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INFRASTRUCTURE FINANCING IN MEXICO: THE ROLE OF THE INTERNATIONAL FINANCE CORPORATION

CAROL M. MATES, ESQ.*

INTRODUCTION

This article explores the history of the International Finance Corporation (IFC), its mission, unique characteristics of IFC debt financing and equity investments. It then discusses the particulars of infrastructure financing and the innovative Tlalneantla municipal waste-water treatment plant project that the IFC has recently assisted in financing. From a general perspective to the most recent practical achievements, this article will inform the reader as to the various roles that the IFC plays in financings in emerging markets, and how it can use innovative finance structures to achieve its organizational mission.

IFC HISTORY

In order to understand the IFC and its role in developing countries' private sector financing, it is important to understand the whole World Bank group because the IFC is an integral part of the World Bank group. During the Post-World War II era, the victorious Allies were looking for ways in which countries could settle their differences without having to go to war with each other. From that spirit of internationalism and idealism, the first effective, multi-lateral institutions were formed. After World War I, the League of Nations had been formed, but it did not work. The United Nations (UN) was then formed when the charter was signed in San Francisco in 1945.¹ To bring some practicality to the idealism the Articles of Agreement for the International Bank for Reconstruction and Development (World Bank Group charter) was signed in 1945.²

The World Bank opened its doors for business in 1946 with a headquarters in Washington, D.C. The World Bank's original purpose was to help reconstruct the war-torn economies resulting from World War II and also to provide development in the less-developed member countries.³ However, the World Bank focused initially on reconstructing Europe and Japan and did not get into the development business until the late 1950s, when decolonization started, principally in Africa and Asia.

The World Bank's Charter is called the "Articles of Agreement," which operate in some countries such as Mexico as an international treaty. In the United States the Articles fall into the legal category of an international agreement because the charter

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1. *Charter of the United Nations*, June 26, 1945, 59 Stat. 1031, T.S. No. 993, 3 Bevans 1153.

2. International Bank for Reconstruction and Development Articles of Agreement, art. XI, available at <http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,contentMDK:20049557~menuPK:63000601~pagePK:34542~piPK:36600~theSitePK:29708,00.html> (last visited March 15, 2004).

3. IBRD Articles of Agreement, art. I, § 1.

did not have to be ratified by the U.S. Senate. The World Bank's Charter provides that the World Bank can make loans to governments and governmental agencies, to private sector entities, and to parastatals, but always on the credit of the sovereign government. So the World Bank, which also has a very important program in Mexico, can only lend on a sovereign guarantee.

In the early years of the World Bank, and up to the late 1980s and early 1990s, the World Bank was lending for large infrastructure projects backed by the host government guarantee in most developing countries. Beginning in the late 1980s and early 1990s, the world changed. The diminution of the East/West power struggle after the breakup of the Soviet Union in 1991 led to new models of infrastructure financing, including public/private partnerships as well as pure private financing. New forms of financing were being tried. The role of the World Bank started to change as the focus of infrastructure financing started shifting to the private sector, and the World Bank stopped financing a significant amount of infrastructure as the public sector retreated from financing many large infrastructure projects.

Dating back to 1956, however, some of the member governments, particularly the United States, decided that there was a role for the private sector to play in international economic development. Because of this desire to include the private sector, the IFC was formed. The IFC was formed by its Articles of Agreement, an international agreement which also operates as a treaty in many countries, and which contains similar provisions as the World Bank charter used. The IFC's mandate is to invest in development in the private sector to promote the development objectives of the World Bank.⁴ There are a few differences in the charter of the World Bank and the charter of the IFC which are important to understand in the context of infrastructure financing in Mexico. The most important difference is that IFC can take *only* private-sector risk; the IFC *cannot* take a government guarantee. The World Bank, on the other hand, must take a host government guarantee for each loan it makes. Additionally, the World Bank loans effectively operate as sovereign government loans: government to government. Under the charter of the World Bank, no domestic exchange control laws (currency controls) apply to World Bank loans.

