

Project Name Mexico-Agricultural Productivity Project (+)

Region Latin America and Caribbean Region

Sector Environmentally and Socially Sustainable Development

Project ID MXPE48505

Borrower Nacional Financiera, S.N.C. with the guarantee of the United Mexican States

Implementation Agency Secretariat of Agriculture, Livestock and Rural Development (SAGAR)

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#### Background

Agriculture remains a weak sector of the Mexican economy. In 1996, agricultural Gross Domestic Product (GDP) accounted for about 6% of total GDP, down from 19% in 1960. The sector's slow growth coupled with stagnating productivity and wages, has resulted in a decline in the sector's employment from 50% to 25% of the total labor force during the same period. Nevertheless, agriculture could remain an important economic sector provided, on the one hand, its commercial sector continues to be competitive through the permanent use of modern technologies and increased yields and on the other, the productive potential of the small farmer agriculture, especially in rainfed areas, can be tapped.

During the late 1980s and early 1990s, the Government of Mexico implemented an important set of reforms in the agricultural sector including liberalization of prices and marketing, trade reforms, and privatizations. Additionally, it also revised the regulatory and legal framework of land tenure as well as of the water and forestry sectors. The Government also promoted a greater role of the private sector in the provision of support services. Following these reforms, Government support switched from commodity price subsidies to non-distortionary direct income transfer to producers through the PROCAMPO program and has established the bases for a gradual exposure of the Mexican economy to international trade and globalization, mainly to the North American Free Trade Agreement (NAFTA).

Besides PROCAMPO, in 1996 the Government launched a national agricultural and rural development program (Programa Alianza para el Campo) to increase capitalization in the agricultural sector with the aim of promoting improved agricultural productivity and production and increased income of farmers. The program fosters agricultural productivity by promoting productive investment (under a matching-grant scheme) and providing more effective support services (research, extension, information, training) for a wide range of agricultural sub-programs. The cornerstone of Alianza is its decentralized approach, with a delegation of administration and decision-making to the States. The program offers the opportunity and the operational mechanism to implement a decentralized, demand-driven approach to channel technical and financial

assistance directly to small farmers.

#### Past performance and Issues

Despite the reforms and policy changes, the performance of the agricultural sector has been lagging and for most of the 1990s its growth has stagnated. Sector performance has remained relatively isolated from recent macro-economic events such as the major financial crisis and devaluation at the end of 1994, the impressive recovery in 1996-1997, and the economic crisis that afflicted the country at the end of last year. However, agricultural exports are expanding and some diversification of production is taking place. But the impact of the reforms and the production response seems to have been mostly limited to the commercial sector. Furthermore, rural poverty has been widening in recent years and the limited options available to small producers to cope with income and consumption fluctuations, have induced farmers into risk-averse investment strategies, thus underpinning the gap with the modern commercial sector competing in the international markets.

Improving the delivery of financial services to the rural population remains one of the main constraints to the agricultural sector development. The Government has started a process of liberalization of interest rates, phasing out government support to state-owned financial institutions, while providing incentives for the private financial sector to increase its presence in the rural areas. Penetration of financial services, in general, in the rural areas remains deficient, although some schemes of savings and loans and micro-finance activities have developed. However, access to financial resources for productive investment continues to be rather limited, especially for small farmers.

The Government's sector development strategy, which would be supported by the Bank, includes the following main lines of action:  
maintaining the policy framework and strengthening the market economy;  
pursuing second generation type of reforms in factor and output markets (financial services, access to output markets, land and water markets; labor markets);  
increasing agricultural productivity of small and medium-sized farmers;  
promoting the integration of small farmers in the economic growth process; and  
strengthening institutional development and decentralization and better integrating social and gender perspectives.

#### Project Description

##### a. Project development objective:

Project's main development objectives are to increase capitalization of small farmers and to improve their productivity and income by promoting the adoption of sustainable agricultural production systems, within the framework of selected programs currently being executed under the ongoing Alianza para el Campo program. This objective would be achieved through: (i) the improvement of access of small farmers to the activities currently supported by the three programs of the Bank-financed PRODAT Project as well as the Rural Development Program that is being executed under the Alianza; (ii) promotion of a better integration of the various activities of the Alianza aimed at the development of irrigated and rainfed agriculture; (iii) generation, validation and transfer of technologies suited to small farmer production conditions; (iv) strengthening production support services for small farmers; and (v)

support of the Government-promoted decentralization process by strengthening the planning and implementation capacity of State institutions and producers' organizations.

b. Project components and costs:

Component	Category	Cost (US\$M)	%of Total
1.- Productive Investment Under this component, the project would finance small grants for demand-driven sub-projects currently financed under the ongoing Bank-financed PRODAT Project, aimed at small irrigation development and modernization, improved pasture establishment and management, improved dairy production technology and marketing, as well as sub-projects providing small-scale on-farm infrastructure and minor equipment and supplies.	Physical	343.3	62
2.- Production Support Services This component would include financial support for applied research and technology transfer as well as demand driven extension, technical assistance and training to small farmers.	Capacity Building	172.9	32
3.- Institutional strengthening and Project Administration This component would support training and technical assistance to staff with implementation responsibilities at the central and state levels, with particular emphasis on sub-project preparation and selection mechanisms and procedures; the development and implementation of a comprehensive monitoring and impact evaluation system; and the establishment and operation of a project coordination unit (PCU)	Institutional Building/ Project Management	34.9	6
	Total	551.1	100

