

# RESTRUCTURING THE INSTITUTIONAL DESIGN OF AN INFRASTRUCTURE DEVELOPMENT PROJECT IN GUANAJUATO, MEXICO

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## *Abstract*

*This paper reviews the institutional design of a pilot project financed by the World Bank in the State of Guanajuato, Mexico, as part of its strategy to improve the institutional capacities of local governments in middle-income countries. After two years of implementation, the project has introduced several institutional improvements such as the consideration of investment proposals over a longer term perspective, the strengthening of the agency responsible for protection of the environment, and the adoption of a better framework for dealing with social issues. However, it has failed so far in its principal objective of introducing procedures to ensure that public investments would be sound from a social and environmental viewpoint and that those affected by such investments would have a voice in the decisions about such projects. The paper identifies the project's institutional design methodology as the primary source of the problems and proposes adoption of the AIC framework for its redesign<sup>1</sup>. This would require (i) establishing a consensus among key stakeholders as to the primary causes of the institutional problems (which the author believes to be the choice of an inappropriate implementation agency and the lack of initial consensus-building processes) to help overcome possible resistance to the proposed changes; (ii) selection of a strengthened alternative implementation agency which would already have the political and institutional legitimacy to promote the intended policy changes; and (iii) design of detailed consultative procedures for implementation by all agencies concerned and strengthening of their process capabilities. The advent of a new administration in 2006 provides a unique opportunity to attempt such changes.*

## **I. Background**

Guanajuato is one of Mexico's 31 States and is considered as middle income. The State has benefited from sound macroeconomic policies, enjoys excellent credit rating and has a remarkably capable fiscal administration. Nevertheless, social disparities persist as shown by several components of the human development index which place Guanajuato below the national average. These include poor coverage of its rural areas in matters of water and sewerage (respectively 79% and 33% compared to 94% and 81 % in urban areas)<sup>2</sup>, literacy rates that are among the lowest in the country, low educational achievement, and one of the highest gender gaps in the country<sup>3</sup>.

To decrease these inequalities, the Guanajuato State Government obtained at the end of 2004 a loan from the World Bank for a decentralized infrastructure reform and development project which aimed at increasing the level of capital expenditures in three sectors (roads, water supply and

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<sup>1</sup> The AIC framework approaches institutional design in terms of both structures and processes. The structural design framework considers: (i) the institution's appreciative (or enabling) environment which is comprised of factors such as physical, socio-cultural, political, economic, and institutional; (ii) its influenceable environment which refers to those external elements such as its clients, financiers, suppliers, and affected communities whose support is essential; and (iii) its controlled (or internal) institutional environment. In terms of institutional design process, the AIC framework similarly provides for 3 steps: (i) the development of agreed upon common goals; (ii) the design of the relationships among stakeholders; and (iii) the preparation of operational plans, creation of internal organizational relationships and incentives, and establishment of feedback mechanisms. See ODII, <http://www.odii.com/>

<sup>2</sup> The World Bank (2002).

<sup>3</sup> PNUD (UNDP) (2005).

sanitation, and low income housing) and at enhancing the institutional capacity of government entities. The project was conceived as a sector loan, namely one under which the borrower rather than the lender is responsible for appraising the soundness of every investment in the sector, whereas the lender focuses on ensuring that the borrower will have the institutional capacity to both appraise and implement such investments. Considering that the State of Guanajuato could have obtained better financial terms from the capital markets, its main reason for borrowing from the World Bank was to gain institutional knowledge: it wanted to benefit from the Bank's expertise in these matters. From the national government's and the lender's perspective, the project was seen as a pilot instrument that, if successful, could be replicated for the benefit of other States in Mexico.

The project's institutional objectives were the following: (i) strengthening the instruments used to prioritize and monitor public investments, (ii) improving the mechanisms for local participation in public investment decision-making, and (iii) enhancing the capacity of the agencies responsible for assessing the potential environmental and social risks of the investments financed under the project – which was intended as a major policy innovation in Guanajuato. The project defined several categories of social and environmental threats and the kinds of remedial actions corresponding to each.