The IFC has a specific provision in its charter, which says that it is subject to currency controls.⁵ That may not be so important now in Mexico because, at the moment, there are no currency controls, but investors recall that there have been currency controls in the recent past. And in many countries that the IFC does business in, for example, in Argentina and Venezuela, the IFC has recently seen currency controls imposed, currency controls lifted, and states of emergency with currency controls imposed. So the IFC's special protections are very important.

In addition to the IFC, there are two further members of the World Bank family. The first is the International Development Association (IDA), formed in 1960.⁶ This is a special cache for funding loans to the poorest countries. Certain member

4. IFC Mission Statement, available at <http://www.ifc.org/ifcext/about.nsf/Content/MissionStatement> (last visited March 15, 2004).

5. IFC Articles of Incorporation, art. III, § 5.

6. Further information on the IDA is available at <http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/IDA/0,,pagePK:118644--theSitePK:73154,00.html> (last visited March 14, 2004).

governments of the World Bank contribute to the IDA, and every three years the IDA's funds are replenished. It is not important for Mexico, as Mexico is too rich a country based on per capita income, but some other countries—India, for example—can borrow from IDA as well as from the World Bank.

The second one is the Multi-Lateral Investment Guarantee Agency (MIGA), formed in 1988.⁷ The MIGA is a political risk insurer. This may be of interest to foreign investors wishing to invest in Mexico, while also being of interest to Mexican companies that are considering investing outside of Mexico to beat the competition. MIGA covers the normal political risks: war, expropriation, civil disobedience, as well as breach of contract, which has been used for some infrastructure projects.

THE INTERNATIONAL FINANCE CORPORATION'S MISSION

The IFC's mission, as a member of the World Bank group, is to promote sustainable private sector investment in developing countries, and to facilitate the World Bank mission of reducing poverty and improving people's lives.⁸ The IFC did not have a mission statement until the mid to late 1990s. Previously, the IFC engaged in a more opportunistic investing style. That is, the IFC would find a good private-sector project in a developing member country, and as long as it had what bankers call "head room," the ability to lend in that country under its internal guidelines, it would make the investment. But in the last few years, the IFC has become very flexible, working much more cooperatively with the World Bank group to define and coordinate country assistance strategies. Now, the IFC will only invest in a country as part of a broader picture of assistance by the World Bank group. The World Bank develops a country assistance strategy (CAS) for a country such as Mexico, and the IFC will work with the Bank to define sectors in which the IFC can assist the government to carry out its development objectives.

The IFC and the World Bank are member institutions. Governments subscribe for shares in each of the institutions. The World Bank and the IFC are almost like giant credit unions because governments buy shares in the institutions. Members are also in charge of determining how the institution should operate. Voting is weighted by the size of the shareholding of the member, and the shareholding is determined by the economic strength of the member.⁹ In order to become a member of the World Bank, a country must first become eligible for membership in the International Monetary Fund (IMF). The IMF will then assess the economy of the country and assigns a percentage before the country will be invited to subscribe for quotas in the IMF. A country is then eligible to join the World Bank, and again, shareholding will be allocated to the country based on its share of the world economy. A country which is a member of the World Bank is then entitled to become a member of the IFC if it chooses. Again, the shareholding that a country can buy in the IFC is based on its economic strength.

7. Further information on the MIGA is available at <http://www.miga.org/screens/about/about.htm> (last visited March 14, 2004).

8. IFC Mission Statement, available at <http://www.ifc.org/ifcext/about.nsf/Content/MissionStatement> (last visited March 15, 2004).

9. IFC Articles of Agreement, art. IV, § 3.

Currently, the United States is the largest shareholder in the World Bank and in the IFC, even though they each have separate capital bases. The United States, which owns 23% of the share capital of the IFC, owns only 17% of the World Bank. Japan is the second largest shareholder in both institutions, owning approximately 8% of the shares of the World Bank. So, the gap between the first and second largest shareholding nations is substantial. After Japan, the next largest shareholder is Germany with a shareholding of just over 5%, followed by Britain and France both holding about 5%. It is clear that the United States has a strong voice at each of these institutions because there is weighted voting.

