

September 17, 2012

**Response of IDB to United Kingdom on the Approval by Mail: Mexico:
Financing Low Carbon Strategies in Forest Landscapes (IDB)**

Dear Andrea,

On behalf of the FIP Mexico working group, please find enclosed a reply to the comments raised by UK on the project “Financing Low Carbon strategies in Forest Landscape”.

We thank UK for the interesting observations and we will consider them in the implementation of the project.

Kind regards

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QUESTIONS UK

- **We suggest the proposal is amended to include an estimate of the number of hectares of deforestation and degradation that will be avoided as a result of the programme.**

We agree with the importance of the proposed estimates. In fact, one of the expected results in the draft loan proposal of the project refers to the hectares included on low carbon strategies to avoid deforestation. This refers to the direct impact of the program, however, significant impacts are also expected indirectly from the policy approaches that are replicated in other parts of the county and that are part of the rationale for integrating Mexico’s FIP with the larger Forest and Climate Change project. Baseline data for the program will be refined during the first year of implementation in line with the national approach being developed.

EXPECTED RESULTS

Indicators	Measure Unit	Baseline		Intermediate Measurements						Goals		Source/ Verification Mechanism	Comments		
		Value	Year	Value	Year	Value	Year	Value	Year	Value	Year				
FINAL RESULT 1: Land under low carbon strategies increased in EARA															
Coverage of land where a low carbon strategy is implemented in order to avoid deforestation or capture carbon	Thousands of Hectares	0	2012	9.75	2013	22.7	2014	27.0	2015	31.3	2016	90.75 ⁶	2017	Financiera Rural, with TA Facility information	See Economic Analysis for assumptions. Low carbon strategies are defined in the Program and will be reflected in the operating regulations ⁷ .

In addition to these indicators already included in the plan, other measurements could be considered to determine the success of the project.

- **There is currently no target or expected results in the proposal for number of people who will have improved livelihoods/incomes as a result of the project. We would like to see this as likely to be a core FIP indicator.**

The expected impact No. 2 “*Household income increased*” included in the Results Matrix is used as a proxy to determine the improved livelihoods of the beneficiaries. The beneficiaries of the program are the ejidos and communities and their members, in some cases, one project in one ejido (the area of communal land) could include several hundred people from the community while in other cases one project could be implemented by a single member of the community.

Throughout the implementation of the project it will be possible to track the precise number of people who is directly supported by the project.

- **How will the project contribute to increased loans within the wider financial sector? The project is focussed entirely on FR and does not discuss how lessons and experience will be shared to help scale up private sector lending.**

In Mexico, financial penetration in the rural sector is still limited, furthermore in the forest sector. The loan is targeted to attend marginalized communities that currently do not have access to financial services. This line of credit represents an important opportunity to increase the financial penetration in Mexico’s rural sector. Once is proved the feasibility of the project through proper training and assistance, this methodology will develop awareness to ejidos, and comunidades about the benefits of such financial services.

The project (both the reimbursable and not reimbursable parts) will create incentives for ejidos and communities to acquire and use loans to scale up investments in low carbon projects and activities in their communities (such as new methods in agriculture, silvopastoral systems, and traditional forest activities, among others).

The project will also enhance the technical and financial capacity in ejidos and communities, increasing their reliability as potential future clients of different Banks beyond Financiera Rural.

This is part of a learning experience not only for the beneficiaries of the loans but also for current (Financiera Rural) and future banks that, testing the financial viability of REDD projects through the FIP program, will be willing to mobilize additional financing for similar activities.

- **Will the project generate and sell carbon credits? If so, has the sale of carbon credits been factored into the emission savings calculations.**

The possibility is open. Within the project, it could be considered at the voluntary market. The new General Law on Climate Change provides for the institutional structure for an eventual market. The architecture of any carbon market would be determined by the Ministry of the Environment and it is expected that this project will open market opportunities in line with the national regime.

- **How will the project ensure permanence beyond the life of the project? Is there a risk of leakage and if so how will this be managed?**

The project is designed mainly to enhance the current land use practices which minimize the risk of leakage. For example, in the areas where the silvo-pastoral practices are promoted, the carrying capacity of the land (the maximum number of animals that can be kept per unit area) will increase, thus no displacement of grazing would occur; the same occurs with agroforestry practices while in the case of commercial plantations, the selection of areas will prioritize highly degraded lands where the baseline land use practices are mostly subsistence oriented. In cases where leakage might occur, this would be detected through the MRV system for the entire area of intervention of the project.

The main strategy of the project is to promote more profitable land use practices that would increase carbon stocks or avoid emissions from deforestation and degradation. This means that the incentive of the beneficiaries to ensure permanence of the intervention is mostly economic, as the profitability of the loan provided will be perceived until trees have reached commercial harvesting size which will occur beyond the lifetime of the project.

- **According to the economic appraisal, the silvo-pastoral element of the project has a cost-benefit ratio above 1 i.e. costs exceed benefits. Given this, what is the economic justification for including this element?**

Profits are based on the income generated by the productive project. For the case of silvopastoral systems, those correspond to the sale of milk and calves. Costs are the inputs for each activity; i.e, silvopastoral systems require the purchase of livestock, the establishment of a protein bank and related labor force.

Cash flow is estimated with benefits minus costs, discounted at 12% over a period of 50 years. In the case of silvopastoral systems, depending on the

region, for every dollar invested, there is on average a net benefit of between \$1 and \$5 (costs discounted). Silvopastoral systems have an estimated recovery period from 2 years in Yucatán to 5 years in Campeche.

These seemingly positive results, however, do not take into account a number of barriers that prevent them from being implemented:

- i. Institutional barriers associated with weak social organization inside ejidos and communities
- ii. Technical barriers associated with the lack of technical expertise to develop robust projects of this type.
- iii. Economical barriers related to the inability of ejidos and communities to offer effective collateral and other guarantees for the investment. This has biased the existing supply of financing to short term loans that do not enable this type of projects.

The project is precisely aimed at addressing these barriers.