The main entities involved with the project were the following:

- The State's Ministry of Finance which was put in charge of project implementation and controlled the allocation of funds and the timing of disbursements;
- The State Planning Office which was in a staff position under the Governor's office and was responsible for preparing the State's investment plan, providing planning assistance, and monitoring the progress of implementation;
- The three Lines Ministries directly concerned with the investments under the project: the Ministry of Public Works (*Secretaria de Obra Publica - SOP*) in charge of the maintenance of the State's road network; the State Water Commission (*Comision Estatal del Agua - CEAG*) responsible for water and sanitation services, and *IVEG (Instituto Estatal de Vivienda)* in charge of housing; and finally,
- The Ministry of Social and Human Development (*Secretaria de Desarrollo Social y Humano – SDSH*) and the Institute of Ecology (*Instituto de Ecologia - IEG*), which were responsible for monitoring the social and environmental risks associated with investments across all sectors.

## **II. Initial achievements under the project**

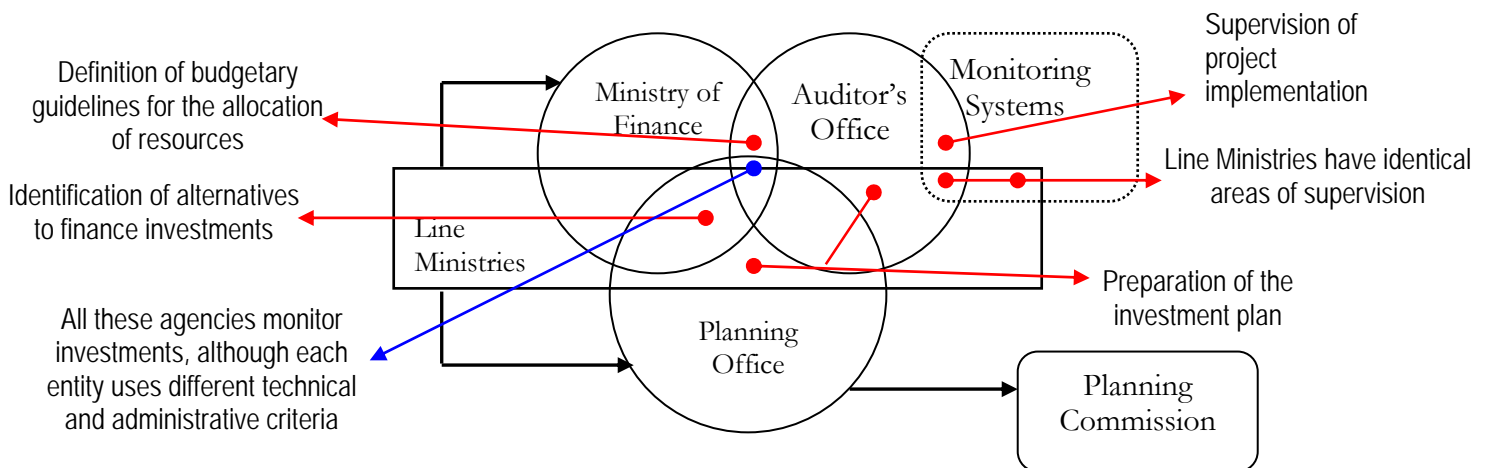
**A. Strengths.** Besides allocating funds for various investment proposals during its first two years of existence, the project promoted consideration of decisions over a longer-term perspective (5 years) than previously and created a new framework to assess the risks associated with investment projects. In the environment sector the project increased the influence of the responsible agency, the Institute of Ecology, which received financial support to enhance its administrative capacity, its role in monitoring environmental risks, and its involvement in the implementation of sustainable development policies. In the social sector, the project helped the State move away from relying on the Ministry of Interior whose primarily political approach to solving social conflicts had led to relations of clientelism that political parties used for their electoral campaigns. Instead, it adopted a

new framework under which the Ministry of Social and Human Development emphasized various mechanisms of communication with local communities.<sup>4</sup>

**B. Weaknesses.** However, the project did not introduce specific measures to ensure that its other institutional objectives would be achieved, but relied on the State Government's regular budget procedures. For example, although the project appraisal document clearly defined as one of the project's key institutional objectives the improvement of "*the mechanisms to screen, prioritize and monitor public investments*", the project did not propose specific actions to review and improve the current methods used to define the investment projects funded by the Ministry of Finance. This issue may be the most important weakness of the program because the institutional instruments used in the State to prepare the investment plan are weak and the participation schemes adopted by local authorities exclude major sectors of civil society. In practical terms, the State's process of screening, prioritizing, and monitoring is quite disorganized because of overlapping responsibilities<sup>5</sup> of the various entities concerned, which are a source of potential conflicts among agencies (see Chart 1. Preparation of the Investment Plan).