Mexico votes with Spain and certain other Latin American countries, which together have about a 4% shareholding in the IFC. These countries together cast their votes to elect a director on the Board of the IFC (and an executive director on the Board of the World Bank). This year, the countries with which Mexico has organized have elected Venezuela to represent them on the Board, while the alternate director is from Spain.

SPECIAL CHARACTERISTICS OF IFC LENDING

The IFC's fundamental role is to promote economic development through the private sector of its developing member countries. Mexico is a shareholder in the IFC, and the IFC lends to companies in Mexico. Under the IFC's Articles of Agreement, no project financed by the IFC can be objected to by the host government. In the case of Mexican projects, therefore, the financing of any project by the IFC would have the approval of the Mexican government.¹⁰ Prior to the time any project is presented to the Board for approval, a "No Objection" fax is sent to the government of the country in which the proposed project will be located. The IFC explains what it is going to do and it requests that the government confirm that it has no objection to our investment.

As a practical matter, the IFC's lenders generally talk to the authorities beforehand about the proposed investment. It would be extremely unlikely that the IFC would send this fax to the government and they would object. However, the IFC's charter requires that the government be notified of the project and that it not object to the proposed investment in the country.

The IFC provides loans and equity capital for viable projects in emerging markets. "Viable" means not only economically viable, but it also means that the projects have to be sustainable. Sustainability is a term that has several levels of meaning, including environmental, social and financial sustainability.¹¹ Projects have to be sustainable in many different areas, not just in economics.

The IFC mobilizes other sources of capital in a number of ways. The IFC's job, as stated in its charter, is to supplement, not to replace, the private sector;¹² it invests together with other financial institutions. The IFC only finances a project where sufficient capital is not available at reasonable terms in the private market.¹³

10. *Id.* art. III, § 3 (ii).

11. IFC Mission Statement.

12. IFC Articles of Agreement, art. I.

13. *Id.* art. III, § 3 (i).

The IFC also brings resources other than financing to the project. It brings advisory services, along with the environmental, social and technical expertise that it has gained from working world-wide.¹⁴ The IFC provides advisory services to companies and also to countries. It has a unit which performs privatization advisory services for governments. Regrettably, the IFC has not yet been able to come to an agreement with authorities in Mexico to provide these services, but hopefully in the coming years, it will be able to do something.

The IFC serves an important function in mobilizing capital from many sources. The IFC mobilizes debt capital for projects from foreign international banks, generally through its B-loan syndication program. Local banks cannot partake of the IFC B-loan syndications program, but are often present in IFC-financed projects as parallel lenders. The local banks will lend to the project in local currency, and the offshore banks will come in and bring in dollar financing or other foreign currency financing. Finally, the IFC can also serve as a *de facto* seal of approval to other sources of financing, which take comfort from the fact that the IFC is reliably diligent on each project prior to investing.

CHARACTERISTICS OF IFC FINANCING

I cannot stress this strongly enough: the IFC can participate only in private-sector financing, and cannot lend on the financial support of a host government guarantee. Many infrastructure projects in emerging markets are currently being undertaken at the sub-sovereign level—that is, by governmental entities at the provincial, state, or municipal level below the level of the national government. The IFC is exploring financing projects at this sub-sovereign level, projects which do not have a host government guarantee, starting with municipal water financing.¹⁵

IFC shares all of the risks of the investment that private sector investors take. But as an international organization, IFC has certain legal protections and legal immunities.¹⁶ For example, IFC has certain tax immunities.¹⁷ IFC also has sometimes been classified as a “local” investor by the relevant governmental authorities.

The IFC also has quasi-diplomatic status,¹⁸ which means that its representative in Mexico has access to government officials to discuss matters relevant to the IFC’s work in Mexico and IFC projects. IFC officials can generally get an audience with the relevant government official in case of a problem or concern. Because the IFC is a member of the World Bank Group, and because a government is a member of the IFC, IFC concerns are listened to. And because Mexico is a member of the World Bank group and an IFC shareholder, it can reciprocally influence the IFC’s policies. In that respect, there is a likelihood that member countries are more willing to talk to the IFC than to a private-sector investor.