Project implementation

The project would be implemented over a period by the Secretariat of Agriculture Livestock and Rural Development (SAGAR). Implementation of the Productive Investment Component would be highly decentralized, utilizing the institutional structure established by the Government for the administration of the ongoing PAC. Formal agreements (Convenios) would be signed annually between SAGAR and each state, which include Technical Annexes describing proposed project activities and the annual budget, with the respective

financial commitments of the federal and state governments. Beneficiaries, either individually or organized in groups, would be responsible for sub-project implementation, consistent with a highly participatory demand-driven approach to sub-project identification, design and selection. Delivery of demand-driven Support Services (technical assistance, extension and training) would be based on direct contracts from beneficiary organizations or groups to private sector individuals or small firms, following the ongoing SINDER and PEAT programs for poor farmers and the recently established programs for small commercial livestock and irrigation producers. Definition and delivery of services, and any necessary in-service training of TA providers, would be supervised by coordinators operating from the offices of the PAC at the State and municipal level. Technology Transfer and Adaptive Research would be implemented by the existing PRODUCE Foundations in each state, who would award contracts on a competitive basis to specialized institutions, including INIFAP, State research agencies, Universities and the private sector. The Project Coordinating Unit (PCU), would be established and located in the General Directorate of Agricultural and Livestock Development (DGDA) of SAGAR.

#### Project Sustainability

The project is expected to be sustainable, as it would increase the long-term viability and impact of the Government's existing matching grant program. This would be achieved by improving the quality of proposed productive investments, through strengthening small farmer participation in project selection, and by addressing a series of technical, institutional and financial aspects directly linked to the sustainability of project activities, including the development and adoption of improved technologies, the incorporation of financial criteria for the evaluation and selection of subproject proposals, the promotion of decentralized delivery mechanisms, and the establishment of adequate monitoring and impact evaluation systems.

#### Lessons Learned from Past Operations

The proposed project builds on the experience of decentralized, rural development investment programs. In general, they indicate that flexibility and grass-root demand-driven approaches are key in building ownership, defining local priorities, and setting the ground for better implementation and sustainability. The Bank's record of financing this type of programs in Mexico and elsewhere is on the whole satisfactory, and there is consensus on continuing this line of financial assistance. In Mexico, positive experiences can be drawn from the first and second Decentralization and Rural Development projects (DRD I and II) as well as the Rainfed Areas Development Project (PRODAT). Over time, however, some shortcomings in the implementation of these programs have emerged:

- a) Past municipality demand-driven approaches in Mexico (DRD I and II) have been globally successful in the promotion of rural infrastructure and social investments. However, little has been achieved in triggering production-oriented activities and tapping the productive potential of existing resources;
- b) Notwithstanding their intrinsic merits, micro-investments tend to form a disparate collection of interventions, and may not reach the critical development mass required to attract the private sector, generate buyers competition, facilitate access to markets, and foster the establishment of support services;
- c) It is important that access to resources for productive investments be accompanied by the required technical support for technology adoption and community organization; and

d) Poor timing and lengthy budgetary and bureaucratic processes are likely to jeopardize the implementation of this type of programs.

The proposed project would take up the challenge of trying to overcome these limiting factors by: (i) promoting decentralized and agile mechanisms for sub-projects approval and disbursement at the state level; (ii) providing a broad range of technical assistance and training to small producers to improve the quality of project design and implementation, thus strengthening the demand-driven nature of proposed productive investments; and (iii) fostering more integration between investment projects and technical assistance to small farmers.

Program Objective Category: Environmentally Sustainable Development

#### Environmental Aspects

The proposed project has been rated "B" for environmental purposes. The project is designed to improve the efficiency and sustainability of agriculture in the small-farm sector. The investment component supports small-scale subprojects aimed at improvement and diversification of existing irrigation systems where increased exploitation of groundwater will not be financed; sustainable intensification of cropping and livestock operations; diversification of income and employment opportunities through small-scale rural enterprises; and, use of renewable energy sources for power generation in marginal rural areas outside the national grid. Overall the project is expected to have no negative environmental impacts. In order to achieve this, rigorous environmental procedures will be applied.

The Operations Manual would include screening criteria and procedures oriented primarily to mitigation of potential contamination arising from selected types of sub-project. The Manual contains a list of these sub-projects, the environmental checklist to be applied, and the procedures to be used at the state level with participation state delegations of federal agencies responsible for environmental issues (SEMARNAP and the National Water Commission [CNA]).

Due to the specific resource management focus adopted, all potential impacts in other types of sub-project should be positive or insignificant. A list of activities which would not be eligible for project financing has been established in the Operations Manual including : deforestation, road construction, resettlement, restrictions on use of agro-chemicals and encroachment on natural habitats, wetlands, parks and reserves.

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Note: This is information on an evolving project. Certain activities and/or components may not be included in the final project.

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## Annex

Because this is a Category B project, it may be required that the borrower prepare a separate EA report. If a separate EA report is required, once it is prepared and submitted to the Bank, in accordance with OP 4.01, Environmental Assessment, it will be filed as an annex to the Public Information Document (PID) .

If no separate EA report is required, the PID will not contain an EA annex; the findings and recommendations of the EA will be reflected in the body of the PID.