**Chart 1. Preparation of the Investment Plan:**

**Current scenario: identical functions assigned to different institutions**

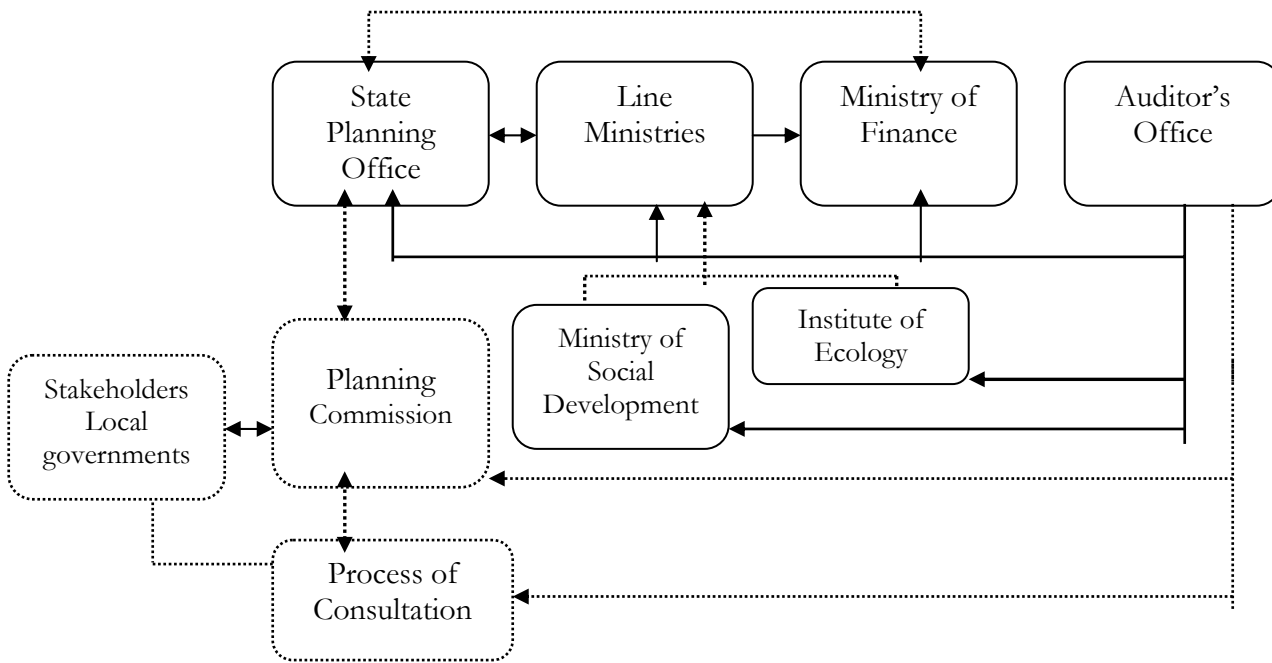


Also, while it had been assumed that the Planning Office would make use of the Planning Commission (*Comision de Planeacion para el Estado de Guanajuato*) to design and evaluate the annual investment plans through a broad process of consultations with civil society (see Chart 2), in reality, due to lack of institutional and administrative capacity in the State Planning Commission, the Line Ministries continued to make their investment plans and design their projects without the formal participation of local citizens.

<sup>4</sup> For a detailed version of the environmental and social management framework, see Annexes IX and X of the project appraisal document available on the World Bank's web site.

<sup>5</sup> For a discussion of the consequences of overlapping functions, see Ascher (1998).