The IFC has the ability to make debt and equity investments in any form permitted by relevant local law. The policies, in terms of pricing, are that the IFC provides market-based financing. The IFC is neither a charity, nor is it an aid

14. IFC Mission Statement.

15. See *infra*, p. 37, IFC Financing in Action: Tlalnepantla Water Project.

16. IFC Articles of Agreement, art. VI.

17. *Id.* art. VI, § 9.

18. *Id.* art. VI, § 7.

provider. It invests together with the private sector and takes private-sector risks. IFC project sponsors understand that the IFC, like the project sponsors, seeks to invest for a profit.

The most important thing is that the IFC does not take a guarantee from the host government. The IFC cannot take a guarantee of repayment from the host government. And it always makes sure that the project is oriented toward providing economic and developmental benefits to the country. So it cannot invest in something that is profitable but has no development benefits for the country, such as real estate speculation or something similar.

The presence of the IFC gives comfort to the various parties to the investment. It provides a feeling of security to the foreign investors, who may be suspicious of the local investors and the government. It also comforts the local investors who may be suspicious of the foreign investors as well as the government. And it gives comfort to the member government, which is often suspicious of both the foreign *and* the local private-sector investors. This is what the IFC calls its “honest broker role.”

The IFC provides a certain level of political risk coverage, and that level comes from two sources, neither of which is a legal protection—but they are *de facto* coverage. The ‘preferred creditor status’ is one of these *de facto* protections. In the event of a shortage of foreign exchange in a country, governments will sometimes declare a moratorium on repayments of foreign debt to foreign private investors. However, governments have allocated available foreign exchange for servicing obligations due to multilateral institutions against payment of sufficient local currency. Traditionally, Mexico and other member governments have made available foreign exchange to repatriate monies due to the IFC by IFC borrowers in such circumstances. The most recent situations where this preferred creditor status role has played a part were in Argentina and Venezuela. In those cases, the governments have honored this preferred creditor status and have provided the foreign exchange so that that companies in their countries could continue to service their IFC debt obligations. It should be noted that governments honor the IFC’s preferred creditor status because they know that the IFC will reinvest the money in their country, because it is a development institution. The IFC has already started lending back to Argentina, and may well have been the first foreign investor to make new loans to Argentina after the recent crisis.

So effectively, the governments know the IFC is recycling investment money. In Mexico, during the crisis of the 1980s and again in 1994-95, the IFC was practically the only lender because foreign investors would not invest in Mexico. In those years, the IFC made many investments in Mexico and the government continued to provide adequate foreign exchange so that companies could meet their obligations to the IFC. Mexico has come a long way from the previous financial crises, and has achieved investment grade rating for its debt obligations. This has enabled Mexico and Mexican companies to borrow in the private international capital markets on reasonable terms. Similarly, as Mexico’s domestic capital markets develop, there is adequate liquidity to meet the needs of many private Mexican enterprises. And for this reason, as Mexico’s creditworthiness has risen, many companies have chosen to borrow from the international capital markets and enhance the status of the local companies in the world markets.

The other level of political risk coverage that the IFC brings to investors, which also is not a legally required protection but rather an accommodation by governments, is to exempt IFC loans from any general rescheduling of private-sector debt. IFC debt has never been rescheduled in any general debt moratorium. As mentioned above, one of the IFC's roles is to serve as a catalyst to bring in other private-sector financiers and B-loan participants, which are the foreign commercial banks that participate with the IFC in loans to Mexican companies. These lenders continued to receive debt service payments during the financial crisis in Mexico when other foreign banks were not being paid.

It is especially attractive for European banks to come in as a B-loan participant in IFC financing, because their local regulators have said that they do not have to provide for losses when lending to a developing country if the loan is made through an IFC B-loan. This makes lending to emerging markets through an IFC B-loan structure a more attractive option to European banks.

FINANCING GUIDELINES IN MEXICO

There are some fundamental guidelines the IFC follows when providing financing in Mexico. First, the targeted financing recipient must be a Mexican private-sector company.¹⁹ Second, the project has to be economically, environmentally, and socially sustainable.²⁰ Finally, the IFC's amount of investment cannot be more than 15 to 25% of the equity capital of the company, and generally not more than 25% of the project cost, although under certain circumstances, it can provide as high as 50% of the cost of a specific project.

