTENS", written over a horizontal line.

DR. AGUSTIN GUILLERMO CARSTENS CARSTENS

C.c.p. Dirección General de Crédito Público. Presente.

SECRETARIAT OF FINANCE AND PUBLIC CREDIT
Mexico City

Mr. James D. Wolfensohn
President
World Bank
Washington DC, 20433
USA

Dear Mr. Wolfensohn,

I would like to bring to your attention the intention of the present administration to move ahead with the program of strengthening the national system of taxation. For the sake of this, the Government of Mexico requests the support of the World Bank by means of the *Tax Reform Adjustment Loan* and the *Tax Administration Institutional Development Loan*, with the objective to facilitate the programs recently put in motion in our country.

To emphasize the importance for Mexico of continuing with the agenda of taxation matters, a brief summary is presented of the highlights in the evolution of the Mexican economy, the most relevant aspects of the tax reforms recently approved by the Federal Congress, and the main themes in the tax area on which the Government of Mexico plans to focus its energies in the medium term.

I. Macroeconomic Situation

In recent years, the Mexican economy has recovered favorably from the crisis faced in the middle of the previous decade and is advancing with firm steps toward integration with its main commercial and economic partners in the world. Mexico has recovered price stability, thanks to the fiscal discipline adopted by the authorities and to the prudent management of monetary policy on the part of the Central Bank. Despite the fluctuations of the economic cycle, the internal and external accounts have been maintained in order at all times, thus strengthening the confidence of economic agents within and outside the country. This has made it possible to create a framework of stability that has favored investment by domestic and foreign firms.

The evolution of macroeconomic variables reflects the strengthening of the national economy. In the period 1996-2000, the gross domestic product recorded an average annual growth rate of 5.6 percent, a process that was interrupted temporarily in 2001 along with the deceleration of the world economy.

The prudent management of monetary policy and fiscal discipline have been helping to reduce inflation considerably. During 2001, for example, the national index of consumer prices reached its lowest rate of increase since the time it was created in 1968, registering an increase of 4.4 percent annually, lower than the official target of 6.5

percent for the year. The domestic interest rates also registered a clear downward trend, reaching historic lows in April 2002. Furthermore, the exchange rate is showing strength and stability.

The external accounts have evolved in an orderly manner. The deficit of the current account of the balance of payments has been maintained at levels congruent with the availability of long-term foreign savings.

The above has been possible thanks to the discipline in the management of fiscal policy. The authorities have reacted opportunely in the face of the fluctuations of the economic cycle and the abrupt changes in the international price of petroleum—management that made it possible to achieve the fiscal goals announced in recent years. In this process, the public budget deficit has declined from 1.3 percent of GDP in 1998 to 0.7 percent in 2001.

In matters of public debt the government has used a proactive policy that has permitted it to utilize certain opportunities to repay some debt, which translated into future savings and improvements in the maturity profile.

The challenges that the Mexican economy will face in the short and medium term are to maintain discipline in economic policy management in order to guarantee an orderly and sustainable recovery, as well as to advance with the agenda of structural reforms that will modernize the regulatory framework and improve the productivity and competitiveness of the production system.

II. Fiscal Reform.

From its beginning in December 2000, the present administration in Mexico has accorded high priority to fiscal reform. The growing necessity for resources to cover satisfactorily the responsibilities of the State require an expansion of the permanent sources of public revenues, for which it has been necessary to implement actions in the three following areas:

- Tax Policy— To reduce distortions and increase the permanent sources of tax revenue, to advance a more equitable tax scheme, to simplify and improve the tax compliance, to make the tax system more competitive, and to close the gaps for tax evasion and avoidance.
- Tax Administration— To design and implement programs to increase the efficiency in tax collection and compliance, to reduce corruption and facilitate the compliance of obligations to the Treasury, to expand the mechanisms and the coverage of the assistance to taxpayers, and to strengthen the powers of the tax administration to combat tax evasion.
- Subnational Finances— To increase the tax bases of the state and municipal governments in a form that is consistent with the Federal System.

Thanks to the combined effort of the Executive and the Congress to work constructively and seek consensus among their representatives, important changes were approved on December 31, 2001, in the tax legislation. The following are some of the advances that were achieved.

Tax Policy. One of the objectives of the reform is to increase collections without introducing distortions. In this sense, the reform seeks to increase the tax receipts, expanding the taxable base through the elimination of exemptions and special regimes.

The tax reforms that were approved contain significant advances, especially in the area of income taxes. This reform eliminates the special regimes for the agriculture, trucking, and publishing sectors; unifies the tax rate for corporate earnings, independently from whether they are distributed or not; reduces gradually the tax rate for corporations and individuals over the next 3 years; reduces the number of personal income tax brackets; sets forth the combination of all personal income into one taxable sum, including government and commercial bond interest, stock profits, and dividends; eliminates the cost to the government of salary subsidies up to 3 percent of the payroll of firms; and simplifies the calculation of the inflation adjustment and the tax compliance of small and medium enterprises. Also, the reform includes changes in the rates of excise taxes on tobacco and alcoholic beverages and introduces new taxes on beverages sweetened with fructose and on telecommunications. The impact of these changes on public revenue started when they came into effect in January 2002, and it is expected that it will grow in the medium term as the taxpayers assimilate completely the regulatory improvements.