**Chart 2. Flow Chart for Preparation of Investment Plans**  
(as assumed under the project design)



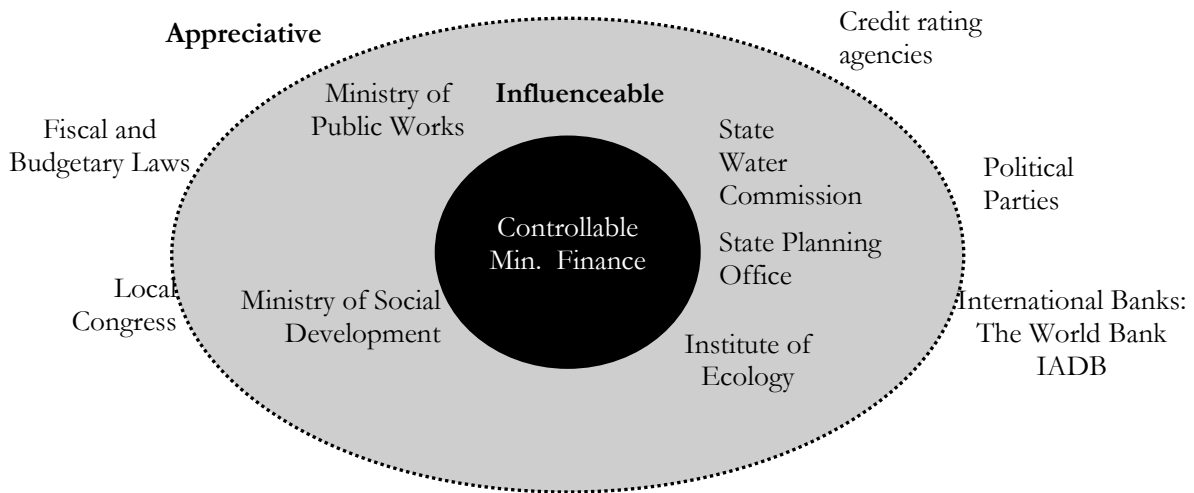
### III. Reinterpretation of the project's institutional experience through the lens of the AIC framework.

**Appreciative environment.** A fundamental principle of institutional design is that the organization responsible for the implementation of a project should be committed to its objective. Unfortunately in this case, the Ministry of Finance, which was chosen as the implementation agency, faced several constraints. Indeed, its mandate as clearly stated in the Organic Law of the Executive Power (*Ley Organica del Poder Ejecutivo*) is the collection of taxes, the control of public expenditures and the maintenance of a budgetary balance (see Chart 3. AIC framework). This narrow mandate which allows the Ministry to have close relationships with the World Bank, unfortunately limits its contacts with the project's main social and environmental stakeholders, for which the Planning Office is actually responsible through the Planning Commission. As a result, the Ministry of Finance has been unable to exercise leadership in promoting a shared vision among Line Ministries on the importance of social and environmental criteria in the design of their investment projects.

**Influenceable environment.** Because its legitimacy is exclusively defined in terms of the application of sound financial and budgetary criteria, the Ministry of Finance has been in no position to change its relations with the Line Ministries and require that their investment proposals be first vetted by the agencies in charge of social and environmental policies. In addition, the proposal to involve local participation in the design and decisions about projects represents, in terms of the AIC framework, shifting the project's beneficiaries (or those negatively affected by it) from the project's controllable environment (under a "top-down" planning mode), to its influenceable environment ("interactive" planning), and therefore giving them a major increase in political power – a change with which the Ministry of Finance and the State authorities may, or may not be, comfortable. Thus, another hypothesis for the lack of introduction of consultations with local organizations is that the

administrative reasons used to explain the reluctance of the Ministry of Finance to implement the project as designed, may actually be a bureaucratic rationale for a political decision. Interestingly, this particular hypothesis is not new in the case of World Bank projects in Mexico and was already formulated in quasi AIC terms by Eric Miller in his celebrated article about the obstacles encountered during the implementation of PIDER – the World Bank’s attempt in the 1970s at promotion of more participatory development in Mexico’s rural areas<sup>6</sup>.