The IFC can provide flexible financing. The IFC can provide either U.S. dollars or Mexican peso financing. Because Mexico has a good exchange market, the IFC can lend in Mexican pesos. The IFC lends in fixed or floating market-based interest rates. And we tailor the financing to the specific product that is being offered and to the specific project. Very importantly, IFC projects are exempt from Mexican withholding taxes because the Mexican government honors the privileges and immunities accorded to the IFC under its Articles of Agreement.²¹

The amount of debt or equity which the IFC will invest depends on the results of its profitability analysis, which the IFC investigates diligently. Most importantly, perhaps, is the fact that the IFC is a passive investor. Under the IFC's charter, the IFC is prohibited from taking management control of any business.²² So, the IFC's role in a company will often be to provide technical advice and to share some of its worldwide advice. An exception to this prohibition on exercising management control occurs in the event the IFC's investment is in financial jeopardy. In such case, the IFC charter permits the IFC to take such action as is necessary to protect the IFC investment.²³ When the IFC is making an equity investment, it will negotiate minority rights. It will look to different exit options. The IFC will ask for tag-along rights upfront, and generally seeks to divest through a public offering of

19. IFC Mission Statement.

20. *Id.*

21. IFC Articles of Agreement, art. VI.

22. *Id.* art. III, § 3 (iv).

23. *Id.* art. III, § 4.

the investee company's shares, thus developing the capital markets of the country. It also takes quasi-capital investments, which will usually take the form of some type of income-participating convertible loan.

Other financial products that the IFC offers are swaps, hedges, and other derivative products. The IFC treasury department is continually seeking to develop products that will assist companies in emerging markets to mitigate financial risks. In Mexico, the IFC has invested in and made loans to some well-known companies.²⁴ The IFC is a shareholder in other companies, as well.²⁵ There are three Mexican companies in which the IFC has quasi-capital investments.²⁶ IFC bankers are always trying to devise very interesting quasi-capital income participations based on the value of the investments.

The IFC finances a great variety of projects: it will finance start-ups, it will finance expansion, and it has recently considered acquisition financing, which is something new.

REFINANCING COMPANIES

Refinancing of companies has become a boutique specialty for the IFC in the current economic environment. Mexico is currently experiencing a recession, and many companies that borrowed heavily during the last few years are now over-leveraged and unable to repay their debts. Often, the local commercial financial institutions are not willing to offer debt refinancing of companies where the companies are in trouble. As a development institution, the IFC will come in and will analyze the fundamentals of the company. If the IFC's due diligence shows that it is a good company, under good management, with good product and good operations, but simply financially over-leveraged, the IFC will look at refinancing their balance sheet. The IFC will not simply refinance an enterprise, but will bring fresh financial assistance and ask that there be some productive capacity added. It will not simply buy out the existing lenders. The IFC may ask existing lenders to lengthen their maturities and continue to lend to the company, but it will also make it a more attractive new financing opportunity for existing lenders as well as establish the company on a new, sounder financial footing.

IFC PERSPECTIVE ON INFRASTRUCTURE FINANCE

The IFC is ready to consider financing projects where private companies are allowed to take private-sector risks. So the real challenge for the IFC is to find where in the infrastructure sectors the government has allowed private-sector companies to come in and take these risks. The IFC in conjunction with these companies has been financing a number of infrastructure projects. The IFC has

24. *Posadas, Su Casita, Bimbo, Grupo Calidra, Bancomer, Coppel, Minsa Girsra, Apasco, Hospital ABC, Grupo Vitro.*

25. *FEMSA, Fomento Económico Mexicano* (U.S. \$8.0 million); *Grupo Calidra* (U.S. \$6.0 million); *Grupo Minsa* (U.S. \$10.0 million); *Grupo Posadas* (U.S. \$20.0 million); *Hipotecaria Su Casita* (U.S. \$11.1 million); *Industrias Innopack* (U.S. \$15.0 million); *Grupo Vitro* (U.S. \$10.2 million); *Grupo Financiero BBVA Bancomer* (U.S. \$2.7 million).