With relation to the agenda of tax policy reform, in the medium term, the drive will be continued to put more emphasis on indirect taxes relative to direct taxes, with the object to continue expanding the taxable base, to minimize the distortions and to reduce tax evasion and avoidance, as well as to continue strengthening the finances of the state and municipal governments.

Tax Administration. The improvement of tax administration is also part of the objectives of the fiscal reform. In this sense, a series of measures have been orchestrated to improve the efficacy and efficiency of tax administration, which to date have indicated favorable results. Among other measures, the following stand out: to improve the coordination between the administrative units of the Tax Administration Service (SAT); to improve the process of auditing; to reduce corruption; to improve the capture, quality, and security of information within the organization; to intensify the training of personnel; improve the attention and service to the taxpayers; and to modernize the informatics programs and equipment. The Government of Mexico plans to continue with these improvements in the medium term. The previously mentioned Tax Administration Institutional Development Project will make an important contribution to that effort.

Fiscal Federalism. Concerning federalism, the reform that was approved recognizes the necessity to increase the tax bases of the states and municipalities, since they are the ones that to a great extent carry out the spending of the public sector. In this sense, the

reform grants to the states new tax base, in order to strengthen their own revenues, for which their respective state congresses would provide the authorization. In particular, the 2002 Revenue Law empowered the states to establish an additional tax, up to a certain maximum, on the final sales of goods and services. And it empowered states to tax the income of individuals with entrepreneurial activity, at a rate up to 5 percent on the net income of those with annual revenue up to 4 million pesos and at a rate up to 2 percent on the gross income of those with annual revenue not exceeding 1.5 million pesos. It should be mentioned that the additional revenues that the states collect with these measures are not shared with the Federal Government. In the future, the Federal Government will continue the efforts to improve the coordination of tax enforcement between the local governments and the Federation (SAT) and will maintain the assistance for local governments to strengthen their sources of own income, and thus to consolidate the stability of their local finances.

III. Other Measures

One of the priorities of the present administration is to strengthen public finances. In this sense, the government has orchestrated a series of measures, in addition to the tax reform recently approved by Congress, oriented to guarantee the sustainability of the fiscal stance. Among others, the following stand out:

Fiscal Discipline and Transparency. With the objective to preserve the stability and certainty in the macroeconomic framework, the government has maintained fiscal discipline. In this sense, and in order to guarantee the compliance with the fiscal targets approved by Congress, a series of automatic adjustment procedures have been included in the Expenditure Budget. In particular, the 2002 Expenditure Budget provides that it is necessary to adjust the budgeted expenditure in the event that revenues are less than estimated. On the other hand, if the revenues are greater than forecast, then the additional revenues need to be destined, in equal proportions, to the Stabilization Fund for Petroleum Revenues, to improve the public sector balance, and to support infrastructure investment programs. Likewise, the government is continuing with the effort to improve fiscal transparency, publishing at regular periods the principal fiscal outcomes and the public debt, and also expanded fiscal indicators that reveal reliably the public sector borrowing requirement (PSBR). Thanks to the achievement of its fiscal targets and to the fiscal transparency, among other things, Mexico has recently obtained investment-grade credit ratings from the principal international rating agencies.

Budget Reform. As part of the reform initiative for the New Public Finances, submitted to Congress in 2001, the executive sent a proposal for budgeting reform, that has as its objective to reduce the uncertainty in the process of discussing and approving the budget, as well as to facilitate the execution of multi-year investment projects.

Public Spending Policy. It is a commitment of the Government of Mexico to continue the effort to attend to the needs of health, education, social security and basic infrastructure of all groups of the population, and especially those most in need. For that, a series of social programs has been instrumented, including *Contigo* and *Oportunidades*,

that have the objective to combat poverty, especially in urban areas. Nonetheless, due to the growing social needs, it is imperative to continue promoting measures that strengthen the permanent revenues of the State, to be able to assign more resources to combat poverty.

Energy Pricing Policy. Recognizing the importance of the energy sector for public finances, and with the objective to promote conservation, the government announced in February 2002 the reduction in the subsidy for residential electricity tariffs. This policy translated into an increase in tariffs for the households with more than minimum power consumption, for the purpose of protecting the income of families with less resources.

IV. World Bank Support

Even though the fiscal reform that was approved represents important advances in all the taxation areas, it is recognized that there is much remaining to be done, especially in the area of tax administration. For that, the Government of Mexico is asking the World Bank for its help through the Tax Reform Adjustment Loan. In the same way, it is the intention to continue with improvements in the area of tax administration, a process for which Mexico is asking technical assistance and financing from the World Bank through the Tax Administration Institutional Development Project.

Conscious of the importance of maintaining a healthy and sustainable fiscal stance, the World Bank has shown special interest in the theme of fiscal reform. By virtue of the above, the Government of Mexico is asking the technical and financial support of the World Bank for the consolidation of the programs mentioned above, and considered by the country authorities as being of highest importance, in order to continue the Program of Fiscal Reform during the next four years.

Sincerely.
Effective suffrage, no reeleccion.
The Undersecretary,

Dr. Agustin Guillermo Carstens Carstens

Cc: General Directorate of Public Credit

MEXICO



- National capital
- State capitals
- Principal cities or towns
- Divided highways
- Selected main roads
- Railroads
- Rivers
- Principal airports
- State boundaries
- International boundaries

KILOMETERS 0 100 200 300 400 500
 MILES 0 100 200 300

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