**Chart 3. AIC framework from the viewpoint of the Ministry of Finance**



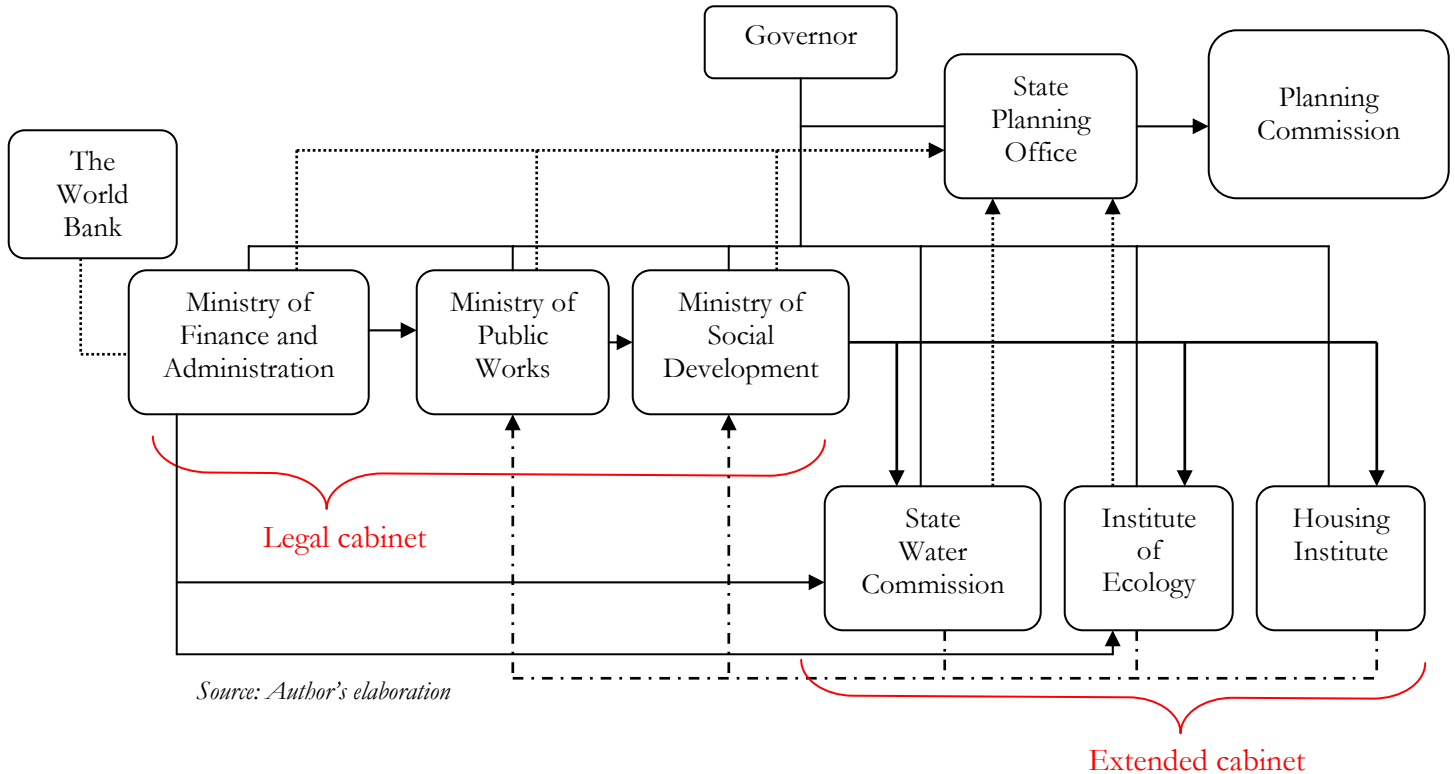
**Controllable environment.** Regarding the substantive planning of investments, while it is in theory the responsibility of the Planning Office, its administrative and technical weaknesses are such that it has to restrict its functions to the administrative coordination of the projects prepared by the Line Ministries and to communicating general information to the public about project progress. In matters of public participation, the Planning Office limits itself to reporting on the physical and budgetary progress of the projects instead of promoting appropriate methods of consultation with the public (see Chart 4. Organizational Chart<sup>7</sup>). In addition, the guidelines for the sector loan have caused controversies among the Line Ministries, the Planning Office and the financial authorities of the State Government. In the opinion of the civil servants from the Line Ministries, the World Bank guidelines are stricter than those used by the State in other projects and therefore delay financial transfers. In addition, they are afraid that the audit office will focus its attention on the strict application of the guidelines rather than on ways to facilitate operations. In the case of the State Planning Office, its staff feel that the Ministry of Finance’s agenda is merely focused on revenue generation rather than the soundness of public investments. In the case of the institutions in charge of implementing the environmental and social safeguards, their officers are concerned that the Ministry of Finance has not given enough attention to the potential risks associated with the projects.

<sup>6</sup> Eric J. Miller. Open Systems Revisited: A proposition about Development and Change. In W.G. Lawrence (ed.), *Exploring Individual and Organizational Boundaries: A Tavistock Open Systems Approach*. Chichester, UK: John Wiley, 1979

<sup>7</sup> In addition, as mentioned earlier, the lack of competency in matters of public participation may also be due to a lack of political support for promoting such consultations.

Finally, the officers from the Ministry of Finance argue that the State’s priority is to tightly control its borrowing, and therefore that credit funds should be used with discipline and prudence.