26. *Grupo Posadas* (U.S. \$15.0 million); *Internacional de Cerámica* (U.S. \$6.0 million); and *Grupo Financiero BBVA Bancomer* (U.S. \$30.0 million).

already financed five of the Independent Power Producers (IPPs). This is out of a total of around 17 IPPs that have been licensed in Mexico, so the IFC has shown its support by being heavily invested in this sector.

The IFC has financed different kinds of transportation services, such as port projects, rail projects, and a water project. The IFC is open for business in Mexico, and seeks to increase its investments in Mexico. Now the IFC has also started to invest, because of its growing partnership with the World Bank, in the health and education sectors, sectors that previously may not have been considered infrastructure sectors. In Mexico, the IFC has been investing in private education, private schools and hospitals, and other projects previously mentioned. The IFC is also increasing financing activity in the housing sector. *Su Casita* is one of our borrowers, and we are interested in furthering our involvement in complex deals, securitizations for mortgages, and like matters. Anything that the business folks can dream up, we are willing to finance as long as it is a private-sector risk and as long as we think it is a good risk and is going to be profitable and sustainable.

In Mexico, the IFC sees infrastructure development, specifically in the area of electricity and water, as priorities. Again, the IFC understands that Mexico is undergoing what I would call a great internal debate, a cultural and political debate. Where should these investments be financed? Should they be financed in the private sector or in the public sector? Legal and regulatory reform will almost certainly follow any decision to finance infrastructure more in the private sector.

IFC FINANCING IN ACTION: TLALNEPANTLA WATER PROJECT

The Tlalnepantla project has a fairly complicated structure, and was very innovative in many ways. To quote from the IFC 2003 Sustainability Review:

Municipal governments provide most essential infrastructure services in developing countries but usually lack access to market financing. With a \$3 million partial credit guarantee for a water project in Mexico, IFC has entered the municipal finance market. Partnering with a private bank, IFC will provide a peso-denominated guarantee to a private Mexican trust which will issue bonds of up to \$8.8 million equivalent in the local capital market. Bond proceeds will be used to provide a loan to the City of Tlalnepantla and its municipal water company for design and construction of a wastewater treatment plant. IFC also helped to secure a \$5 million letter of credit from a private lender. This project is both the first municipal bond offering in Mexico that is not reliant on sovereign support and the World Bank Group's first direct support to a municipality. It creates a model whereby municipalities in Mexico can secure financing entirely through their own revenues rather than a federal guarantee or assignment of federal transfers—and can mitigate their foreign exchange risk. The transaction also introduces a new local asset class for the country's capital markets.²⁷

The project is the first municipal water project the IFC has financed worldwide. This waste-water treatment plant, right outside Mexico City, is going to stop the

27. *IFC Enters the Municipal Finance Market*, IFC Sustainability Review, 2003. World Bank Group, available at http://www1.ifc.org/ar2003/sustainability/sidebar/3_priority_municipal.htm (last visited March 15, 2004).

sewage from flowing untreated into the Rio San Javier. It is going to recycle both residential and industrial waste water and free up the drinking water, and the environmentalists hope that it will relieve pressure on the heavily exploited ground water aquifers.

To touch briefly on the structuring of the transaction, figure 1 (below) provides a visual graph of the interests and their relations. The *fideicomiso* (trust) was created to hold the collection of rights. The *fideicomiso* raised funds from the bondholders. The *fideicomiso* raised funds from the bondholders. The bonds were issued on the local capital markets and were registered with the Mexican Stock Exchange under the guarantee of the foreign investment bank, Dexia. Dexia is a French bank, which participated in this project through its office in New York and has long been active in the municipal credit market. Dexia has done this type of financing in France for years. The IFC and Dexia entered into a reimbursement arrangement. To secure the bonds, the IFC entered into a direct guarantee with the trust. This is a fairly new product the IFC has been developing over the last few years called a "partial credit guarantee," where the IFC bankers analyze the risks of default, and will guarantee a percentage of that default—not the whole thing but just enough to make the bonds marketable.

By having the guarantee of the IFC and Dexia, it was possible to raise the credit rating of the trust in the local capital markets from a double-A local currency to a triple-A. In that way the investment credit rating level increased so that pension funds and other entities that have to have their bonds with a high credit rating could purchase these bonds.