#### 4. Organizational Chart Decentralized Infrastructure Reform and Development Loan



#### IV. Proposals for improving the project’s institutional strategy.

To summarize our findings, the mandate of the Ministry of Finance and the objectives of the reform program are inconsistent: while the project has the comprehensive objectives of strengthening the State’s processes of consultation and participation, improving its mechanisms to prioritize investments, and enhancing the social and environmental safeguards of public investments, the Ministry of Finance has a much narrower mandate and vision of its responsibilities. In addition, the project erroneously assumes that there is technical and administrative expertise in the State Planning Office to design the investment plan through a broad process of consultation. Finally, the project design was not accompanied by an assessment of the political feasibility of increasing the voice of the poor in the State’s decision-making processes. The project’s institutional arrangements – both structural and process -- must therefore be re-designed. Fortunately the State’s political cycle offers an opportunity to do so. Indeed, part of the project’s problems arose because the project was designed in the last years of the 2000 – 2006 administration, as a result of which the core planning instruments (*Government Plan 2000 -2006 – “Plan de Gobierno 2000 -2006” and the long-term plan “Guanajuato 2020 -2025”*) could not have reflected the objectives and provisions of the Decentralized Infrastructure Reform and Development Project. With the advent of a new administration (2006 -2012) there is an extraordinary opportunity to reform these mechanisms and to improve the program’s institutional design. As part of its legal obligations, the new government must submit to the local Congress the Government’s plan for the next six years and update its long-term

vision. This paper therefore proposes that all the entities involved in the program demonstrate their commitment to its guidelines by introducing the necessary changes in the State's planning processes.

**Appreciative stage of redesign.** Assuming that there would be an agreement to re-examine such processes and that the Mexican authorities and the World Bank would be willing to adopt the AIC methodology, under the first "appreciative" stage of (re)design the Mexican authorities responsible for the project should identify its main stakeholders and help them (with the assistance of process consultants) develop a common vision about the future of Guanajuato, with the hope that they would view this particular program as essential to accomplish the State's social goals.

**Influence stage of redesign.** Following agreement on such a long-term vision, it will be possible to proceed with the second, "influence" stage of redesign, namely (i) a delineation of the responsibilities of the participating agencies, including whether to put a different core government agency in charge of the project, and (ii) an identification of the institutional mechanisms to ensure the necessary communication and consultation between the State's public institutions and citizens' organizations. Only then would the redesign process go into the third stage of design, which deals with detailed organizational arrangements for the agencies concerned, procedures to be strengthened, and the preparation of action plans.

Substantively, it is hoped that the above process would lead to recommendations similar to those arrived at by this paper's author, namely that *i. the State Planning Office be put in charge of the program; ii. its technical and administrative expertise be strengthened; and iii. appropriate methods of consultation with stakeholders be introduced in the preparation of the investment plans.* Regarding (ii), we suggest transforming the SPO into a **Planning Institute** to be led by a Council with a broad representation of society, including civil society organizations, municipalities and State authorities. The responsibility for carrying out the social and environmental safeguards would be given to specialized independent commissions drawing on external experts and ensuring that proper consultation processes had been followed. Under this scenario the Planning Institute would receive the proposals from the Line Ministries, the technical divisions of the Institute would make their recommendations to the Council regarding the feasibility of the investment proposals, and on that basis the Council would decide which projects should be supported (see Chart 5. Revised AIC framework and Chart 6. Organizational Chart Proposal). Furthermore, to arrive at their recommendations the technical divisions would have synthesized the views of the Ministry of Finance regarding the financial feasibility of the investment proposals and those of the two Commissions regarding social and environmental aspects. In turn, this assumes that the Commissions would require that (a) each investment proposal be accompanied by a mandatory environmental and social impact statement, and (b) appropriate local level consultation procedures would have been adhered to, such as local level hearings, workshops, or other forms of local consultations led by local authorities about the priority, merits, and design of investment proposals. If necessary, Government (or the project) should finance the appointment of individual process consultants/ facilitators on the staff of the local administration, appropriate retraining of its existing staff, or outsourcing those functions to the private sector and NGOs (Chart 7. Steps in the local level consultation process).

**Control stage of redesign.** Finally, considering that the State Planning Commission used to be excluded from the core decisions in matters of public investment, the strengthening of its technical and administrative expertise would be a top priority and would need to be pursued aggressively - though in a participative manner -- so as to ensure a strong commitment from the staff

towards its successful implementation. These efforts would improve not only the implementation of the project, but should also achieve a sustainable impact on the preparation of all the State's future investment plans.

## V. Conclusions

This paper has attempted to identify key institutional design issues undermining the implementation of the Decentralized Infrastructure Reform and Development Project and proposed a process for generating a consensus towards its redesign, together with a series of measures to improve planning methods and strengthen the institutional capacity of local governments in Mexico. While the analysis focused on the case of one specific State, the proposed methodology and the reform proposals would be an important package of lessons for replication to different regions of Mexico. One general lesson is particularly relevant: appropriate institutional features such as the mandate of the institution responsible for the implementation of the project can be a key factor of success--- but so are the assessment of the enabling political environment within which the policy changes will be occurring, the incentives necessary for interagency cooperation to materialize, the actual administrative capacity of the main implementation agencies, and finally the appropriateness of the processes chosen to carry out the institutional design.

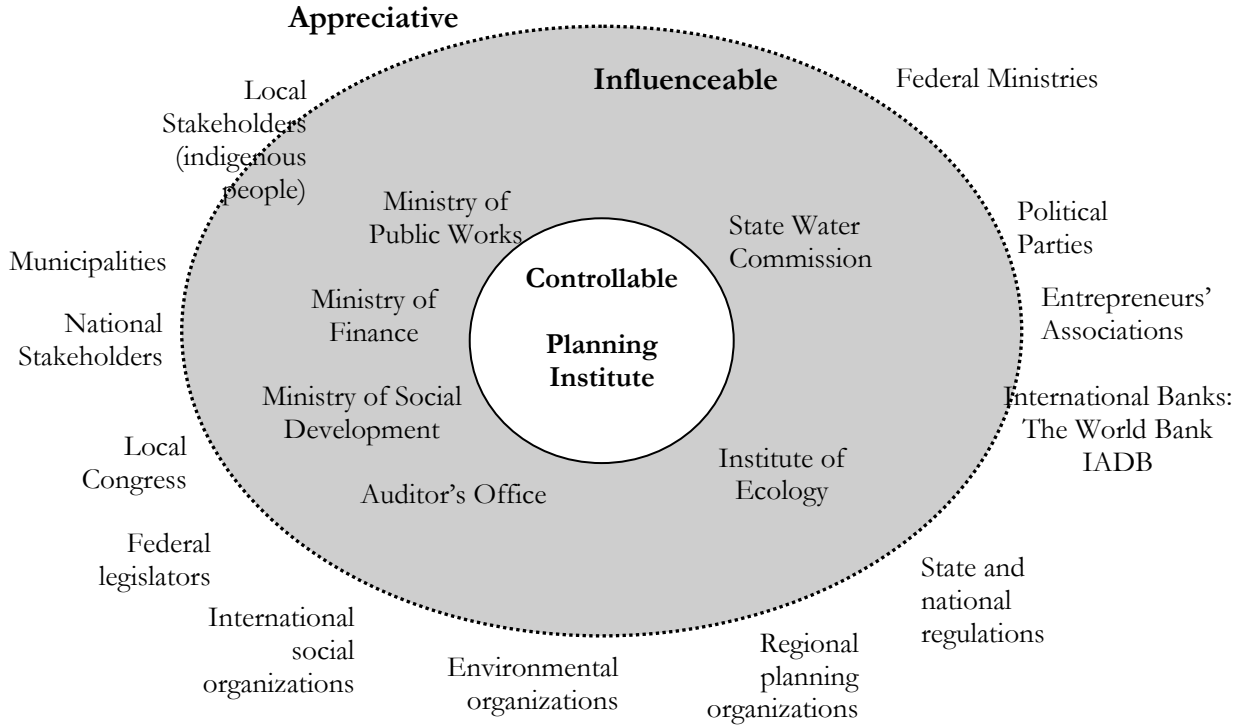
While much of the background methodology used by this paper was developed by the World Bank more than 25 years ago, its applicability to today's problems has not diminished with the passage of time.