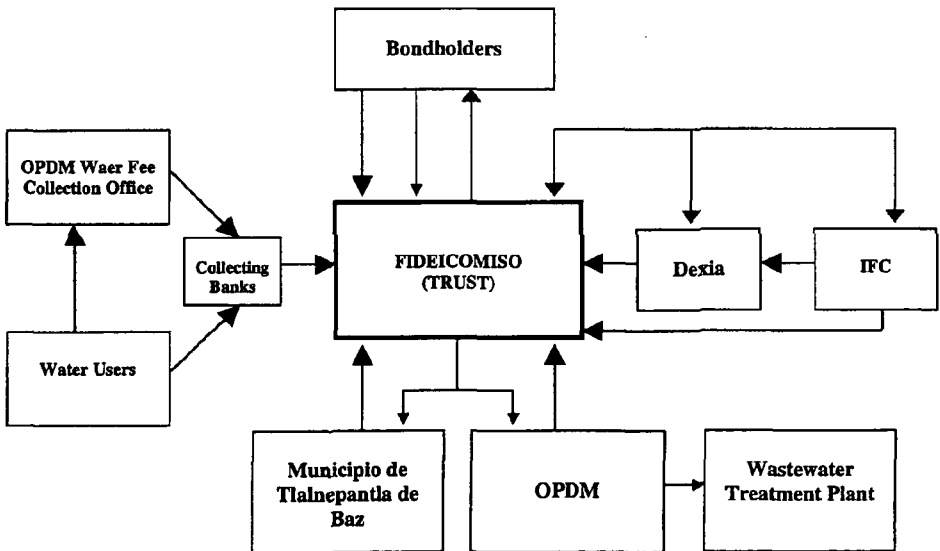


Figure 1

The municipality and the water collection office collected the fees from the users and put those fees through the collecting banks, which was used to repay the *fideicomiso*. The *fideicomiso* collected the funds from the bond holders, lent it to the municipality and the water company, which was a separate entity, but the water

company and the municipality were jointly and severally liable, and they used that money to then lend to the water company. The repayment came from the fees from the actual end-users of the water.

Since the IFC takes only private-sector risks, it finances the trust, a private-sector trust. But that trust ultimately is dependent on a municipal credit. How did we get comfortable doing this? The World Bank can only take national, host-government risk. The IFC can only take private sector risk. The majority of water financing in Mexico, as in the rest of the world, is done through municipal governments. So where does this fall on the spectrum between national government risks and private sector risk? It falls somewhere in the middle. Since the World Bank is prohibited by its charter from taking the municipal-government risk, if the World Bank were to make a loan to assist the municipal water sector, the World Bank would have to get the Mexican Government to guarantee the loans. This is going to cause a further drain on the balance sheet of the Mexican Government, which the World Bank would like to avoid. The World Bank would prefer that the Mexican Government, as governments in all developing countries, would put their scarce public resources to areas where there is no other way of obtaining financing. In that respect, the IFC encourages the Mexican Government to finance the poorest of the poor and sectors where there is no way of obtaining private sector investors.

IFC's Board of Directors is, under IFC's Articles, composed of the same persons who sit as Executive Directors of the World Bank.²⁸ The same World Bank Board members sit in a different capacity, put on their hats as the Board of IFC, and are very supportive of the idea of helping to relieve the Mexican federal budget from things that can be financed in the private sector. So the Board has permitted the IFC to gently put their toe in the water and to start looking at how the IFC can finance municipal projects.

IFC is exploring how to assist our developing member countries further in this type of financing. We have now set up a six-person unit composed of Board members from the World Bank and the IFC to look worldwide at how this type of financing can be achieved. The IFC started with this Tlalnepantla project in Mexico because Mexico is a very developed country in many ways, because there is such a need, and because we found a water utility that we thought was run on a very commercially sound basis, and was providing a good service. We are very pleased that we can start off trying to finance sectors that in the past have not been financeable by the private sector in Mexico.

28. IFC Articles of Agreement, art. IV, § 4.