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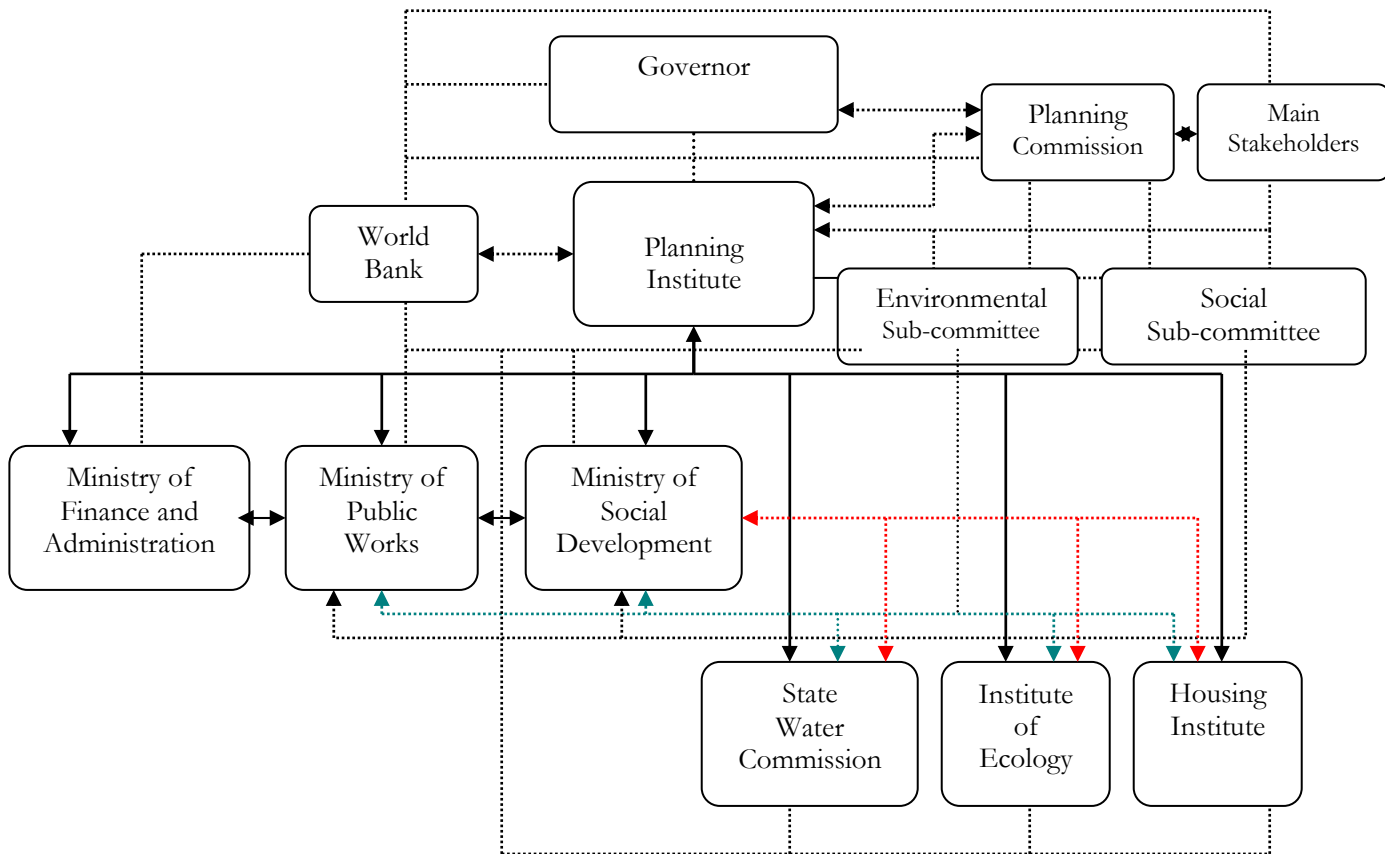
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### 5. Revised AIC framework



### 6. Organizational Chart: Proposal



**Chart 7. Proposed steps in the local consultation process**

1. The Planning Institute communicates project priorities to the Ministry of Public Works and to the Water and the Housing administrations. **—1 month?**
2. The three administrations (i) formulate their investment ideas and directly consult with the local populations or through local municipal government; and (ii) review the investment ideas initiated by the local municipalities; **-- 3 months?**
3. The reformulated investment ideas get developed in detail by the three administrations and are reviewed by the Institute of Ecology (Environmental Impact Analysis), the Ministry of Social Development (appropriateness of the consultative process, and social feasibility), and by the Ministry of Finance (financial feasibility); **-- 3 months?**
4. The investment proposals together with the Social and Environmental Impact Statements and the financial feasibility appraisal are submitted to the Planning Institute; **-- 1 month?**
5. The Planning Institute submits the package to the Environmental and Social Sub-Committees; **-- 2 months?**
6. The Planning Institute synthesizes all views; **-- 1 month?**
7. The Council makes its decision whether to approve the investment proposals **-- 2 months?**

**Estimated total time** required by the consultation and decision-making process: **-- 13 months**